IMPACT OF NON- PERFORMING LOAN ON PROFITABILITY IN DEVELOPMENT BANKS

A Dissertation submitted to the Office the Dean, Faculty of Management in partial fulfillment of the requirements for the Master's Business Studies (MBS)

By

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CERTIFICATION OF AUTHORSHIP

I hereby corroborate that I have researched and submitted the final draft of dissertation entitled **"IMPACT OF NON- PERFORMING LOAN ON PROFITABILITY IN DEVELOPMENT BANKS**" The work of this dissertation has not been submitted previously for the purpose of conferral of any degrees nor it has been proposed and presented as part of requirements for any other academic purposes.

The assistance and cooperation that I have received during this research work has been acknowledged. In addition, I declare that all information sources and literature used are cited in the reference section of this dissertation.

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REPORT OF RESEARCH COMMITTEE

Mr. Suraj Sapkota has defended research proposal entitled **"IMPACT OF NON-PERFORMING LOAN ON PROFITABILITY IN DEVELOPMENT BANKS**" successfully. The research committee has registered the dissertation for further progress. It is recommended to carry out the work as per suggestion and guidelines of supervisor Prof. Dr. Keshav Raj Joshi and submit the thesis for evaluation and viva-voce examination.

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APPROVAL SHEET

We, the undersigned, have examined the thesis entitled **"IMPACT OF NON-PERFORMING LOAN ON PROFITABILITY IN DEVELOPMENT BANKS**" presented by Suraj Sapkota, a candidate for the degree of Master of Business Studies (MBS Semester) and conducted the Viva voce examination of the candidate. We hereby certify that the thesis is worthy of acceptance.

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Suraj Sapkota

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ABBREVIATIONS

GBBL	=	Garima Bikas Bank Limited
JBBL	=	Jyoti Bikas Bank Limited
LLP	=	Loan loss provision
LLPTTNPLR	=	Loan loss provision to total Non-performing loan
LLPTTNPLR	=	Loan loss provision to total non-performing loan
MBBL	=	Muktinath Bikas Bank Limited
MLBBL	=	Mahalaxmi Bikas Bank Limited
NPL	=	Non-performing loan
NPLTTLR	=	Non-performing loan to total loan ratio
ROA	=	Return on Assets
ROE	=	Return on Equity
ROL	=	Return on Loan
SDBL	=	Shangri-La Development Bank Limited
TA	=	Total assets
TC	=	Capital/ equity
TL	=	Total loan
TLTTAR	=	Total loan to total assets ratio

ABSTRACT

The study is focused on analysis of Impact of Non- Performing Loan on Profitability in Development Banks. The objectives of the study were to analyze significance of non-performing loan on risk and return on development banks in Nepal, examine impact of non-performing loan on particular development banks profitability, examine impact of non-performing loan on aggregate of development banks profitability and compare the impact of non-performing loan on particular and aggregate profitability of development bank. The study is completed under the descriptive and analytical research design taking the five development banks as the sample out of population total development bank 17 in Nepal, to complete study used both financial tools and statistical tools, like financial ratio, mean, standard deviation, correlation and regression line. The correlation among the return on assets with loan loss provision, non-performing loan, total loan, equity/capital and total assets is negative, with these variable increases the return on assets decreases. Similarly, return on equity also associated negatively with variables loan loss provision, non-performing loan, total loan, equity/capital and total assets. The regression analysis shows the return on assets and return on equity both significantly influences by the loan loss provision, non-performing loan, total loan, equity/capital and total assets at significant level 0.05. However, particular coefficient of variables, some are significant and some are insignificant at 0.05 level.

Keywords: Return on assets, Return on equity, Loan Loss provision, Non-performing loan, Total loan, Capital/equity and total assets

CHAPTER I

INTRODUCTION

1.1 Background of the study

Profit is the remaining amount after deduction of expenditure occurred during the process of business activities. It is also known as the factor reward to entrepreneur, in the process of business run. The business objectives is to achieve the profit from business activities. Profit of the organization provide the life blood to business. The factor of production get reward in the form of rent, interest, wages and profit to land, capital, labor and entrepreneur respectively. Entrepreneur get the reward in the form of profit to contribute collection, allocation of various production resources. Profit can be defined as net income of business paying all cost to the factor of production. The profit can be categorized into gross profit and net profit. The gross profit is the remaining amount after deduction of direct production expenditure from sales revenue. However, net profit is the amount after deduction of direct expenditure and indirect expenditure from the sales revenue. The financial institution is also a business organization, they have profit motive. The institution try to max profit through the increase in sales revenue or reduction of cost in the business (Rawal, et al. 2019)

Patil, (2008) Banks are those financial institutions that play an intermediary role, which bridges the gap between the surplus sector and deficit sector of the economy. Banks collect the scattered fund from different areas and then mobilize the collected funds in productive sectors of the economy. Most of the businesses and industries are builds up with financial support of banks and financial institutions. Therefore, we cannot deny the role of banks in developing a nation's economy. The banks source of income is loan and advance, lending of various loans to economic agents in an economy. The interest is main income sources of banks and financial institutions. They lend deposit and equity capital in market as, investment loan, agriculture loan, home loan, education loan etc. But there is no any guarantee loan repayment in time because of large number of economic and

non-economic variables. And, such loans after 90 days of irregularity in repayment becomes non-performing loan.

Non –performing loan (NPL) is a leading indicator of credit quality. Non-performing loans are the loans emanated from the deterioration in the quality of the loan portfolios. Unified directive has instructed banks and financial institutions to classify their loans into two categories; performing loan and non-performing loans. The classification is based on duration of delay in debt servicing. Pass loans and watch list loans fall under performing loans. However, the subcategories of non-performing loan into substandard loans, doubtful loans loss loans and restructured. However, NFRS (Nepal Financial Reporting System) assumes that even the worst non-performing loan have some residual value. Generally, non-performing loan seen in financial institution due to various problem in an economy, such as if the business fails to operate effectively, poor management of business, borrower's bad intension about the loan and it's repayment, financial crisis, economic crisis and various types of calamities in an economy. Non-performing loan is the sum of borrowed money upon which the debtor has not made scheduled payment for at least three months. The delay in payment could be either interest or principle and can be both. The classification is done on the basis delayed time period. Non- performing loan is the real economic cost for financial institution because they cannot use the fund in productive sector and repayment of deposit is disturbed. It also results in additional cost for realization of non- performing loan, (Koirala et al, 2019).

There is no long history of banking sector development in Nepal, systematic banking practices started after establishment of Nepal Bank Limited in 1994 kartik 30. In Nepal banking sector is flourishing from past few decades. Banking sector plays very crucial role in the economic development of the country. Banks are those financial intermediaries that transfer the fund from surplus unit to deficit unit. All the economic activities are directly or indirectly channelized through the banks and financial institutions. People or business units keep their surplus balance as deposits in the banks and hence banks make funds available to the individual, businesses, households and communities in the form of loans and advances. A bank is such institution that deals with money and credit. Hence, a bank borrows money from its customers and sells its own credit to the individuals, businesses, households and communities who need funds. Some households, businesses unit and some

unit of governments may be surplus unit while other units like some households, businesses and other units of government can be deficit units (Rawal et al, 2018).

Generally, the profit of banks depends on lending portfolio of the banks, out of total profit loans and advances cover 70% to 80% every year (NRB Survey: 2075/76). A bank also faces many risks in banking business, there are number of risks like credit risk, market risk, liquidity risk, operational risk, country risk, legal risk, reputational risk etc. Among all those risks, credit risk is one of the most critical risk that arises due to un-timely payment or non-payment of the disbursed loans and advances. Banks invest huge amount from the accepted deposits in the form of loan and advances rather than other sector of investment. Providing loan and advances are the major economic functions of the bank. The non –performing loan brings threat for banks. According to NRB directives having 5% and more than 5% non-performing loan is very bad and bank is not eligible to distribute the bonus and dividends. In each and every bank's balance sheet, loan and advances occupies the greater portion in the assets side. Loan is the risky asset. The major reason behind non-performing loan is poorly managed loan portfolio. Non-performing loan reduces the liquidity of bank, credit expansion, and growth of the economic activities and along with performance of bank.

As per the unified directives no.2 laid down by Nepal Rastra Bank those loans whose payment has not been received for 3 months or more is treated as NPL. As the overdues goes on provision of 25%, 50%, and 100% of loan amount is separated and it is treated as expenses and allocation of loan is reduced from capital. Further, due to such NPL, banks are unable to generate future income.

Development Bank: The Bank, which facilitates the economic sectors such as industrial, agricultural, rural, etc. by providing capital and technical assistance for their development, is known as a development bank. Development bank helps the industries directly or indirectly for the preparation of plans and policies and implementing them.

Meaning of Development Banks:

Development banks are specialized financial institutions. They provide medium and long-term finance to the industrial and agricultural sector. They provide finance to both private

and public sector. Development banks are multipurpose financial institutions. They do term lending, investment in securities and other activities. They even promote saving and investment habit in the public.

There is no precise definition of the development bank. William Diamond and Shirley Bosky consider industrial finance and development corporations as 'Development banks'. Fundamentally, a development bank is a term lending institution. Development bank is essentially a multi-purpose financial institution with a broad development outlook. A Development bank may, thus, be defined as a financial institution concerned with providing all types of financial assistance to business units, in the form of loans, underwriting, investment and guarantee operations, and promotional activities, economic development in general, and industrial development, in particular. In short, a development bank is a development oriented bank. In general, sense: Development banks are those financial institutions whose prime goal is to finance the primary need of the society. Such funding results in the growth and development of the social and economic sectors of the nation. However, needs of the society vary from region to region due to differences in its communal structure, economy and other aspects? The study is focused on Nepalese Development Bank. They are Garima Bikas Bank Limited, Muktinath Bikas Bank Limited, Shangri-La Development Bank Limited, Jyoti Bikas Bank Limited and Mahalaxmi Bikas Bank Limited.

Garima Bikas Bank Limited: Garima Bikas Bank Limited is one of the well-known Development bank in financial system of Nepal. It was established in 2064 by a group of individuals who are from various fields with excellence experience and energy do to something new in banking field with vision of "we focus on equal access of all peoples who are real seeder of banking services". The major initiators of the institution are from professional sectors like business, teaching, engineering, doctor, banking, as well as management. The strategy of bank based on its vision, so it is gradually expanding branches across the country. The current situation of bank access is in 34 districts with 123 branches *(www.garimabank.com.np).*

Muktinath Bikas Bank Limited: Muktinath Bikas Bank Limited is also B class bank established in 2063, licensing by central money authority of Nepal. The bank has established to provide financial services in corporate sector, agriculture sector, retail

business and microfinance sector. The bank has introduced itself as differ than others by providing the diversified service to the target customer in banking market. Bank has targeting to rural, modern and micro sector to serve by using latest banking technology. The bank operates under the vision "Be the most preferred robust Bank in Nepal while uplifting socio-economic status of people" The central corporate office of the bank is located in Kamaladi Kathmandu Nepal with its slogan "Janata Bank ma Hoina, Bank Janata ma Janu Pardachha" *(www.muktinathbank.com.np)*

The Bank prioritized opening branches in the rural areas where people were in direct need for banking services. The customer friendly products, services and door-to-door facility are the major factor for its popularity and success among the local people of the area. Within one and half year of operations on the month of April 2009, the Bank started Microfinance Program by starting a dedicated department at central office and branches to serve low income but high potential people with high productivity. The Bank was the first "B" class Bank serving to low-income people with dedicated department for same. It is also exemplary Banking system believed to be first of its kind in the world where two different systems operating under one roof of the Bank both dedicated to community Development *(www.muktinathbank.com.np).*

Shangri-la Development Bank Limited: The Bank was established with a dream project of few innovative and motivated entrepreneurial minds rather than being just another bank in the crowd of financial institutions. Promoted by respected professionals, bankers, chartered accountants, doctors, engineers, businessmen, entrepreneurs, social workers, and other renowned personality of other fields with very good integrity and social standings and it becomes national development bank after merger of Bageswari Development Bank and Shangri-la Development Bank. 112 branches are in operation across the country. This bank had acquired Cosmos Development bank in 2074. The head office of the bank is located at Baluwatar, Kathmandu with its vision "we committed to providing the quality services to every customer with utmost courtesy and care" *(www.shangrilabank.com).*

Jyoti Bikas Bank Limited: Jyoti Bikas Bank limited is a B class bank established in 2065 license by money authority of Nepal with its vision "To be established as an institution with the larger cause of citizens and society at the center, delivering modern, informed and easy financial services by building upon best practices of risk management and operation system". The main focus areas of this bank are hydropower and infrastructure development. National Level Development bank its operation from 2065. Providing banking services to public for various purposes. JBBL aims to serve wide range of customers with its unique customer- oriented quality services *(jbbl.com.np).*

Mahalaxmi Bikas Bank Limited: The Mahalaxmi Bikas Bank Limited started as development bank from 2016 after merger of two financial institutions Mahalaxmi Finance, Malika Development Bank and Siddartha Finance. The bank is operating as development bank with license of B class bank from Nepal Rastra Bank with 103 branches across the country. The bank has taken slogan "Service with Smile". The bank has also adapted it's service through modernize banking services *(www.mahalaxmibank.com).*

The bank always moves forward on implementing prolong business practices through consistent growth to all its stakeholders for sustainability and profitability with the long-term mission of innovation, improvement, corporate governance, and culture.

Bank had been awarded with Best Presented Award-2018 from ICAN for presenting best financial report among Development banks. Similarly, bank had also been awarded with SAFA-2018 in Bangladesh for being successful presenting best financial report *(www.mahalaxmibank.com).*

1.2 Problem statement

There was increased in the number of development banks in few past decades after implementation of liberalization, privatization and globalization policy. Development banks are being major part of financial system because development banks are accepting public deposit, and make funds available through their lending and investing activities to the borrowers like individuals, businesses, and governments. Being dozens of bank in small economy of Nepal, there is unfair competition among the banks in the name of

collecting deposits and lending funds. Economic growth and development are based upon the investment policy of the country. Investment problem has become one of the very serious for the least developed country like Nepal. This is because lack of efficient and sound investment policy of banks. The major problem faced by development bank these days are competitive environment, limited investment opportunities, inadequate deposits, challenge to maintain authorized capital, non-performing loan and so on. Non-performing loan is increasing in bank's balance sheet. Granting loan against insufficient deposits, loan against undervalued collateral, ineffective credit monitoring and political pressure to the lender are the major reason behind the increasing non-performing loan. Liquidity risk, credit risk, operation risk, loss investment opportunities are some of the implications of non-performing loan.

Development banks' investment has been found to have lower productively due to the lack of effective supervision regarding whether there is proper utilization of their investment or not. Nepal Rastra Bank was established in order to make economic stability. Various rules and regulations have been made and brought out by central bank for the effective performance of the Banking and Financial Institutions (BFIs). The study is conducted to find out the solution of the following problems:

i. What is the trend of profitability, loan loss provision, non-performing loan, total loan, capital and total assets of development from year 2072/73 to 2079/80?

ii. What is the impact of loan loss provision, non-performing loan, total loan, capital and total assets on profitability of development bank?

1.3 Objectives of the study

The main objective of this research is to examine the level of non-performing loan of selected development banks in Nepal. The specific objectives of this study are;

i. To assess trend of profitability, loan loss provision, non-performing loan, total loan, capital and total assets.

ii. To examine impact of loan loss provision, non-performing loan, total loan, capital and total assets on profitability of development bank.

1.4 Rationale of the study

In context of Nepal, the major source of revenue of development banks is interest received from loan and advances. Thus, development banks have invested huge deposits in loan and advances. In this way, non-performing loan bring prominent threat to banks. The part of loan that cannot generate regular interest and principal increases the volume of non-performing loan. Big amount of loan loss provision is required as increase in the amount of non-performance loan (NPL). The possible threat from development banks non-performance loan is credit risk, liquidity risk, operational risk, legal risk, reputational risk and, as a result effect on overall financial performance of banks. With respect to this, this dissertation is conducted to examine the issue of non-performing loan in selected banks.

Good investment policy of the bank has positive impact on economic development of the country and vice-versa. This study will be beneficial to the shareholders, depositors and other stakeholders in regard to identify the performance of banks with respect to development bank of Nepal. The main focus of this comparative study will be helpful to analyze the non-performing loan, assets management and policies of the bank in comparison of these five selected banks. This study can be helpful in improving credit policies. With the help of this report, bank can analyze the effectiveness of their credit department.

1.5 Limitations of study

The limitations of this research study are as follows:

i. The study will cover selected Development banks in Nepal and will not consider other financial institutions and sectors to provide a more broad-based analysis.

ii. This comparative analysis will rely on availability of secondary data.

iii. The study has taken random samples out of 17 development banks.

CHAPTER II

LITERATURE REVIEW

Information from prior studies on topic associated to the research problems is included in this chapter. This chapter highlights upon the existing literature. It examines what diverse scholars and authors have stated about the relation between non-performing assets and profitability. Further empirical studies carried out by other researchers are included in the subsequent part of the paper.

2.1 Conceptual Review

A conceptual review is an evaluative examination that delves into the theoretical underpinnings and fundamental ideas of a subject, rather than focusing solely on empirical evidence or practical applications. It involves a critical analysis of concepts, theories, and frameworks within a particular field, aiming to clarify, refine, or challenge existing ideas. Unlike traditional literature reviews that primarily summarize existing research, a conceptual review aims to synthesize and interpret the conceptual landscape, offering insights into theoretical developments, conceptual frameworks, and emerging trends. Through synthesizing diverse perspectives and identifying gaps or inconsistencies, conceptual reviews contribute to advancing understanding and shaping future research agendas within a given discipline (Adhikari & Pandey, 2018). The relevant variables are:

2.1.1 Loan and Advance

Generally, loan and advance means lending money by the financial institution to customer based on creation condition to generate income. Loan and advance given to micro financial institution as well as other bank and financial institutions are growing day to day in financial system of Nepal. Presented under this account, the net amount after deduction of specific impairment on loan and advance to bank and financial institutions are shown a separate schedule (Thapa, 2012)

The loan and advance to customer are being major source of income of bank and financial institution. Bank work as intermediaries between surplus and deficit parties in

an economy. According to NRB directives (2075), loan and advances are categorized into two categories:

Performing loans: The components of performing loans and advanced are pass loans and watch list loans fall under performing loans.

Non-performing loans: The loans are substandard loans, doubtful loans, loss loans, and rescheduled loans. The loans have defaulted their payment by 1 month are to be excluded from the pass loans. NRB included rescheduled loan into non-performing loans.

2.1.2 Performing Loan

Performing loans refers to the loans amount repay interest and principal in time. It is known as productive assets because it generates revenue for financial institutions. Institutions lending to the customer time to earn profit on principle amount as interest. Customer's pays loan with interest on given period known performing loan.

2.1.3 Non-performing loan

Non-performing is amount which is not received by the Bank interest as well as principle under loan condition and agreement from last 90 days. The delay in payment could be either interest or principal amount. The loan amount shows the assets of bank and major source of revenue for bank. However, some time and some amount cannot perform as expectation of bank and financial institution. It is also known as non-performing assets (NPA). NPA is the loan emanated from the deterioration in the quality of the loan portfolios and a leading indicator of credit quality. United directive has instructed banks and financial institutions to classify their loan into two categories: performing loans and non-performing loans. Non-performing loan are substandard loans, doubtful loans, loss loans and restructured loans (Rawal, Sapkota, & Timilsina, 2076)

2.1.4 Loan Loss Provision

Loan loss provision is a financial provision adopted by every financial institution to the directives of central money authority to maintain loan loss of bank and financial institutions. The Banks and financial institution take provision on non-performing loan. The loan loss provision depends on loan and advance and quality of loan (Rawal, Sapkota, & Timilsina, 2076)

2.1.5 Profitability

Profitability refers to the number of banks and financial institutions after subtraction all the expenditure from its revenue in a period. The banking sector provides financial service among the surplus unit of economy as well as deficit unit of economy by taking charges. To operate daily activities, Bank and Financial Institution (BFI) expense some amount. The main source for revenue for BFI is loan, advances, and other nominal charges for providing services to customers. The profitability of institution depends on the performance of bank, quality of loan, operation cost. Non-performing loan and quality of loan influences the profitability of banks.

2.1.6 Impact of NPAs

The NPAs have its multiple impacts on the performance of the financial institutions and banks. It simultaneously affects the profitability, liquidity, resource mobilizing, goodwill and overall performance of the organization. The followings are the important factors, which are affected by the mounting NPAs.

2.1.6.1. Profitability

The main source of income of the Financial Institutions is from the interest earned from the standard assets. NPA refers to the investment of money in the bad assets, which occurred due to wrong choice of client and project. Because of the money getting blocked the prodigality of financial institution decreases not only by the amount of NPA but it leads to opportunity cost also as that much of profit invested in some return earning project/asset. So NPA does not affect current profit but also future profits, which leads to losing some long-term beneficial opportunity. The profit of the FIs also reduced due to write off provision for NPAs.

2.1.6.2 Capital adequacy

As per BASEL norms, banks are required to maintain adequate capital on risk-weighted assets on an ongoing basis. Every increase in NPA level adds to risk weighted assets, which warrant the banks to shore up their capital base further.

2.1.6.3 Difficulty in resource mobilization

NPAs cease the income from both interest and principal, which ultimately blocked the cash inflows from the investments. So, it is difficult in the part of the FIs to mobilize resource effectively. The new investments can't possible due to lack of funds in hand.

2.1.6.4 Liquidity

Fund is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for shortest period of time which lead to additional cost to the corporation. Various difficulties arise in operating the functions of FIs are another cause of NPA due to lack of funds. Therefore, the non-performing asset directly affects the liquidity of the financial institution and banks.

2.1.6.5 Sanctions and disbursement

The NPA has greatly affected the sanction for the new project. As the corporation do not have sufficient fund to invest in new project due to stoppage of inflow of funds because of NPAs, it faces difficulty in sanction and disbursement.

2.1.6.6 High operative cost

The operational cost of the corporation is increased due to increase in the NPAs. Monitoring cost of the NPAs is too high. Both the preventive and curative measures for reducing the NPAs attract high expenses. The NPAs in one hand ceases to generate any income from interest and in other hand it creates loss through effective management (Gowri and Surullive, 2017).

2.1.6.7 Goodwill

The NPAs also affect the goodwill of the organization. The main cause of the NPA is lack of efficiency in management. So, the goodwill of the organization is adversely affected by it. Another cause of reduction in the value of goodwill is lack of profit due to non-receipt of interest and principal from the NPAs (Raja and Mehta, 2018).

2.1.6.8 Shareholders' confidence

The increased NPA level is likely to have adverse impact on the bank business as well as profitability thereby the shareholders do not receive a market return on their capital and sometimes it may erode their value of investments.

2.1.6.9 High cost of fund due to NPAs

Quite often genuine borrowers face the difficulties in raising funds from banks due to mounting NPAs.' Either the bank is reluctant in providing the requisites funds to the genuine borrowers or if the funds are provided, come at a very high cost to compensate the lender's losses caused due to high level of NPAs. Therefore, quite often corporate prefer to raise funds through commercial papers(TCS) where the interest rate on working capital charged by banks in higher. Other various pressing factors are relevant from the point of view Nepalese banking operations with a view to focusing on NPAs and its related effects (Raja and Mehta, 2018).

2.1.6.10 Liability management

In the light of high NPAs, Banks tend to lower the interest rates on deposits on one hand and likely to levy higher interest rates on advances to sustain NIM. This may become hurdle in smooth financial intermediation process and hampers banks 'business as well as economic growth.

2.1.6.11 Public confidence

Credibility of banking system is also affected greatly due to higher level NPAs because it shakes the confidence of public in the soundness of the banking system. The increased NPAs may pose liquidity issues, which is likely to lead, run on bank by depositors. Thus, the increased incidence of NPAs not only affects the performance of the banks but also affect the economy as a whole. In a nutshell, the high incidence of NPA has cascading impact on all important financial ratios of the banks viz., Net Interest Margin, Return on Assets, Profitability, Dividend Payout, Provision coverage ratio, Credit contraction etc., which may likely to erode the value of all stakeholders including Shareholders, Depositors, Borrowers, Employees and public at large (Nagaraja, 2020).

2.2 Theoretical Review

A theoretical review serves as the backbone of academic research, offering a comprehensive examination and synthesis of existing theoretical frameworks, concepts, and models relevant to a particular topic. It involves a meticulous analysis of scholarly literature, identifying key theories, debates, and gaps in understanding. By critically evaluating existing theories and proposing potential avenues for further inquiry, a

theoretical review provides a solid foundation for new research endeavors, guiding researchers in developing hypotheses and methodologies. Ultimately, it enriches the academic discourse by fostering a deeper understanding of the theoretical underpinnings shaping a specific field of study.

2.2.1 The real bills doctrine theory

Mukoya, Muturi, Oteki & Wamalwa (2015) Analyzed the real bills doctrine or the commercial loan theory states that a commercial bank should advance only short-term self-liquidating productive loans to business firms. Self-liquidating loans are those, which are meant to finance the production, and movement of goods through the successive stages of production, storage, transportation, and distribution. When such goods are ultimately sold, the loans are considered to liquidate themselves automatically. For instance, a loan given by the bank to a businessperson to finance inventories would be repaid out of the receipts from the sale of those very inventories, and the loan would be automatically self-liquidated. The theory states that when commercial banks make only short-term self-liquidating productive loans, the central bank, in turn, should only loan to the banks on the security of such short-term loans. This principle would ensure the proper degree of liquidity for each bank and the proper money, supply for the whole economy. The central bank was expected to increase or diminish bank reserves by rediscounting approved loans. When business expanded and the needs of trade increased, banks were able to acquire additional reserves by rediscounting bills with the central banks. When businesses fail and the needs of trade declined, the volume of rediscounting of bills would fall, the supply of bank reserves and the amount of bank credit and money would contract. Such short-term self-liquidating productive loans possess three advantages. First, they possess liquidity that is why they liquidate themselves automatically. Second, since they mature in the short run and are for productive purposes, there is no risk of their running to bad debts Menkhoff, (2000). Third, being productive such loans earn income for the banks. Despite these merits, the real bills doctrine suffers from certain defects. First, if a bank refuses to grant a fresh loan till the old loan is repaid, the disappointed borrower will have to reduce production which will adversely affect business activity. If all the banks follow the same rule, this may lead to reduction in the money supply and price in the community. This may, in turn, make it impossible for existing debtors to

repay their loans in time. Second, the doctrine assumes that loans are self-liquidating under normal economic conditions. If there is depression, production and trade suffer and the debtor will not be able to repay the debt at maturity. Third, this doctrine neglects the fact that the liquidity of a bank depends on the sale-ability of its liquid assets and not on real trade bills. If a bank possesses a variety of assets like bills and securities, which can be readily, should in the money and capital markets, it can ensure safety, liquidity and profitability. Then the bank need not rely on maturities in time of trouble. Fourth, the basic defect of the theory is that no loan is in itself automatically self-liquidating. A loan to a retailer to purchase inventor is not self-liquidating if the inventories are not sold to consumers and remain with the retailer. Thus, a loan to be successful involves a third party, the consumers in this case, besides the lender and the borrower. Fifth, this theory is based on the "needs of trade" which is no longer accepted as an adequate criterion for regulating this type of bank credit. If bank credit and money supply fluctuate based on the needs of trade, the central bank cannot prevent either spiraling recession or inflation.

2.2.2 Credit creation theory of banking

Starkey (2018) examined credit creation theory of banking proposes that individual banks can create money, and banks do not solely lend out deposits that have been provided to the bank. Instead, the bank creates bank deposits because of bank lending. Consequently, the amount of money that a bank can create is not constrained by their deposit taking activities, and the act of bank lending creates new purchasing power that did not previously exist. The repayment of existing debt destroys money, because of reducing bank loans and customer deposits. A bank's ability to create new money, which is referred to as credit money is a consequence of a range of factors. Firstly, non-cash transactions account for more than 95% of all transactions conducted within the economy, with non-cash transactions being settled through non-cash transfers within the banking system. Banks' ability to create credit money arises from combining lending and deposit taking activities. Banks act as the accountant of record within the financial system, which enables banks to create the fiction that the borrower deposited money at the bank. Members of the public are unable to distinguish between money that a bank has created, and money saved at the bank by depositors. Bank's ability to create credit money is also a consequence of being exempt from the client money rules. Regulations in the

form of the client money rules prevent nonbank organizations creating credit money, because non-bank organizations are required to keep client's money separate from the non-bank organizations assets and liabilities on their balance sheet. However, banks' exemption from the client money rules enables banks tore label liabilities on their balance sheet at different stages of the process when extending a loan, which enables banks to expand their balance sheets. Exemption from the client money rules enables banks to rename their account payable liability as a customer deposit, despite the money not being a consequence of a customer making a deposit. There is no law, statute or banking regulation that allows banks to reclassify their bank liabilities as a fictitious customer deposit. Consequently, the legality of banks creating credit money is unclear. Banks' exemption from the client money rules also means that when customer deposits money at their bank, the customer no longer owns the money and becomes a general creditor of the bank. The accounting entries associated with second stage of the process, when the bank places money into a borrower's bank account, is the point at which the banks accounting treatment of the loan differs from other types of financial intermediary. A bank creates new credit money because of their accounting treatment of liabilities. The bank ledger converts the account payable arising from a bank is lending activity to a customer deposit, where the customer deposit represents another category of bank liability. This accounting process causes the bank to create a new customer deposit that was not previously paid into the bank, but instead represented the reclassification of an account payable liability of the bank. This accounting treatment of the transaction enables the bank to expand both sides of their balance sheet at the same time when making a loan. Bank lending activity is constrained by the need to remain profitable. Bank profitability is a consequence of interest received on loans exceeding interest charges on bank liabilities. The difference between interest received on bank loans and the bank's cost of capital is then used to cover the bank's cost of provisions for bad and doubtful debts and operating costs of the bank, and the remainder is bank profit. Banks money creation capability is constrained by their motivation to ensure there is an appropriate spread between the interest rate received on money loaned, and the cost of bank capital. A rapid expansion of bank lending will require the bank to reduce the interest rate charged to borrowers, which will reduce bank profitability. A bank must also ensure that it has sufficient provisions

and capital to cover unanticipated losses arising from bad and doubtful debts, whilst also meeting regulatory requirements. Creation of credit money is determined by a commercial bank's confidence that issued loans will be repaid. Therefore, banks perception of "credit default risk" is an important factor influencing the amount of bank lending. Strong growth in property prices over a prolonged period of time reduces bank's perception of the level of credit default risk associated with property lending, because money owed as a consequence of the borrower's failure to repay a loan will be recovered by the bank repossessing the property that provided security for the loan. Secondly, borrowers are likely to repay loans whilst the asset value exceeds the total amount of money outstanding on the loan. When property prices are continuously increasing the bank will perceive that property lending incurs a very low credit default risk, and will therefore attribute a very low level of credit default risk when lending for property purchase. Levels of credit default, and bank provisions for bad and doubtful debts, are likely to increase substantially in the event of a significant reduction in property prices.

2.2.3 Credit Policy and Its Parameters

Credit is financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for an obligation of repay on specified date on demand. Credit is the amount of money lent by the creditors to the borrower based either on security or without security. Sum of the money lent by a bank, is known as credit. Credit and advances are an important item on the asset side of the balance sheet of a commercial bank. Bank earns interest on credits and advances, which is one of the major sources of income for banks. Bank prepares credit portfolio, otherwise it will not only add bad debts but also affect profitability adversely (Francis, 2003: 6) In fact, it is a very sensitive subject that what sort of credit policy a bank should have. Therefore, it should pay more attention to the loan, advances that it provides. The commercial banks are inspired with the motive of gaining profit. To fulfill these objectives, they should manage and improve its banking sector. They must give more attention to the flow of loan. Regarding loan policy, it should be clear and follow such policy, which would match the economic policy of the nation. Credit policy of Himalaya bank ltd. is the approved methodologies for conducting its lending operations with an objective to maximize profit of the bank and serve its best to the nation. The general assembly is the sole authority to approve such policy.

Normally, the Board of Directors is authorized to approve such policy on the recommendation of the management. The general assembly in its annual general meeting or special meeting may initiate the approve changes or can guide the Board management to implement, suggest, renew or cancel the existing policies. Credit management in Himalaya bank ltd. basically covers loan approval process, credit analysis, method and mechanism, lending documentation, disbursement and administration of loan including credit audit. As there is a saying "Precaution is better than cure" bank should be more analytical and farsighted while disbursing loan in order to prevent loan flow in unproductive sector and non-performing assets.

2.2.4 Loanable fund theory of interest

Kumar (2019) conducted the neo-classical theory of interest or loan able fund theory of interest, which was first developed by the Swedish economist Kunt Wicksell. Later economists Ohlin, Myrdal, Lindahl, Robertson and J. Viner had considerably contributed to this theory. According to this theory, rate of interest is determined by the demand for and supply of loan able funds. This theory was more realistic and broader than the classical theory of interest. Loanable funds theory differs from the classical theory in the explanation of demand for loan able funds. According to this theory demand for loanable funds arises for the following three purposes i.e., investment, hoarding and deficit. Investment is the main source of demand for loanable funds is the demand for investment. Investment refers to the expenditure for the purchase of making of new capital goods including inventories. The price of obtaining such funds for the purpose of these investments depends on the rate of interest. An entrepreneur while deciding upon the investment is to compare the expected return from an investment with the rate of interest. If the rate of interest is low, the demand for loanable funds for investment purposes will be high and vice versa. This shows that there is an inverse relationship between the demands for loan able funds for investment to the rate of interest. Those people who want to hoard it as idle cash balances to satisfy their desire for liquidity also make up the demand for loanable funds. The demand for loanable funds for hoarding purpose is a decreasing function of the rate of interest. At low rate of interest demand for loanable funds for hoarding will be more and vice-versa. This demand comes from the people at that time when they want to spend beyond their current income. Like hoarding,

it is also a decreasing function of interest rate. The supply of loanable funds is derived from the basic four sources as savings, dishoarding, disinvestment and bank credit. Savings constitute the most important source of the supply of loanable funds. Savings is the difference between the income and expenditure. Since, income is assumed to remain unchanged, so the amount of savings varies with the rate of interest. Individuals as well as business firms will save more at a higher rate of interest and vice-versa. Dishoarding is another important source of the supply of loanable funds. Generally, individuals may dishoard money from the past hoardings at a higher rate of interest. Thus, at a higher interest rate, idle cash balances of the past become the active balances at present and become available for investment. If the rate of interest is low, dishoarding would be negligible. Disinvestment occurs when the existing stock of capital is allowed to wear out without being replaced by new capital equipment. Thus, high rate of interest leads to higher disinvestment and so on. Banking system constitutes another source of the supply of loanable funds. The bank advance loans to the businesspersons through the process of credit creation. The money created by the banks adds to the supply of loanable funds. According to loan able funds theory, equilibrium rate of interest is that which brings equality between the demand for and supply of loanable funds. In other words, equilibrium interest rate is determined at a point where the demand for loanable funds curve intersects the supply curve of loanable fund.

2.3 Empirical Review

Empirical review refers to the review of previously conducted research and article of scholars to related study. Various studies are conducted by the various scholars in various countries and banking sector about impact of non-perming loan. The empirical review of various research studies is as:

2.3.1 Article Review

Odebode et. al (2024). Studied examined *"Effects of Non-Performing Loans On Return On Assets Of Selected Commercial Banks In Nigeria"*. The essence of creating Commercial banks to act as intermediary between the surplus and deficit units of funds. In addition to other vital objectives of profitability, growth in assets, and growth in customer base. To achieve these objectives, commercial banks allowance loans to

individuals, business organizations and governments among other profit springy ventures. Loan default could be rampant resulting from low quality of assets, high non-performing risk assets that may result in huge loan losses and reduction in bank profitability primary to complicated effect on return on assets of commercial banks. This study investigates the effect of non-performing loans (using loan loss provision as proxy) on return on assets of selected commercial banks in Nigeria. Secondary data from 2010 to 2021 were sourced from Central Bank of Nigeria Statistical Bulletin and the Annual Financial Reports of affected bank, and panel least square method of analysis was used as our estimation technique. The results revealed that while loan loss provision has negative impact on return on assets of the selected commercial banks, interest rate has a positive impact on return on assets of the selected commercial banks within the period of study.

Nabella et. al (2023). Studied diagnosed "*The Effect of Financing on Islamic Banking Assets with Non-Performing Finance As a Moderating Variable in Indonesia*|". Study with secondary data obtained from the official website of the Financial Services Authority (OJK). The data collected by the author starts from 2011 – September 2020. This study used the MRA (Moderated Regression Analysis) method. Objectives of study was to determine whether there is a partial influence and how moderation forms on disbursed financing (PYD) on Islamic Banking Assets with Non-Performing Finance (NPF) as a moderating variable. The results of this study show that there is a partial influence of PYD variables on Islamic Banking Assets. This is evidenced by the acquisition of t count greater than t table (42,000 > 0.7111) and significant values less than α (0.000 < 0.05). Then the moderating variable in the form of Non-Performing Finance (NPF) can moderate the relationship between PYD and Islamic Banking Assets. This is evidenced by the acquisition of significance values in the third regression model (including interaction variables) obtained by 0.000 this significance value is smaller than $\alpha = 0.05$

Chaudhary and Patel (2020) study conducted on *"A Study on Impact of Non-performing Assets on Profitability of Public and private Sector Banks".* The objective of study was to analyze the trend of non-performing asset on private and public sector banks in India, examine the impact non-performing loan on the profitability of bank under causal and

analytical research design using correlation and regression statistical tools. The main variables in study were profit, NPA of private and public sector bank. The findings of study were significant negative relationship between NPA with return on assets of public and private sector bank.

Nagaraja (2020) study conducted on "Non-performing Assets Management in the Co-operative Banks in India: A descriptive Analysis" as object comparing performance of co-operative banks by analyzing trend on non-performing assets for the period 2008 - 2018 using Statistical tools tabulations and graphs. The major finding of the study was, high level of non-performing assets suggests diminishing assets quality and profitability of the bank. The strength of financial institution depends on the quality of its assets.

Kashyap, Reddy, Addae and Bansal (2020) study conducted on *"Non-performing Assets and Profitability of Indian Bank".* The objectives of study were to find out the level of non-perfuming assets of banking sector in India and the impact of non-performing assets on profitability and financial performance in India used ratio analysis for study and time series data up to 14 years from 2000-2014. The main finding of study was non-performing assets of public owned bank and increasing level of NPAs impact the profitability.

Wadhwa and Ramswamy (2020) study conducted on "*Impact of NPA on Profitability of Banks".* The objectives of study were to understand concept of NPA and its recovery, determine whether there is significant relationship between profitability of bank and NPA. The study was completed under descriptive research design using secondary data. The study had used descriptive statistical tool; correlation and regression for data analysis. The study mainly focused on impact on dependent variable i.e., profitability due to NPA. The main finding from the study was negative correlation between NPA and profit.

Arasu, Sridevi and Ramya (2019) Study conducted on "*A Study on analysis of non-performing assets and its Impact on Profitability"*. The objective of study was to know the level of non-performing assets of private and public sector banks, impact of and recommendation under descriptive research design by descriptive statistical tools such as mean, standard deviation, and correlation and regression line. The variables included in

study were ROA, Non-performing assets of private sector, public sector banks. The major finding of study was NPA has a significant negative influence on ROA.

Raja and Mehta (2018) Study conducted on *"Measuring the Effect of Non-performing Assets on the Profitability of the Public and Private sector Banks in India".* The objectives of study were to measure the effect of non-performing assets on the profitability of the public and private sector banks in during last seven years using secondary data from 2011-2016/17 used regression line for data analysis. The main variables are profit, net interest margin, net advance and NPA in the study. Major finding of study were public and private sector banks have also shown negative and significant relationship with both the ratios but net interest margin has shown positive and insignificant relations with gross NPA to gross advances and net NPA to net advance ratio.

Devi and Pant (2018) Study conducted on *"Impact of NPA on Profitability Performance of Selected Public and Private Bank in India".* Objectives of study were to calculate the relationship between NPA and profitability of the selected banks, find out the impact of NPA on net profit of the selected banks. The study had included profit and NPA as variable considering data from year 2012-2016 to find out impact of NPA on profit of banks. The finding of study was SBI and BOS has lowest meant value, NPB and BOB highest NPA out of sample banks of study.

Gowri and Surullive (2017) Study conducted on *"NPA Impact on Profitability of Indian overseas Bank".* The objectives of the study were to understand non-performing assets, what are the underlying reasons for the emergence of the NPA and understand the impact of NPA as on the operations of the bank. The tool for data collection was structured questionnaire and for analysis, descriptive statistics tools were used i.e. Frequencies, regression and factors analysis were used. The study was completed based on secondary data. The results of study were the gross NPA reduces the profitability of overseas regional bank and operational process influenced.

Shiralshetti and Poojari (2016) study conducted on *"non-performing assets impact on profitability of Bank"* with objectives to analyze Gross Non-performing Assets (GNPA) and Non-performing Assets (NPA), and impact of GNPA on profit. The main variable of these studies was profit, NPA and GNPA. The study was completed under the descriptive research design and analytical research design. The study was based on secondary data, analyze through percentage and inferential statistical tool t-test and NONVA. On the basis of these statistical tools the finding of the study was there is moderate relationship between gross NPA and Net Profit of bank. The dependent variable profit was influences by the independent variable GNPA and NPA moderately. That means there was role of GNPA and NPA to measure the profitability of banking institutions.

Kiran and Jones (2016) the study conducted on *"Effect of Non-performing assets on the Profitability of Bank".* The objectives of the study were examining the relationship between the non-performing assets and profitability of bank. Main focus of the study was on what is the relationship between profitability and non-performing loan of bank. The research efforts were on to examine the impact of NPA on profit of banks. Profitability and non-performing loan of bank were main variables of study. The study was completed under the descriptive research design taken 27 banks as sample size of the study. The finding was there is negative impact of gross non-performing loan on profitability of bank and non-performing assets influences the profitability of the banks significantly.

2.3.2 Thesis review

This part consists the previously conducted thesis by university scholars, related with non-performing loan are reviewed in this research review part. These completed studies provide the fact, data and finding of study to guide the new study on regarding topic to a researcher. The following are the main thesis related to impact of non-performing assets on profitability of banking institutions.

Muasya (2009) Study Conducted on **"***The Impact of Non-performing Loans on the performance of the Banking Sector in Kenya"* with objectives of study was how non-performing loans affects the performance of commercial banks in Kenya. The study was based on survey design to identify non-performing loan in Kenya for the 2004 to 2008.

All commercial banks are taken as sample of study in Kenya which had more than KSh 25 billion value of assets, more 20 billion of loan and based on more industry 28 billion in assets values. Secondary data was used for the study. SPSS software for data analysis was used. From the above analysis of this thesis, report had shown there are commercial banks negatively affected by raising levels of non-performing loan through provisioning made and interest suspense.

Karki (2019) study carried on "*A study on non-performing loan Management of Commercial Bank in Nepal". T*he objectives of the study were to examine the non-performing loan of selected banks, investigate the impact of non-performing loan on financial profitability of selected banks. There was mainly profitability like ROA and ROE as dependent variable and non-performing loan as independent variable. The researcher has used the descriptive and comparative research design and secondary data were used to study. Main variable of this study were non-performing loan of banks and time of data included in the study. The major finding of study was positive correlation between loan and NPL amount.

Tamang (2019) studied on topic *"Impact of non-performing loan on Profitability of Commercial Banks in Nepal".* The objective of study was to analyze impact of non-performing loan of the commercial banks in Nepal. The study has shown clear picture about status of NPL of those commercial banks, study also helps to know the present issues faced by those commercial banks and study reflects the financial performance of banks. Under descriptive research design, the researcher in the study used secondary data. The main variable of study was profitability and NPL where profitability was dependent variable and non-performing loans was independent variable for the study. The major finding of the study was increase in NPL can significantly influence the profitability of the selected commercial banks, fluctuated trends in ROA, downward sloping ROE of selected commercial banks. But R square equal to 0.086 which means NPL explained by ROA is only 8.6%.

Bhattarai (2018) studied on "*Effect of Non-performing Loan on profitability of Nepalese commercial bank"*. The objectives of study were to identify the relationship between non-performing loan and profitability of the bank, examine the effect of loan loss

provision on profitability of banks and analyze the effect of loan and advance on profitability of bank. The study was under the descriptive and analysis research design. The study has used bank's secondary published data. The sample banks were from 28 commercial bank. The study was completed by taking three sample banks out of 28 commercial banks. Out of three sample banks one was public bank and two were private banks. The study has taken non-performing loan, profit, loan loss provision, loan and advance as main variable of study. The major finding of the study was NPL leads to decrease the return of shareholder's equity.

Ghimire (2018) analyzed *"Non-performing Assets and Profitability in Commercial Banks of Nepal with Reference Himalayan, Everest, Nepal SBI and Nabil Bank limited"*. The objective was to analyze the impact of NPA on profitability of Nepalese commercial bank using diagnostic and exploratory research design. The data for study was secondary from published source of banks report. The result of the study was significantly improved their working performance in the areas of NPAs by passing years.

Acharya (2018) study associated with *"non-performing loan of Everest bank and Nabil bank".* The objectives of study were to analyze the NPL of selected banks, investigate the impact of non-performing loan on profitability of selected banks, and analyze the ratio trend of NPL on Nepalese commercial banks. The study had followed descriptive and comparative research design. The study was completed based on secondary data. The sample of the study was Everest and Nabil bank out of 28 Commercial banks in Nepal. The result of study shows downfall of the NPL ratio, there was positive correlation between total loan, and NPL amount of bank, the regression ANOVA test shows NPL and ROA opposite direction association. However, there was insignificant relation between NPL and ROA, NPL and ROE.

Bajracharya (2016) study correlated with *"An Economical Analysis of Non-performing Assets of Himalayan Bank Limited"* with objectives to examine trend and growth pattern of NPA of Himalaya Bank Limited, identify major problems and prospects associated with NPA. The study used descriptive as well as analytical research design through using secondary data from annual report of bank, prospects, balance sheet, journal, internet and other sources through Himalaya Bank Limited select as sample out of 29 commercial

bank and purposive sampling method. For data analysis table, mean, standard deviation, correlation trend analysis, correlation and regression statistical tool were being used. The major finding of the study was NPA has caused a serious impact on the bank's profitability but the trend of NPL of Himalaya Bank Limited was in decreasing average NPL of bank was NRs. 1128.36 million.

Khanal (2010) studied associated with *"Non-performing Assets of Nepal SBI bank and Bank of Kathmandu Limited"* the objectives of the study were to analysis the proportion of NPAs to total assets, total deposits and total lending of commercial banks, analyze whether banks are complying with NRB directives with respect to management of loan and advance and other interest bearing assets, examines and evaluates the effects of NPA on ROA and ROE of Commercial banks and make recommendation to overcome the difficulties in managing NPA of banks with high level of NPA with variable NPA, ROA, ROE, to analysis the proportion for NPAs to total assets, total deposits and total lending of commercial bank used descriptive and analytical research design with secondary data from published source of annual report and NRB website and population of study was 30 commercial banks out of them Nepal SBI bank limited and Banka of Kathmandu limited taken as sample of this study for analysis financial ratio was used. The finding of the study was ROA and ROE of the some who depend up on the level of NPA, the level of NPA to total assets, total lending and total deposits of Bank of Kathmandu seems at acceptable level at the end of all fiscal years. That means the bank has good management of loan and advances that doesn't seem to be alarming to danger till the date of study, the result of correlation analysis concludes that ROA and return on equity ROE of the bank depends on level of NPA, the high degree negative correlation between NPA and ROA as well as between NPA and ROE clearly indicates that there is inverse relation between NPA and ROA as well between NPA and ROE.

Muasya (2009) Study Conducted on **"***The Impact of Non-performing Loans on the performance of the Banking Sector in Kenya"* with objectives of study was how non-performing loans affects the performance of commercial banks in Kenya. The study was based on survey design to identify non-performing loan in Kenya for the 2004 to 2008. All commercial banks are taken as sample of study in Kenya which had more than KSh

25 billion value of assets, more 20 billion of loan and based on more industry 28 billion in assets values. Secondary data was used for the study. SPSS software for data analysis was used. From the above analysis of this thesis, report had shown there are commercial banks negatively affected by raising levels of non-performing loan through provisioning made and interest suspense.

Table 1

Meta table

Date	Article	Writer	Objective	Methodology	Finding
January 2024	Effects of Non-Performing Loans on Return on Assets of Selected Commercial Banks in Nigeria	Odebode et al	This study investigates the effect of non-performing loans (using loan loss provision as proxy) on return on assets of selected commercial banks in Nigeria	Secondary data from 2010 to 2021 were sourced and panel least square method of analysis was used as our estimation technique	The results revealed that while loan loss provision has negative impact on return on assets of the selected commercial banks, interest rate has a positive impact on return on assets of the selected commercial banks within the period of study.
January 2023	The Effect of Financing on Islamic Banking Assets With Non-Performing Finance As	Nabella et al	to determine whether there is a partial influence and how moderation forms on disbursed financing (PYD) on Islamic	Study with secondary data from year 2011 to 2020 and Moderated Regression Analysis tool was used	There is a partial influence of PYD variables on Islamic Banking Assets

	a Moderating Variable in Indonesia		Banking Assets with Non-Performing Finance (NPF) as a moderating variable		
July 2020	Impact of non-performing assets on profitability in Nepalese	Pokharel and Pokharel	To examine the impact of non-performing assets on profitability of commercial bank, existing position of non-performing assets	Analytical research design, data from year 2013-2018 secondary data, descriptive statistical tools are used	The impact of NPA on profitability was positive
May 2020	Impact of NPA ON Profitability of Banks	Wadhwa, and Ramsaswamy	To understand concept of NPA and its recovery, determining whether there is significant impact of financial Heads on NPS. Determine the impact on eh profitability of banks due to NPA	Descriptive research approaches with secondary data, correlation and regression	There is negative correlation between NPA and profit, regression analysis shows that there is significant impact of NPA on profit
2020	Non – performing Assets and profitability of Indian bank	Kashyap et al	To find out the level of non-performing assets of banking sector in India and the impact of non-performing assets on profitability and financial performance in India.	Ratio analysis used for study, by times series upto 14 year from 2000-2014.	Study shows that high non-performing assets of public owned bank and increasing level of NPAs impact the profitability.
April 2020	A study on Impact of	Chaudhari and Patel	To trend of non-performing asset	Causal and analytical,	There is significant

	non-performing Assets on Profitability of Public and Private Sector Banks		of private and public sector banks in India, Examine the impact of non-performing loan on the profitability of bank	correlation and Regression	negative relationship between NPA with Return on Assets of public and Private sector.
June 2019	A study on analysis of Non-performing Assets and its impact on Profitability	Senthil et al.	To know the level of no-performing assets of private and public sector banks, impact of and recommendation	Sample from www. Moneycontrol.com. Mean, standard Deviation, correlation and regression line	The NPA has a significant negative influence on ROA
July 2018	Impact of NPA on profitability performance of select public and private sector banks in India	Devi and Pant	To calculate the relationship between NPA and Profitability of the select banks, find out the impact of NPA on net profit of the select bank	5 year secondary data was used from 2012 to 2016	SBI and BOS has lowest mean value, NPB and BOB highest NPA
April 2018	Measuring the effect of non-performing Assets on the Profitability of the Public and Private Sector Banks in India	Raja and Mehta	To measure the effect of non-performing assets on the profitability of the pubic and private sector banks of India, Trend of NPA in during last seven years.	Secondary data are used from 2011-12 to 2016-17 with regression model used	Public and private sector banks have also shown negative and significant relationship with both the ratios but net interest margin has shown

					positive and insignificant relation with gross NPA to gross advances and net NPA to net advance ration
April 2017	NPA impact on Profitability of Indian overseas Bank	Gowri and Surulivel	To understand non-performing assets and what are the underlying reasons for the emergence of the NPA, understand the impact of NPA as on the operations of the Bank	Data were collected from questionnaire, percentage, frequencies, regression and factors were used secondary data used for NPA	The growth NPA reduce the profitability of oversea regional bank.
March 2016	Effect of non-performing assets on the profitability of Bank-A selective study	Kiran and jones	Examine the relationship the relationship between the non-performing assets and profitability of banks,	Descriptive research design, sample 27 banks	There is negative between gross non-performing loan and profitability
2016	Non – performing assets: A case study of Syndicate Bank	Shiralashetti and poojari	To analyze the gross and net NPA., Analyze net NPA and impact of GNPA on Net profit	Study based on secondary data and analyze through percentage, t-test regression and one way ANOVA	There is moderate relationship between gross NPA and Net profit of the bank.

2.4 Research Gap

Research gap is a question or problem that has not been answered by any of the existing studies or research within the field. Prior to this study, many research and articles regarding non- performing loan were reviewed but there are very studies that actually examine the specific relationship between profitability and non-performing loan of the development banks. The limited studies were done on impact of NPL in profitability of development banks. So that this study completely related to finding fact and figure of ROA, ROE, NPL, Total loan to assets ratio, non-performing loan to total assets ratio and loan loss provisioning to non-performing loan ratio and impact of NPL on profitability of those banks. While going through the literature review there is no study found that has used the profitability indicator profit ratio on total loan, assets and capital? Study is focused on development banks, finding out the impact of Loan loss provision (LLP), Non-performing loan (NPL), total loan (TL), (TC) capital/equity and Total assets (TA) on Return on assets (ROA) and Return on equity (ROE) of sample development bank in Nepal. The literature review part support to comparative study of non-performing loan and its impact on profitability of banks.

CHAPTER-III

RESEARCH METHODOLOGY

3.1 Research Design

It considers plan of whole study that is framework about collection data, method, techniques of study and direction in which the research method utilized and sampling followed. Research design is the way through which we find the required answers of the research questions and ultimately meet the research objectives. Researcher has applied the descriptive and causal comparative research design. The descriptive research explain the features of data and causal comparative research design measure the relationship and impact of dependent and independent variable this study also used a correlation research methodology

3.2 Population and sampling

The population for this study is overall development banks in Nepal. As on 2080 prescribed by NRB on monthly banking statistics, there are 17 development banks in Nepal. The study selected five development banks are taken as sample for the study. .The study employed convenience sampling .a type of .non-probability sampling method for analysis. The sample banks are:

(i) Muktinath Bikas Bank Limited

(ii) Garima Bikas Bank Limited

(iii) Shangri-La Development Bank Limited

iv) Mahalaxmi Bikas Bank Limited

v) Jyoti Bikas Bank Limited

3.3 Nature and Sources of data

The study completely based on secondary sources of data. The published annual reports of development banks, reports and directives of Nepal Rastra Bank. The required

information has obtained from journals, articles, related websites, published and unpublished thesis, dissertations, and books.

3.4 Techniques of analysis

In order to get the study accomplished, as the research is based upon secondary data, about eight years annual (2072/73-2080) and data are collected from the related websites of the selected development banks. In addition, they are synchronized in the systematic manner in order to analyze those raw data.

3.5 Tools of Analysis

Financial as well as statistical tools were used to make analysis easy and reliable. The data are organized in such a way that the calculations and result findings can be easily carried out. Different ratios, mean, standard deviations, correlations and regression are used in order to interpret the data and their numerical values. The list of financial and statistical tools has been listed as follows:

3.5.1 Financial Tools

(1) Profitability ratio

Profitability ratio measures the bank's profit based on different variables like assets, equity, operating income as well. It is simply a capacity to make a profit. These ratios assess the bank's efficiency in terms of making additional return to the bank's resources. In this study following ratios are considered.

(i) Return on assets (ROA)

ROA measures how effectively the bank produces income from its assets. How much the bank is able to make rupee return for each rupee of total assets. We can calculate it by using following formula:

$$ROA = \frac{Net\ profit}{Total\ Assets}$$

(ii) Return on equity (ROE)

ROE is also one of the major profitability ratios that measure how much a bank makes a rupee return for each rupee invested by equity shareholders. A ratio calculates the profit for the equity investment. It can be calculated by using following formula:

$$ROE = \frac{Net\ profit}{Equity}$$

(iii) Return on Total Loan

It is the ratio of net profit of and total loan lending of banks to customers. The ration shows how much return is received by the bank on its total loan. The higher ration of return of loan indicates lending loan earn more profit. Calculation is done by the following formula:

$$ROL = \frac{Nept\ profit}{Total\ loan}$$

(2) NPL indicator's ratio

(i) Total loan to total assets ratio (TLTTAR)

The Loans to assets ratio measure the total loans outstanding as a percentage of total assets. The higher this ratio indicates a bank is loaned up and its liquidity is low. Higher the ratio, higher risky a bank may be to higher defaults. High 'loans to assets' ratio might mean two things. Firstly, bank is at higher risk because loans are fewer liquid assets than other financial assets. Secondly, loans usually are the most profitable assets of the bank; it is highly expected that bank with high 'loans to assets ratio' will have higher 'net interest income'. This ratio calculated by using following formula: -

$$\text{TLTTAR} = \frac{Total\ Loan}{Total\ Assets}$$

(ii) **Non-Performing loan to total loan ratio or NPL ratio (NPLTTLR)**

The non-performing loan ratio, better known as the NPL ratio, is the ratio of the amount of non-performing loans in a bank's loan portfolio to the total amount of outstanding loans the bank holds. Financial analysts frequently use the NPL ratio to compare the

quality of loan portfolios among banks The NPL ratio measures the effectiveness of a bank in receiving repayments on its loans. Higher the NPL ratio indicates engaging in high-risk lending policy it calculated by using following formula:

$$\text{NPLTTLR} = \frac{Total\ Non{-}performing\ loan}{Total\ Loan}$$

(iii) **Loan loss provision to total Non-performing loan (LLPTTNPLR)**

The loan loss provision to total non-performing loan ratio is the ratio of amount of loan loss provision to total amount of non-performing loan in bank's portfolio. The loan loans ration is a tools to analyze the provision about maintained by the banks about the non-performing loan or non-performing assets. Bank's lending is main source of income, however sometime lending amount cannot paid by the borrowing parties due to various reasons. So, the financial institution managed that non-performing loan through the loan loss provision by profit accordance to central bank's directives. It calculated by dividing loan loss provision by non-performing loan of banks, which is in following formula:

$$\text{LLPTTNPLR} = = \frac{Loan\ Loss\ provision}{Total\ Non{-}perfomring\ Loan}$$

3.5.2 Statistical Tool

The field of statistics divided into two broad categories, they are descriptive and inferential. Among them, some of the tools are used in this research.

3.5.2.1 Descriptive statistics

(i) Arithmetic Mean

Mean is the figure we get when the total of all the values in a distribution divided by the number of values in the distribution. Mean is thus the arithmetic average of a variable. So, the arithmetic mean is also known as the average. It calculated as:

$$Mean\ \overline{X} = \frac{\Sigma X}{n}$$

(ii) Standard Deviation

The standard deviation indicates the ranges and size of deviance from the middle or average. It used to measure the spread of values from the mean value. It indicates the deviation of an individual value from that of an average value. In analytical term, it measures the total risk of the data that is fluctuating during the time. More value indicates, more risk and vice versa.

$$\text{Standard Deviation } (\sigma) = \sqrt{\frac{\Sigma\,(X-\bar{X})^{\,2}}{n-1}}$$

3.5.2.2 Inferential Statistics

(i) Correlation of coefficient

The correlation coefficient provides us with an index of the direction and magnitude of the relationship between two sets of scores. This coefficient is obtained by dividing covariance of two variables by the product of their standard deviation. This magnitude of correlation coefficient tells you the degree of linear relationship between two variables. The correlation of zero indicates no relationship exists. As the strength of relationship increases, the value of the correlation increases towards +1 and if the strength of relationship is negative between variables the correlation increases to the -1. Since +1 indicates perfectly positive relationship between variables and -1 indicates perfectly negative relationship between two variables (Basnet, 20114). In this research, simple correlation coefficient used as a tool which calculated by using following formula:

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

(ii) Regression Analysis

Testing Regression analysis is a mathematical measure of average relationship between two or more variables in terms of original units of the data. Thus, it can be said that regression is the estimation or prediction of one variable's value from the given of other variable where there are dependent and independent variables. Independent variables are also known as predictor variables and response variables

are dependent variables. In regression analysis, the statistical tools help us to determine the change in response variable due to one-unit change in predictors by bringing regression coefficients indicates by ‘b’. Hence, there are two types of linear regression analysis (Basnet, 20114). Which are further explained as below

(a) Multiple Regression Analysis

In real life situations, there is rare case of using simple line of regression because there is more than one independent variable that predicts the response variable. So, in this case we have to consider multiple regression analysis to know the joint effect of independent variable

Let, Dependent variables independent variables

ROA = α + β + β1LLP + β2NPL + β2TL + β2 TC + β2 TA ……1

ROE = α + β + β1LLP + β2NPL + β2TL + β2 TC + β2 TA ……2

Were, as

α = Intercept or autonomous coefficient

β, β1, β2, = Parameter, indicates coefficient of regression line

ROA = Return on Assets

ROE = Return on Equity/Capital

LLP = Loan loss provision

NPL = Non performing loan

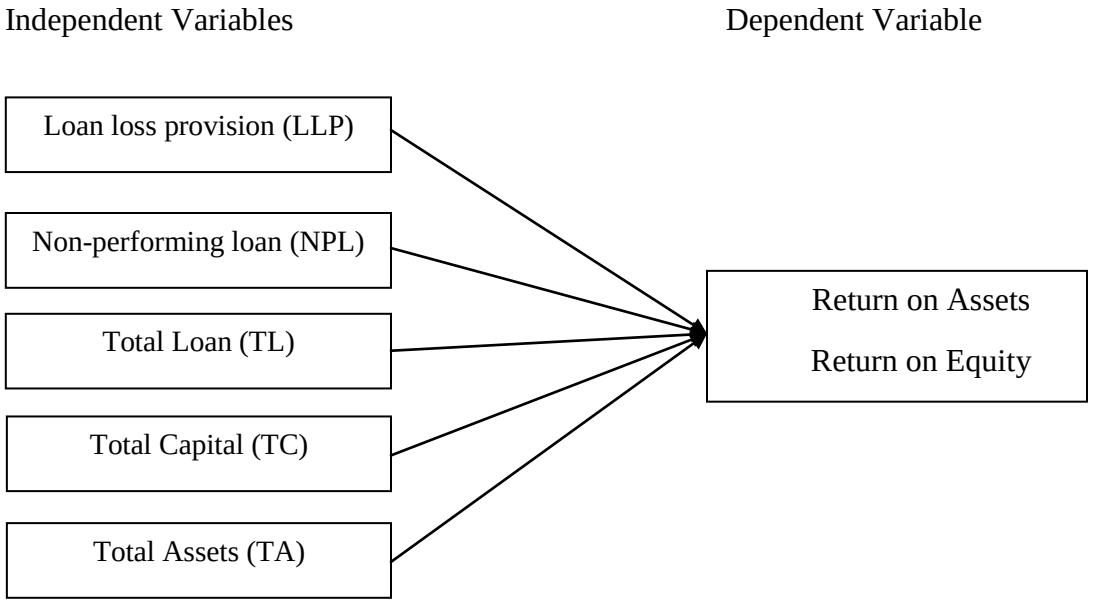
TL = Total loan

TC = Capital

TA = Total Assets

3.6 Conceptual Framework

The study focused on impact of non-performing loan of Development bank on profitability of those banks. It shown as the dependent variable profit margin, return on assets and return on equity shown in right side and independent variable shown in left side of following group.



Define Variables

Return on Assets (ROA): The return on assets that means proportional relationship between net profit after tax and total assets of banks. Where net profit getting deduction

all expenditure within organization. The higher return always indicates the soundness of banks and financial institution. It also indicates low risk for institution.

Return on Equity (ROE): The return on equity is proportional relationship between net profit after tax and equity of bank. The net profit getting deduction all expenditure with organization. Equity return is another main indicator of risk factor in banking and financial institutions, where high return on equity indicates low risk of institution compared to low return institution.

Loan Loss provision: The amount separated by the financial institution for estimated future loss on loan and advance is knowns as the loan loss provision. The money authority regulates the loan loss provision according to economic and financial situation. The directives by the money authority clarify how much amount should keep in loan loss provision based on estimated loan loss. The loans and advance shown in balance sheet of Nepalese banks and financial institution are the net loans and advance. The ratio of loan loss provision is calculated by provision for loan loss divided by total loans and advance.

Non-performing Loan: Non –performing loan are a leading indicator of credit quality. Non-performing loan are the loans emanated from the deterioration in the quality of the loan portfolios. Unified directive has instructed bans and financial institutions to classify their loans into two categories; performing loan and non-performing loans. The classification is based on duration of delay in debt servicing. Pass loans and watch list loans fall under performing loans. However, the subcategories of non-performing loan into substandard loans, doubtful loans loss loans and restructured. However, eh NFRS assumes that even the worst non-performing loan have some residual value. Generally, non-performing loan seen in financial institute due the various problem in an economy, if the business fail to operate effective, poor management of business, borrower intension about the loan, financial crisis, economic crisis and various types of calamities in an economy. Non-performing loan is the sum of borrowed money upon which the debtor has not made scheduled payment for at least three months. The delay in payment could be either interest or principle and can be both. Non-performing loan is categorized in three types. They are substandard loan, doubtful loan, and bad loan. The classification on the basis-delayed period. Non- performing is the real economic cost for commercial bank

because they cannot use the fund in productive sector and repayment of deposit is disturbed. It also results in additional cost for realization of non- performing loan.

Total loan: Loan and advances to customers are the major earnings assets of banks. so the larger portion of banks revenue comes from loans, advances to customers. Under this account, sum of the outstanding amount of all loans and advances extended to the customers other than BFIs as well as bills purchased and discounted less the amount of impairment allowances are presented. The amount exhibited in a separate schedule. Loan to employees provided according to the employees by laws of banks are also be presented under this account. Directives (2075) of NRB, loan and advances are categorized into two categories; performing loans and non-performing loans, the components of performing loans and advances are; pass loan and watch list loans fall under performing loans. However, the subcategories of non-performing loans are; substandard loans doubtful loans, loss loans, and rescheduled loans. Loans that are not overdue falls under pass loans. The loans defaulted their payment by 1 month are to be excluded from the pass loan category previously, loans that have missed out their payments up to 3 months were termed as pass loan.

Capital: The amount of paid up share capital of the licensed institution. Amount credited in share capital by issuing bonus shares utilizing the accumulated profit and reserves also disclosed under share capital. Share capital include paid up amount of ordinary share capital and equity component of preference share capital. The convertible preference shares which includes an option for the holder of the share to convert the preferred shares into a fixed number of ordinary shares at any time after a predetermined data, irredeemable preference share and perpetual debt instrument t, the equity component that is recognized and measured as per NFRA as equity. Main component of equity are share premium, retained earnings, reserves and general reserve fund, exchange equalization reserve, fair value reserve, assets revaluation reserve, capital reserve, special reserve, dividend equalization reserve, corporate social responsibility reserve, regulatory reserve and other reserve.

Total Assets: The assets refer to things, which have monetary value. The asset in BFIs includes cash, investment, land and building, marketable security, loan and investment.

There various types of assets; short-term securities and short-term loans have maturity of none year less are interest-rate- sensitive assets. The variable rate loans are also interest rate sensitive. All other assets are non-interest rate sensitive, including vault cash, long-term securities, long-term loans, and other assets. Similarly, interest-rate-sensitive liabilities are short-term saving deposits, money market deposits.

CHAPTER IV

RESULTS AND DISCUSSION

The chapter presents data analysis and interpretation of bank result. The data collected from the website of respective bank, especially annual report each and every sample bank are Shangri-La Development Bank, Garima Bikas Bank Limited, Muktinath Bikas Bank Limited, Jyoti Bikas Limited and Mahalxmi Bikas Bank Limited.

4.1 Descriptive statistic of ROA, ROE, LLP, NPL, TL, TC and TA

Descriptive statistics provide a snapshot of key financial metrics, offering insights into a company's performance and risk profile. Return on Assets (ROA) measures a firm's efficiency in generating profits from its assets, indicating how effectively it utilizes its resources to generate earnings. Return on Equity (ROE) evaluates the profitability of shareholder investments, reflecting the return generated on their equity stake. Loan Loss Provisions (LLP) represent funds set aside by financial institutions to cover potential losses from defaulted loans, serving as a buffer against credit risks. Non-Performing Loans (NPL) gauge the quality of a bank's loan portfolio by identifying loans where payments are overdue or in default, signaling potential asset quality concerns. Total Liabilities (TL) encompass a company's debts and obligations, reflecting its financial leverage and risk exposure. Total Costs (TC) encapsulate all expenses incurred by a business in its operations, providing insights into its operational efficiency and cost management strategies. Total Assets (TA) represents the sum of a company's resources, encompassing both tangible and intangible assets, indicating its overall size and investment base. By analyzing these descriptive statistics, stakeholders can assess a company's financial health, performance efficiency, and risk management practices, aiding in informed decision-making and strategic planning.

Table 2

Descriptive statistics of LLP, NPL, TL, TC and TA of Sample Banks

	Minimum	Maximum	Mean	Std. Deviation
LLP	31.36	896.17	301.14	322.70
NPL	53.59	532.29	191.06	148.38
TL	4110.96	113449.51	26781.64	35870.86
TC	572.11	2344.33	1560.47	569.73
TA	5678.92	41406.73	23078.79	13454.74

(Source: Appendix I)

Table 2 shows that the Loan Loss Provision (LLP) measures the funds set aside for potential loan losses. With a range from 31.36 to 896.17, a mean of 301.14, and a standard deviation of 322.70, the high standard deviation and broad range indicate significant variability, suggesting considerable fluctuations in expected loan losses. The mean value indicates a substantial average provision for potential loan defaults. Non-Performing Loans (NPL), representing loans that are in or close to default, have a range of 53.59 to 532.29, a mean of 191.06, and a standard deviation of 148.38. Compared to LLP, NPL has a narrower range and lower mean and standard deviation, implying more consistency in non-performing loans. However, the mean value still indicates a notable level of problematic loans, requiring careful management to maintain financial health. Total Loans (TL), indicating the total amount of loans issued by the institution, exhibit an extremely wide range from 4110.96 to 113449.51, a mean of 26781.64, and a high standard deviation of 35870.86. This suggests significant variability in the loan portfolio's size, possibly due to different loan segments or periods of increased lending activity. The high mean value points to a substantial overall loan book, critical for the institution's revenue generation. Total Capital (TC), reflecting the institution's total capital and its ability to absorb losses and support growth, ranges from 572.11 to 2344.33, with a mean of 1560.47 and a standard deviation of 569.73. The moderate range and lower standard deviation compared to TL and TA indicate more stability in capital levels, and the mean value shows a solid capital base, essential for regulatory compliance and financial stability. Total Assets (TA), representing the total resources owned by the institution, range from 5678.92 to 41406.73, with a mean of 23078.79 and a standard deviation of

13454.74. The wide range and high standard deviation highlight significant variability in asset size, reflecting changes in business operations or asset acquisitions. The mean value suggests a substantial asset base, crucial for generating income and supporting operational needs.

Table 3

Descriptive Statistics of ROA, ROE, ROL, TLTAR, NPLTLR and LLPNPLR

	Minimum	Maximum	Mean	Std. Deviation
ROA	0.77	2.22	1.41	0.50
ROE	13.60	22.25	17.95	3.27
ROL	0.89	2.68	1.88	0.60
TLTAR	69.75	283.79	151.81	106.54
NPLTLR	0.54	1.81	0.99	0.41
LLPNPLR	0.97	9.83	3.83	3.58

(Source: Appendix I)

Table 3 shows that financial health and operational efficiency across eight observations. ROA indicates how efficiently an entity is using its assets to generate profits, with a mean of 1.41 suggesting satisfactory asset utilization. ROE measures the ability of an entity to generate profits from shareholders' equity, and with a mean of 17.95%, the entities provide significant returns to investors, far exceeding the common benchmark of 10%. ROL assesses the profitability of the loan portfolio, and a mean of 1.88 suggests efficient loan utilization and reasonable returns on the loans extended. TLTAR provides insight into the leverage employed by the entities, with a wide range and high standard deviation reflecting diverse capital structures. A mean TLTAR of 151.81% indicates that, on average, loans exceed assets, which may suggest aggressive growth strategies or high leverage. NPLTLR indicates the proportion of loans that are not performing, with a mean of 0.99 suggesting prudent risk management practices but with some room for improvement. LLPNPLR measures the adequacy of provisions made for potential loan losses relative to non-performing loans. A mean of 3.83 indicates that, on average, the provisions are nearly four times the non-performing loans, suggesting a conservative approach to managing potential loan losses. However, the high standard deviation of LLPNPLR indicates significant variability in risk management strategies among the entities. Collectively, these metrics provide a comprehensive overview of the financial

performance and risk profile of the observed entities, highlighting strengths in profitability and areas requiring careful management, such as leverage and risk provisioning.

4.2 Correlation and Regression Analysis

Correlation analysis deals with degree and direction at which the two variables are related each other. Two variables correlated to each other when the change in one is associated to the change in the other variables. The simple correlation coefficient also called total correlation as it deals only with relationship between two variables and there are no other variables involve influencing the relationship.

4.2.1 Correlation Analysis of ROA, ROE with total loan loss provision, Non-performing loan, Total loan, Capital and Total assets.

This study focused on analysis of correlation between various development banks' variable like ROA, ROE, loan loss provision, non-performing loan, total loan, capital and total assets. What is the degree of correlation between various variable of sample development bank in study is focus point of study.

Table 4

Correlation of ROA with LLP, NPL, TL, TC and TA of Sample Banks

	ROA	LLP	NPL	TL	TC	TA
ROA	1					
LLP	-.763*	1				
NPL	-.779*	.852**	1			
TL	-0.664	.864**	.974**	1		
TC	-.922**	.880**	.794*	.714*	1	.
TA	-.887**	.938**	.769*	.718*	.967**	1

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

(Source: Appendix II)

Table 4 shows the correlation coefficients between various financial ratios for a set of

companies. Each cell in the table represents the correlation between two different ratios. For instance, the correlation between Return on Assets (ROA) and Loan Loss Provision (LLP) is -.763, which is significant at the 0.05 level, indicating a moderate negative relationship. Similarly, the correlation between LLP and Non-Performing Loans (NPL) is .852, highly significant at the 0.01 level, suggesting a strong positive relationship. Overall, the correlations reveal several noteworthy patterns. For instance, there is a strong negative correlation (-.922) between ROA and Total Cost (TC), implying that as ROA increases, TC tends to decrease significantly. Conversely, there is a strong positive correlation (.938) between LLP and Total Assets (TA), indicating that as LLP increases, TA also tends to increase substantially. These correlations provide insights into the interplay between different financial metrics, offering valuable information for financial analysis and decision-making.

Table 5

Correlation of ROE with LLP, NPL, TL, TC and TA of Sample Banks

	ROE	LLP	NPL	TL	TC	TA
ROE	1					
LLP	-0.260	1				
NPL	-0.630	.852**	1			
TL	-0.515	.864**	.974**	1		
TC	-0.430	.880**	.794*	.714*	1	
TA	-0.259	.938**	.769*	.718*	.967**	1

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Table 5 shows the correlations among various financial metrics, namely Return on Equity (ROE), Loan Loss Provision (LLP), Non-Performing Loans (NPL), Total Liabilities (TL), Total Capital (TC), and Total Assets (TA). Each cell in the table displays the correlation coefficient between the respective pair of metrics. The correlation coefficients range from -1 to 1, where -1 indicates a perfect negative correlation, 1 indicates a perfect positive correlation, and 0 indicates no correlation. The correlations reveal several noteworthy relationships. Firstly, there are strong positive correlations observed between

LLP and the other metrics, particularly with TC and TA, with coefficients ranging from 0.852 to 0.938. This suggests that LLP tends to increase alongside TC and TA. Additionally, there are strong positive correlations between NPL and LLP, TL, TC, and TA, indicating that as NPL increases, these other metrics tend to increase as well, albeit to varying degrees. Conversely, there are negative correlations observed between ROE and the other metrics, with coefficients ranging from -0.259 to -0.630. This suggests that ROE tends to decrease as the other metrics increase. Similarly, negative correlations are observed between TL and the other metrics, with coefficients ranging from -0.430 to -0.515, implying that TL tends to decrease as the other metrics increase. Overall, the data illustrates the interconnected nature of these financial metrics within a company's financial structure and performance, providing insights into how changes in one metric may affect others.

4.3 Analysis of LLP, NPL, TL, TC and TA Impact on profitability of development Bank

Aim of the study is to find out the impact of non-performing loan on ROA and ROE of development bank in Nepal. The study taken five sample banks as study. The study focused on impact of total loan and advance, loan loss provision and non-performing assets on ROA and ROE.

4.3.1 Regression Analysis of LLP, NPL, TL, TC and TA on ROA

Regression analysis is concern with the prediction of value of one variable corresponding to known values of other variable based on already observed data. The two variables are specified under regression analysis is dependent and independent variable. The variable whose value is to be predicted is called dependent variable. The variable whose value is used to estimate the value of another variable is called independent variable. The value of dependent variable is depended on independent variable. The study shows the regression analysis ROA, ROE on LLP, NPL, TL, TC and TA.

Table 6

Regression line of LLP, NPL, TL, TC and TA on ROA

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.969[a]	0.938	0.783	0.23148

a. Predictors: (Constant), TA, TL, TC, LLP, NPL

Table 6 displaying several key metrics to evaluate the performance of the model. The coefficient of determination, denoted as R Square, is a measure of how well the independent variables explain the variation in the dependent variable. In this case, the R Square value of 0.938 indicates that approximately 93.8% of the variability in the dependent variable accounted for by the independent variables included in the model. Moving on, the adjusted R Square provided, which adjusts the R Square value for the number of predictors in the model and the sample size. It is slightly lower than the R Square at 0.783, suggesting that while the model fits the data well, there might be some over fitting or the inclusion of unnecessary predictors.

Table 7

AVOVA Regression line of LLP, NPL, TL, TC and TA on ROA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.623	5	0.325	9.056	.0 48
	Residual	0.107	2	0.054		
	Total	1.73	7			

a Dependent Variable: ROA

b Predictors: (Constant), TA, TL, TC, LLP, NPL

Table 7 provided presents the results of a regression analysis where Return on Assets (ROA) is the dependent variable, and the independent variables are Total Assets (TA), Total Liabilities (TL), Total Capital (TC), Loan Loss Provisions (LLP), and Non-Performing Loans (NPL). The model explains a significant portion of the variance in ROA, as indicated by the F-statistic of 9.056, with a corresponding significance value (Sig.) of 0.48. The Sum of Squares for the regression is 1.623, and for the residuals, it is 0.107, leading to a total Sum of Squares of 1.73. This suggests that the model accounts

for a substantial portion of the total variability in ROA. The degrees of freedom (Df) for the regression model is 5, aligning with the number of predictors, while the degrees of freedom for the residuals is 2, indicating a relatively small sample size. The mean squares for the regression and residual are 0.325 and 0.054, respectively. These statistics indicate that while the model has a good fit, the high p-value suggests that the predictive power of the model might not be statistically significant, potentially due to the small sample size.

Table 8

Coefficient of Regression line of LLP, NPL, TL, TC and TA on ROA

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	2.542	0.435		5.84	0.028
	LLP	1.910	0	1.219	7.84	0.015
	NPL	-2.810	0	-0.824	-5.17	0.047
	TL	2.513	0	0.177	9.04	0.034
	TC	1.011	0	0.12	12.05	0.012
	TA	-6.112	0	-1.64	9.056	0.028

a. Dependent Variable: ROA

Table 8 represents the results of a multiple regression analysis where the dependent variable is the Return on Assets (ROA). The regression model includes five predictors: LLP, NPL, TL, TC, and TA. Each predictor's impact on ROA is assessed through their unstandardized and standardized coefficients, along with their respective t-values and significance levels (Sig.).

The constant (intercept) of the model is 2.542 with a standard error of 0.435, and it is statistically significant with a t-value of 5.84 (p = 0.028). The predictor LLP (presumably representing Loan Loss Provisions) has an unstandardized coefficient of 1.910, a standardized coefficient (Beta) of 1.219, and is significant with a t-value of 7.84 (p = 0.015). This indicates a positive and substantial impact on ROA.

Conversely, NPL (Non-Performing Loans) has an unstandardized coefficient of -2.810, a Beta of -0.824, and is significant with a t-value of -5.17 (p = 0.047), indicating a negative

impact on ROA. TL (Total Loans) shows a small positive effect with an unstandardized coefficient of 2.513 and a Beta of 0.177, having a significant t-value of 9.04 (p = 0.034).

The predictor TC (Total Costs) has an unstandardized coefficient of 1.011, a Beta of 0.12, and is highly significant with a t-value of 12.05 (p = 0.012), indicating a positive influence on ROA. Lastly, TA (Total Assets) has a negative unstandardized coefficient of -6.112, a Beta of -1.64, and is significant with a t-value of 9.056 (p = 0.028), suggesting a significant negative effect on ROA.

Overall, the model suggests that LLP and TC positively affect ROA, while NPL and TA have a negative impact. TL has a minor positive effect on ROA. Each predictor's influence is statistically significant, indicating their respective contributions to the variability in ROA.

4.3.3 Regression Analysis of LLP, NPL, TL, TC and TA on ROE

Table 9

Summary of Regression line LLP, NPL, TL, TC and TA on ROE

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.953[a]	0.909	0.680	1.847

a. Predictors: (Constant), TA, TL, TC, LLP, NPL

The model summary presents the results of a regression analysis, indicating the relationship between the predictors and the dependent variable. The coefficient of determination (R Square) of 0.909 suggests that the predictors included in the model can explain approximately 90.9% of the variance in the dependent variable. This indicates a strong relationship between the independent variables (TA, TL, TC, LLP, and NPL) and the dependent variable. The adjusted R Square of 0.680 adjusts the R Square value for the number of predictors in the model, providing a more accurate measure of the model's goodness of fit. It suggests that around 68% of the variance in the dependent variable can be explained by the independent variables, considering the complexity of the model. The

standard error of the estimate (1.84710) represents the average distance that the observed values fall from the regression line, providing a measure of the accuracy of the predictions made by the model. Lower values indicate better fit.

Table 10

ANOVA of Regression line of LLP, NPL, TL, TC and TA on ROE

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	67.878	5	13.576	13.979	0.013
	Residual	6.824	2	3.412		
	Total	74.701	7			

a Dependent Variable: ROE
b Predictors: (Constant), TA, TL, TC, LLP, NPL

Table 10 shows the results of a regression analysis, likely conducted to examine the relationship between various predictors and a dependent variable, denoted as ROE (Return on Equity). The model exhibits statistical significance, as indicated by an overall F-value of 13.979 ($p = 0.013$), suggesting that at least one of the predictors has a significant effect on the dependent variable.

The regression model accounts for a substantial portion of the variance in ROE, as evidenced by the relatively large sum of squares for regression (67.878) compared to the residual sum of squares (6.824). Specifically, the regression model explains approximately 91% of the total variance in ROE, indicating a strong explanatory power.

Furthermore, the analysis includes five predictors: TA (Total Assets), TL (Total Liabilities), TC (Total Capital), LLP (Loan Loss Provision), and NPL (Non-Performing Loans). Each predictor's contribution to the model's overall explanatory power can be assessed through their respective coefficients and significance levels.

Overall, this analysis suggests that the combination of Total Assets, Total Liabilities, Total Capital, Loan Loss Provision, and Non-Performing Loans significantly influences Return on Equity, highlighting the importance of these factors in understanding and predicting ROE in the context of the analyzed data

Table 11

Coefficient of Regression line of LLP, NPL, TL, TC and TA on ROE

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	T	Sig.
1	(Constant)	26.337	3.474		7.582	0.017
	LLP	-1.809	0	-1.792	-9.219	0.043
	NPL	-8.109	0	-3.698	-9.11	0.03
	TL	3.011	0	3.314	4.51	0.04
	TC	-9.810	0	-1.71	4.51	0.041
	TA	8.611	0	3.542	7.54	0.021

a. Dependent Variable: ROE

Table 11 shows the results of a regression analysis with the dependent variable being Return on Equity (ROE). The model includes several independent variables: LLP (Loan Loss Provision), NPL (Non-Performing Loans), TL (Total Liabilities), TC (Total Capital), and TA (Total Assets). Each coefficient represents the impact of the corresponding independent variable on ROE, both in unstandardized and standardized form.

Starting with the constant term, which stands at 26.337 with a standard error of 3.474, it suggests the expected value of ROE when all independent variables are zero. Moving to the coefficients, LLP shows a negative impact on ROE, as indicated by its unstandardized coefficient of -1.809 and standardized coefficient (Beta) of -1.792. This implies that for every unit increase in LLP, ROE is expected to decrease by approximately 1.8E-09 units, holding other variables constant. The significance of LLP's coefficient is supported by its t-value of -9.219, indicating its statistical importance.

Similarly, NPL exhibits a negative relationship with ROE, with an unstandardized coefficient of -8.109 and a standardized coefficient of -3.698. This suggests that an increase in NPL is associated with a decrease in ROE. The significance of this relationship is underscored by the t-value of -9.11.

Conversely, TL, TC, and TA all display positive relationships with ROE. TL has an unstandardized coefficient of 3.011 and a standardized coefficient of 3.314, implying that

increases in Total Liabilities are associated with higher ROE. TC's unstandardized coefficient is -9.810 with a standardized coefficient of -1.71, suggesting a negative impact on ROE, although the sign is contrary to expectations. Lastly, TA's unstandardized coefficient is 8.611, indicating a positive relationship with ROE, supported by its standardized coefficient of 3.542.

Overall, this regression analysis provides insights into the factors influencing ROE, highlighting the importance of managing loan provisions, non-performing loans, total liabilities, total capital, and total assets to optimize a company's return on equity.

4.4 Result and Discussion

Financial factor for a set of eight observations related to various aspects of a financial institution's performance. Starting with the loan loss provision (LLP), the values range from 31.36 to 896.17, with a mean of 301.14 and a standard deviation of 322.70. Non-performing loans (NPL) exhibit a narrower range from 53.59 to 532.29, with a mean of 191.06 and a lower standard deviation of 148.38. Total loan (TL) amounts span from 4110.96 to 113449.51, showing considerable variability with a mean of 26781.64 and a large standard deviation of 35870.86. Total capital (TC) values range from 572.11 to 2344.33, indicating a moderate spread with a mean of 1560.47 and a relatively low standard deviation of 569.73. Total assets (TA) display the widest range, from 5678.92 to 41406.73, with a mean of 23078.79 and a notable standard deviation of 13454.74. The LLP and NPL figures reflect the institution's provisioning for potential losses, with the LLP values being higher on average. TL, TC, and TA metrics offer insights into the institution's scale and capitalization, with TL and TA exhibiting significant variability. The standard deviations across all metrics indicate varying degrees of dispersion from their respective means, highlighting the diversity and complexity within the financial institution's operations and risk exposure.

Correlation coefficients between various financial ratios for a set of companies. Each cell in the table represents the correlation between two different ratios. For instance, the correlation between Return on Assets (ROA) and Loan Loss Provision (LLP) is -.763, which is significant at the 0.05 level, indicating a moderate negative relationship.

Similarly, the correlation between LLP and Non-Performing Loans (NPL) is .852, highly significant at the 0.01 level, suggesting a strong positive relationship. Overall, the correlations reveal several noteworthy patterns. For instance, there is a strong negative correlation (-.922) between ROA and Total Cost (TC), implying that as ROA increases, TC tends to decrease significantly. Conversely, there is a strong positive correlation (.938) between LLP and Total Assets (TA), indicating that as LLP increases, TA also tends to increase substantially consistence with Odebode et. al (2024) where there was inverse correlation of profitability with LLP, NPL, however positive with total loan.

The correlations reveal several noteworthy relationships. Firstly, there are strong positive correlations observed between LLP and the other metrics, particularly with TC and TA, with coefficients ranging from 0.852 to 0.938. This suggests that LLP tends to increase alongside TC and TA. Additionally, there are strong positive correlations between NPL and LLP, TL, TC, and TA, indicating that as NPL increases, these other metrics tend to increase as well, albeit to varying degrees. Conversely, there are negative correlations observed between ROE and the other metrics, with coefficients ranging from -0.259 to -0.630. This suggests that ROE tends to decrease as the other metrics increase. Similarly, negative correlations are observed between TL and the other metrics, with coefficients ranging from -0.430 to -0.515, implying that TL tends to decrease as the other metrics increase. Overall, the data illustrates the interconnected nature of these financial metrics within a company's financial structure and performance, providing insights into how changes in one metric may impact others.

The regression line of Loan loss provision (LLP), of Loan loss provision (LLP), Non-performing loans (NPL), Total liabilities (TL), Total capital (TC) and Total assets (TA) on return on assets (ROA) table shows the R-square value 0.969 shows the 96.90 percent explained of ROA value by the independent variables LLP, NPL, TL, TC and TA. The regression line is fit at 0.05 level because the value of AVOVA table F-value is significant with 0.048 value. Similarly the coefficient value of Loan loss provision (LLP), Non-performing loans (NPL), Total liabilities (TL), Total capital (TC) and Total assets (TA) are significant at 0.05 level. The significant value of independent variables less than 0.05. LLP significant value is 0.015, NPL is 0.047, TL is 0.034, TC is 0.012 and TA is

0.028. The results of studied consistence with Odebode et. al (2024) the profitability influences by the NPL, LLP and TL, Bhattarai, (2018), Tamang (2019), Khanal (2010). Similarly, the regression line of Loan loss provision (LLP), Non-performing loans (NPL), Total liabilities (TL), Total capital (TC) and Total assets (TA) on return on equity (ROE), the value of R-square 0.953 shows the ROE of sample banks explained by the independent variables is 95.30 percent. The regression line of Loan loss provision (LLP), Non-performing loans (NPL), Total liabilities (TL), Total capital (TC) and Total assets (TA) on ROE is fit at 0.05 because the significant value in ANOVA table is less than 0.05 that means the regression line between dependent and independent variables is significant. Which is 0.013. Similarly the coefficient of independent variables are significant at 0.05 level where LLP significant value is 0.043, NPL is 0.03, TL is 0.04, TC is 0.041 and TA is 0.021. Which are less than 0.05.The variable of model were consistence with studied by Wadhwa and Ramswamy (2020), Arasu, Sridevi and Ramya (2019) and Nabella et. al (2023).. Where total assets, LLP, NPL consistence. However, total capital was insistence.

CHAPTER V

SUMMARY AND CONCLUSION

5.1 Summary

The financial system is one of most important sector for economic development of a country. The financial sector circulates fund from the surplus economic unit to deficit economic unit in an economy. The efficiency of financial system always leads economic progress, financial system refers to the combination of financial institution, financial instrument and financial market from where economic unit carried out their financial transaction. The modern era emerges new technique, tools of financial services for their target customer. The smooth running of financial sector contributes mobilization of real economic resource for economic development. Similarly, financial system mobilizes financial resources from small-unused sector to required sector through expansion of accessibility of financial sectors across the country.

There are various types of financial institution in financial system. They are in different nature in providing financial services to customer. The banks take fund as deposit from the various surplus economic units in an economy and lending those parties who require fund for various purposes. With lending fund there exist risk factors to collect lending amount timely and as desired of banks. This research study focuses on impact of non-performing loan of development bank on its return or profit. The objectives, to analyze impact of non-performing loan on risk and return on development banks in Nepal, examine non-performing loan's impact on individual development bank profitability, comparative analysis of aggregate non-performing loan's impact with impact on particular bank's profitability.

The study reviewed various articles, and previous completed thesis by the scholar in university. The study included the ten articles and eight theses to support and finding the research gap of the study. The review of the article and thesis shows that profit of banks is influences by the non-performing loan or assets. Numerous variables and situations create the non-performing assets for the financial institution. The lending of financial institutions is main source of income generation. The increasing non-performing loan

influences the profitability of banks. Previously, none of the research papers are found which was done to analyze the impact of NPL (or NPA) in profit of development banks and which has been considered as research gap for this thesis. Thesis is focused on finding out fact, figure and impact of NPL (or NPA) on ROA, ROE, LLP, NPL, TL, TC and TA. Of sample development banks. The literature review support to comparative study of non-performing loan's impact on profitability of banks. The study examines the profitability is significantly influences by the non-performing loan as individually or in an aggregate of development bank of Nepal.

The data are collected from the annual report of bank, population of study was 17 out of them only five development banks taken as sample using descriptive and analytical research design. The data are analyzed by financial as well as statistical tool like mean, standard deviation, correlation and regression. The study has taken ROA, ROE and profit of banks as dependent variable whereas LLP, NPL, TL, TC and TA. are as independent variable. Similarly, other independent variables are total loan, loan loss provision, equity, assets. Profitability of individual bank is insignificant with change in independent variables but in case of aggregate (or average), there is significant positive relation.

5.2 Conclusion

There is significant variability in loans and assets, underscoring the need for tailored risk management practices. The institution appears to be conservatively provisioning for potential loan losses, reflecting a proactive risk management strategy. The capital base shows moderate variability, indicating stability essential for regulatory compliance and operational support. The variability in key metrics points to differing levels of financial stability and operational scale within the institution's portfolio. Overall, the institution's financial performance metrics reflect complexity and the necessity for diligent management to navigate varying degrees of risk exposure.

The correlation coefficients between various financial ratios reveals significant insights into their relationships. Return on Assets (ROA) and Loan Loss Provision (LLP) show a moderate negative relationship, suggesting that higher ROA is associated with lower LLP. LLP exhibits strong positive correlations with Non-Performing Loans (NPL) and Total Assets (TA), indicating that increases in LLP are accompanied by higher NPL and

TA. Negative correlations are observed between Return on Equity (ROE) and other metrics, highlighting that higher profitability tends to be linked with lower risk and cost measures. Similarly, Total Loans (TL) shows negative correlations with other financial ratios, implying that as TL decreases, the other metrics increase. Overall, these relationships illustrate the interconnected nature of financial metrics within a company's financial structure and performance.

The regression analysis demonstrates that the return on assets (ROA) is significantly influenced by loan loss provision (LLP), non-performing loans (NPL), total liabilities (TL), total capital (TC), and total assets (TA). The model fit is confirmed by the ANOVA table, indicating a significant relationship between the variables. Each independent variable has a significant impact on ROA. Similarly, the return on equity (ROE) is also significantly influenced by the same set of variables. The ANOVA table for ROE confirms a significant model fit, indicating that these variables are strong predictors of ROE. Coefficient values for all the independent variables are significant, highlighting their importance in explaining ROE.

5.3 Implications

The borrowers may or may not have reliable purpose that bankers surely believe the fund is going to be used in productive and regular earning sectors. Some borrowers may misuse the fund, and some may face the situation of bankruptcy though their intentions are not bad. Anyway, the fund borrowed by the clients ceases to bring timely interest and principal to the bank and stops cash inflows in bank is known as non- performing loans (NPL) which is not good for performance efficiency of BFIs. The problem should be minimized by the banks at the initial stage.

- The loan of every financial institution is one of the most important variables. BFIs should carefully analyze the customers, their attitude, and income level and past regression analysis because of risk assessment associated with the loans and advances of banks.
- The special recovery agency should be established by the banks and financial institutions to recover credit amount from the borrower as systematically.

- Financial institutions may also adopt strategy for motivating clients by awarding the ‘best loan performer of the year’ by the bank that may encourage the others too.
- The bank must take collateral for protection and consideration for minimizing non-performing loan in the process of lending loan and advance to client.
- Bank’s staff should clearly aware customer about the consequences if they default in loan repayment while they apply for loan and sign offer letter. Customers should be well known about condition for blacklisting, write off of loans, DRT (Debts Recovery Tribunal) and their impact on their personal and social life.
- The Corporate governance must be implemented, proactive action to prevent the fraud activities by staffs, officers and other concerned members within institution and outside institutions.

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ii ABSTRACT The study's primary goal is to analyze how non-performing loans affect The investigation of the impact of non-performing loans on development banks' profitability is the main goal of the study. The study's goals were to compare the effects of non-performing loans on the specific and overall profitability of development banks, analyze the significance of non-performing loans on risk and return on development banks in Nepal, and investigate the impact of non-performing loans on the profitability of individual development banks as well as the aggregate. Using five development banks as a sample from the total population of 17 development banks in Nepal, the study was completed using a descriptive and analytical research design. Financial and statistical tools such as financial ratio, mean, standard deviation, correlation, and regression