A STUDY OF NON PERFORMING ASSETS
(With Special Reference to Himalayan Bank Limited and Nepal Credit & Commerce Bank Limited)

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RECOMMENDATION

This is to certify that the thesis

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GIRIJA PRASAD RIJAL

Entitled:

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(With Special Reference to Himalayan Bank Limited
and Nepal Credit & Commerce Bank Limited)

has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

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And found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for the degree of

Master of Business Studies (MBS)

<u>Viva-Voce Committee</u>

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DECLARATION

I hereby declare that the work reported in this thesis entitled **"A Study of Non Performing Assets (With Special Reference to Himalayan Bank Limited and Nepal Credit & Commerce Bank Limited)"** submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Master's Degree in Business Study (M.B.S.) under the supervision of **Dr. Shilu Manandhar Bajracharya** of Shanker Dev Campus.

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Theoretical knowledge alone cannot suffice the need and quench of modern student. Students should also posses great deal of practical knowledge to cope with this competitive world. Tribhuvan University (TU), being aware of this fact has been changing its course curriculum time and again to cope with the changing educational environment of the world. Thesis writing in MBS 2nd year, is one of the such efforts of T.U. which enhances practical exposure and cater real world experience among the students. This is highly commendable.

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- Girija Prasad Rijal

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ABBREVIATIONS

ADBL	:	Agriculture Development Bank Limited
ATM	:	Automatic Teller Machines
CAR	:	Credit Adequacy Ratio
CD	:	Credit Deposit
CV	:	Coefficient of Variation
EBL	:	Everest Bank Limited
HBL	:	Himalayan Bank Limited
LLP	:	Loan Loss Provision
MOF	:	Ministry of Finance
NABIL	:	Nepal Arab Bank Limited.
NBL	:	Nepal Ban k Limited
NCCBL	:	Nepal Credit and Commerce Bank Limited
NIDC	:	Nepal Industrial Development Corporation
NPAs	:	Non-Performing Assets
NPLs	:	Non-Performing Loans
P.E.	:	Probable Error
PL	:	Performing Loan
RBB	:	Rastriya Banijya Bank
ROA	:	Return on Assets
ROE	:	Return on Equity
SCBNL	:	Standard Chartered Bank Limited
S.D.	:	Standard Deviation
SEBON	:	Security Exchange Board of Nepal
SSL	:	Sub-Standard Loan
SCT	:	Smart Choice Technology
T.A.	:	Total Assets
T.D	:	Total Deposit
T.L	:	Total Loan

CHAPTER – I

INTRODUCTION

1.1 Background of the Study

Performance in terms of profitability is a benchmark for any business enterprise including the banking industry. Now a days all business organization are chasing with the profit motive. Profitability is the main tools for the measurement of performance in an organization. In the case of commercial banks same phenomenon's is exercised. Extension of credit is one of the major activities of banks and financial institution. Credit represents the bulk of the bank and financial institution's asset portfolio. However, increasing NPAs have a direct impact on banks profitability as legally banks are not allowed to book income on such accounts and at the same time banks are forced to make provision on such assets as per the central Bank guidelines. Also, with increasing deposits made by the public in the banking system, the banking industry cannot afford defaults by borrower s since NPAs affects the repayment capacity of banks. Further, central Bank successfully creates excess liquidity in the system through various rate cuts and banks fail to utilize this benefit to its advantage due to the fear of burgeoning non-performing assets.

Economic development is the foundation of the country. Economic development is supported by the financial infrastructure of that country. A strong banking sector is important for flourishing the economy. Financial institution constitutes an important part of the financial infrastructure. In the context of Nepal many financial institutions rises after economic liberalization. Granting of credit for economic activities is the prime duty of banking. A party from raising resources through fresh deposits, borrowings and recycling of funds received back from borrowers constitute a major part of funding credit dispensation activity. The main function of the bank is the collection of idle funds and mobilizes them to productive sector causing overall economic development, which finally leads to national development of the country. Bank pools the fund through deposit and mobilize them to productive sector in the form of Loan and Advance. Bank is that financial institution which deals with money by accepting various types of deposits, disbursing loan and rendering various types of financial services. It is the intermediary between the deficit and surplus of financial sources.

It cannot be denied that the issue of development rest upon the mobilization of resources and the bank deals in process of channelizing the available resources in the needed sectors. Commercial bank collects deposits from the public and the largest portion of deposited funds is utilized by disbursing loan and Advance. Lending is generally encouraged because it has the effect of funds being transferred from the system to productive purpose, which results into economic growth. Similarly the profit of the bank depends upon the spreads that it enjoys between the interest it receive from the borrowers and that to be paid to the depositors. An average bank generates about 70% of its revenue through its lending. The return that the bank enjoys of deposit mobilization through loan and Advance is very attractive but they do not come free of cost and free of risk. There is risk in lending. The bank faces number of risk like interest rate risk, liquidity risk, credit risk, borrower risk etc. Such risk in excessive form had led many banks to go bankrupt in number of countries.

Amongst many risk that bank faces one of the most critical is borrower risk – the risk of nonpayment of the disbursed loan or however lending also carries a risk called credit risk which arises from the failure of borrower. Non-recovery of Loan along with interest forms a major hurdle in the process of credit cycle .Thus these loan losses affect the bank's profitability on a large scale. Failure to collect disbursed fund may sometimes results in the bank's inability to make repayment of the money to depositors and return to the shareholders. The bankers have the responsibility of safeguarding the interest of the depositors, shareholder and society they are serving. If bank behaves unresponsively the cost born by the economy is enormous. Banking sector is volatile and sensitive sectors of national economy, which require effective monitoring and efficient supervision. Smooth and effective operation of banking activities is most for sustainable economic growth of a country. The regulatory agency should always be watchful of banking activities carried out by government and non governmental banking and financial institution.

Non-recovery of loan along with interest forms a major hurdle in the process of credit cycle .Thus these loan losses affect the bank's profitability on a large scale. In the distant past, banks had to deal with only few cases of bad-Loan. So, they used to take legal actions against chronic defaulters of bank-Loan. For the last ten/twelve years, banks are suffering from a large chunk of non-performing Loan (assets) as a consequence of economic as well as non-economic factors in the country. By international parameter, non-performing assets of a bank should not exceed five percent while such an indicator is estimated to have been crossed 5 percent, (Rs. 16 billion in aggregate) mainly due to the increase in willful defaulters in the government, semi-government and private sector banks.

Recovery of bad loan by banks and financial institutions has turned into a big issue in the financial sector of Nepal. Complete elimination of such losses is not possible, but banks can always aim to keep the losses at a low level. This has greatly caused negative impact upon Banks' profit, government revenue and the overall financial sector of the country. This calls for an effective system and mechanisms that case the early recovery of debts of Banks and also of bank-like institutions as specified by Nepal Rastra Bank the monetary Authority.

Due to their control role in the economy, government and central bank try their best to rescue banks from such situations. Hence to protect the banks from such situation and protect depositors and shareholders interest, central bank issues various directives and guidelines from time to time with modification and amendments for the sound regulation of the banking system. All the banks have to abide by the rules and regulation issued by central bank of the country.

1.2 Profile of Selected Banks

Banks In this study, two commercial banks are selected. Brief profile of these banks is presented below. Profile’s presentations are related to the establishment, objectives and facilities granted by the concerned banks.

1.2.1 Himalayan Bank Limited (HBL)

Himalayan bank was established in 1993 in joint venture with Habib Bank Limited of Pakistan. Himalayan Bank is also first commercial bank of Nepal with most of share held by private sector of Nepal. Despite the cut throat competition in the Nepalese banking sector, Himalayan Bank has able to maintain a lead in the primary banking activities, loan & deposits.

Legacy of Himalayan lives on in a institution that’s known throughout Nepal for its innovative approaches so sale / merchandising products and customer services such as Premium Saving Account, HBL Proprietary Card and thousand ire deposit scheme, ATMs and Tele-banking were the customer service products, these were introduce by Himalayan bank in first in Nepal. It is currently supplying its service through 32 branches. All branches of HBL are integrated into globes the single banking software where the bank has substantial investments. That has helped the bank to provide service like ‘Any Branch Banking Service, internet banking service and SMS banking service.

HBL has just introduced several new banking products and services such as thousand ire deposit scheme, small business enterprises loan, prepaid visa card, international travel quota and credit card etc. HBL has developed exclusive and proprietary online money transfer - Himalayan Remit. HBL is the biggest inward remittance handling bank is Nepal

The mission of HBL is to become a lending bank of the country by providing premium products and services to customers. Thus ensuring attractive and substantial returns to the stakeholders of the bank. The mission of HBL is to become preferred provide of quality financial services in the country.

1.2.2 Nepal Credit and Commerce Bank Limited (NCCBL)

Nepal Credit and Commerce bank Ltd was established in 1996 A.D. as Nepal’s 11th commercial bank, with goal to provide a wide range of banking services and products in the emerging socio-economic, environment within and outside the country maintaining high standards of integrity and efficiency with excellence. It commenced its operation on 14th October, 1996 as a Joint Venture with Bank of Ceylon, Sri Lanka. It is the first private sector Bank with the largest authorized capital of NRS. 1,000 thousand. The Head Office of the Bank is located at Siddhartha Nagar, Rupandehi, while its corporate office is placed at Bagbazar, Kathmandu.

The name of the Bank was changed to Nepal Credit & Commerce Bank Ltd., (NCC Bank) on 10th September, 2002, due to transfer of shares and management of the Bank from Bank of Ceylon, an undertaking of Government of Sri Lanka to Nepalese Promoters.

At present, NCC Bank provides banking facilities and services to rural and urban areas of the country through its 17 branches. The Bank has developed corresponding agency relationship with more than 150 International Banks having worldwide network. About its capital structure, the bank has 2 Billion authorized capitals, which it has been issued already and it had 1.4 billion paid of capital. In modern banking technology, The Bank offers Any Branch

Banking Service (ABBS) in all 17 branches. Telex and SWIFT are other modes of communication for efficient and effective transmission of information. In order to facilitate the customers with state of art technology, Bank is providing Debit Card facilities under the SCT (Smart Choice Technology) Network jointly in consortium with 40 other member Banks. This facility enables the customers to withdraw cash from any of the 167 ATM Terminals located at different parts of the country and to purchase goods from more than 743 shopping complexes and departmental stores under POS arrangement. We are globally connected through various prominent Banks in Asia, Europe and North America like American Express Bank, Standard Chartered Bank, UBAF etc. NCC Bank's services across the globe include remittance, draft arrangement, import and export business, guarantee etc. The bank is globally connected through various prominent Banks in Asia, Europe and North America like American Express Bank, Standard Chartered Bank, UBAF etc. NCC Bank has strategic alliance with ICICI Bank, which facilitates our customers to remit their money to more than 670 locations of India through ICICI Bank branches and their correspondent Banks in India.

1.3 Focus of the Study

Bank disbursed loan and Advance for certain predetermined periods or every loan and Advance has its maturity period or expiry date and borrower must repay the loan on time by the maturity period but there is no certainty that all the loan are recovered by the maturity date. Some loan recover with in maturity period but some loan do not recover & even after its maturity period and such kind of loan remains as non-performing asset of the banks. The dreaded NPA rule says simply this when interest or other due to a bank remains unpaid for more than 90 days, the entire bank loan automatically turns a non performing asset. The recovery of loan has always been problem for banks and financial institution. To come out of these first we need to think is it possible to avoid NPA, no can not be then left is to look after the factor responsible for it and managing those factors. Bank in Nepal are in poor health. Increasing non-performing asset of Nepalese banking sector is estimated more than 5%. Bank is facing problems in recovering the granted Loan that had turned to non-performing asset. The nationalized two commercial bank named Nepal Bank Limited and Rastriya Banijya Bank have non-performing asset to the extent of 5.40% and 15.70% respectively. Nowadays, in most of national newspaper it can be seen that government owned commercial bank are publishing names of borrower who defaulted in making payment of bank Loan. Even the private and joint venture banks are facing the problem of increasing non-performing asset. Now this problem may lead to bankruptcy bank and failure of banking system adversely affecting the depositors and other parties of the society.

The origin of the problem of burgeoning NPAs lie in the quality of managing credit risk by the banks concerned. What is needed is having adequate preventive measures in place namely, fixing pre-sanctioning appraisal responsibility and having an effective post-disbursement supervision. Banks concerned should continuously monitor Loan to identify accounts that have potential to become non-performing.

In order to rescue bank from the financial distress, to safeguard depositors interest to ensure stability in the economy, NRB issues directives from time to time related to various aspects of the banks. NRB directives number 2 (2066) is related to loan classification and provisioning of commercial banks. As per this directive commercial bank supposed to categorize the loan disbursed into four different categories on the basis of ageing of its past dues and each categories of loan require certain percentage of it to be provisioned for the probable loss. Going through the old directives regarding the loan loss provision, banks had classified Loan into six categories and as per those directives, for a loan to be bad the time period of past due was 5 year. But with new directives, that period has also been reduced. This means the previously categorized substandard loan will now be a doubtful loan and a doubtful loan is bad loan. The provisioning amount is taken from by deducting from the profit of the bank. Hence there is great impact of loan loss provision in the profitability of the banks. The provision of the loan means the net profit of the bank will come down by that amount. Increase in loan loss provision decrease then profit of the bank leading to decrease in dividends to shareholders. However adequate loan loss provision strengthen the financial health of the banks by controlling credit rill and safeguards the depositors money leading to overall economic development of the country.

1.4 Statement of the Problems

After the liberalization policy in 1980s, the financial sector made some progress and prudent regulatory measure have been introduced by central bank of the country. However actual performance of the financial institution couldn't improve. Financial institution in Nepal have been facing several problems like lack of smooth functioning of economy, different policies and guidelines on Nepal Rastra Bank, political instability, security problems, poor information system, liquidity crises and lack of good lending opportunity and increasing

NPAs etc. In the present context where Nepalese commercial banks are facing the problem of increasing NPAs, more amounts have to be allocated for loan loss provision. As earlier mentioned, the provision amount is taken out by deducting from the profit of the bank; the profit of the bank might come down. This research has been conducted to find out the solution of following problem:-

- What is the proportion of non performing asset in the selected commercial banks?
- What are the guidelines and provisions pertaining to loan classification and loan loss provision?
- What is the relationship between volume of loan and loan loss provision in the selected commercial banks?
- What is the impact of loan loss provision on the profitability of the selected commercial banks?

1.5 Objective of the Study

The main objective of this research is to examine and analyze the comparative study of non-performing assets, its effect and factors for rising loan as non performing of selected commercial bank: Himalayan Bank Ltd and Nepal Credit & Commerce Bank Limited. The specific objectives are:

- To analyze the total resources and their utilization in Himalayan bank Ltd and Nepal Credit & Commerce bank ltd.
- To identify the level of non- performing loan/assets, in Himalayan Bank Limited and Nepal Credit & Commerce Bank Limited.
- To analyze the impact of loan loss provision on the profitability of Himalayan Bank Limited and Nepal Credit & Commerce Bank Limited.
- To analyze the future trend of, loan & advance, non performing loan, provision and profit of Himalayan Bank Limited and Nepal Credit & Commerce Bank Limited.
- To analyze whether these two banks are following the NRB directives regarding loan loss provision for non performing assets or not
- To analyze the factors leading to accumulation of non-performing assets in selected commercial banks.

1.6 Significance of the study

It is well known fact that the financial institutions in Nepal has been facing the problem of increasing non- performing assets and issue becomes more and more critical. Unfortunately nowadays banks have been becoming victims of high level of non- performing assets. Non-performing assets are those loans, which neither pay interest nor repay the principal. So, non-performing assets are becoming headache to the banking sector. Likewise Nepalese banking sectors cannot escape from such truth. This study will help in better improvement for further evaluation and regulation body to know existing recovery problem. It will be able to deliver some of the present issues, latest information and data regarding non- performing assets and loan loss provision. Hence this study will be significant to bankers, shareholders, depositors and further researcher, students etc.

1.7 Limitations of the Study

The research is conducted to fulfill the academic requirement of Master of Business degree. It is focused on the study of non performing asset of HBL & NCCBL based of the audited financial annual reports of condition of each bank during the period 2004/05 to 2009/10. This research is tried to cover all the aspects of the non- performing assets. However the present research has the following limitation:

- This research is concerned only with the non- performing assets of Himalayan Bank Limited and Nepal Credit and Commerce Bank Limited. It doesn't consider other aspects of banks.
- This research is focused on the two commercial banks Himalayan Bank Limited and Nepal Credit and Commerce Bank Limited.
- The period of the study is limited for fiscal year 2004/05 to 2009/10.
- Because of the strict policy of the banks, the study is mainly based on secondary data. The data published in annual reports of respective banks, articles, publication, journal etc. have been taken into consideration. Any miss-presentation, mistakes, omission etc may affect the outcome of the study. Thus, the reality of the study depends on secondary sources of the data and questionnaire filled and responses given by the respondents.

- All the analysis in this research is based on the data as of end of fiscal year i.e. end of Ashadh, (Mid July of respective year). Any abnormality in this date may effect the conclusion of the research.

1.8 Organizations of the Study

This research work has been divided into five chapters

1. Introduction
2. Review of Literature
3. Research Methodology
4. Presentation and Analysis of Data
5. Summary, Conclusion and Recommendation

Chapter 1: Introduction

This chapter deals with the subject matter of the study consisting background of the study, focus of the study, statement of the problems, objective of the study, significance of the study, limitation of the study and organization of the study.

Chapter 2: Review of the Literature

The second chapter incorporates review of theoretical and related literature regarding the subject matter.

Chapter 3: Research Methodology

The third chapter deals with the research methodology which consist of research design, sources of dada, population and sample along with different statistical and financial tools used in this research.

Chapter 4: Presentation and Analysis of Data

This chapter deals with the main part of the research. In this chapter effort have been made to present and analyze the data in required form.

Chapter 5: Summary, Conclusion and Recommendation

This chapter deals with summary and conclusion of the research and recommendation given to the concerned organization.

CHAPTER – II

REVIEW OF LITERATURE

The review of literature consists of examination and reviews some of the related books, articles published in different journals, bulletin, dissertation papers, and magazines. In brief, this chapter includes review of following:-

- Conceptual review
- Review of NRB directives
- Review of Related Studies
- Review of thesis

2.1 Conceptual Review

Under this heading the concept and meaning of some of the terms and the related books that are used in this study has been discussed:-

2.1.1 Loan and Advance

Loan and Advance are the most profitable of assets of the bank. This asset constitutes primary income generating source of bank. Commercial bank's main function is to create credit from its borrowed fund. The bank doing so converts liability into active asset. Loan and advance are the least liquid form of asset of the bank. Loan and Advance may take different forms and are allowed against various types of securities. Granting loan and Advance always carries certain degree of risk. Loan and Advance dominate the asset side of the balance sheet of any bank and earning from such loan and Advance occupy a major space in income statement. It is the assets that fetches' income for the bank. "The profitability of the banks depends upon the extent to which it grants load and advance to customers. Loan granted in the form of overdraft, cash credit and direct loan against adequate security. Banks should have to take in consideration safeties of loan and Advance at the time of lending but not only on profitability. At the time of lending the loan, the banks carefully study the lending sectors and make a sound policy for rendering loan. The policy should contain the credit deposit ratio (CDR), that the bank wished to maintain. CD ratio is very much influenced by the behaviors of liabilities. The higher the volatile deposit's and volatile borrowing lower the volume of loan and vice versa. Most of the bank's failure in the world is due to shrinkage in the value of loan and Advance. Hence loan is known as risky asset. Risk of non-payment of loan is known as credit or default risk," *(Shekher & Shekhe: 1998: 27*).

2.1.2 Type of Loan

An arrangement in which a lender gives money or property to a borrower and the borrower agreed to return the property or repay the money, usually a long with interest, at some future points in time. Usually, there is a predetermined time for repaying a loan, and generally the lender has to bear the risk that the borrower may not repay a loan.

"Loan-unlike equity is a fixed payment contract, irrespective of whether there is profit or not. Yet businesses fail and the contractual payments are not honored. If the loan is secured through collateral, the bank can size and sell the collateral, but in many centuries that involves legalities and delays.

Loan and Advance are the primary assets of the commercial banks most of banks fund are used to acquire earnings assets, which provide the bulk of revenue and enable them to cover expenses, including the cost of capital. There are various types of bank Loan, according to the way in which the interest payments are calculated. On the basis of security of loan, banks Loan mainly classified as secured loan and unsecured loan." (*Shrestha, 2006: 263-266).*

a. Secured Loan

If a loan is secured, it means it is secured against an asset that borrower own (typically home, but it can be any item of a greater value than your loan). The asset you have secured is known as collateral, in the loan. Because these Loan are secured, they are considered lower-risk by the lender. Because of this interest rates may be lower than for unsecured Loan, and the amount you can borrow is often higher. Repayments can also be spread over a longer term. However, if borrower fails to keep up on payments, you stand to lose the collateral secured against the loan, so that your creditors can sell it off and reclaim their money.

b. Unsecured Loan

Unsecured loan does not have any collateral place against it. And therefore it is widely considered a lower risk to the borrower, as they generally stand to lose less if they run into trouble with payments. They are typically available in smaller amounts over a shorter period compared with secured Loan. It means Borrowers who fall behind on payments will still face consequences- in a worst case scenario. In some cases the courts can even have the terms of the loan changed to become a secured loan, meaning it is still possible for borrowers to lose their homes or other assets.

2.1.3 Loan Management

"Loan and Advance dominate the asset side of the balance sheet of any bank. Lending is the major and regular activity of bank. However, it is very important to be reminded that most of the bank failures in the world are due to shrinkage in the value of loan and Advance .Hence loan is known as risky assets. Risk of non-repayment of loan is known as credit risk or default risk,"*(Bhandari; 2003: 114).*

Performing loan has multiple benefits to the society while non performing loan erode even existing capital. Considering the importance of lending to the individual bank and also to the society it serves, it is imperative that the bank meticulously plans its credit operations. Sound credit policy, whose objectives are as follows, is a foundation in this direction.

I. To have performing assets.

II. To contribute to economic development.

III. To give guidance to lending officials.

IV. To establish a standard for control.

2.1.4 Performing Assets / Loan

"Performing loan is those loan that repay principle and interest timely to the bank from the cash flow it generates. In other word, performing loan are the productive assets that generate the some profits. Loans have the certain time period to return its principle with its interest. If anyone repays loan with its interest on time, is known as the performing loan. It is the most profitable assets of banks. Its helps to rapid growth of banking sector in this fast pace competitive age. Better performing loan are the symbol of success of banks. But many banks are suffering from the non repayment of loan amount," *(Timilsina; 2003: 67).*

2.1.5 Non Performing Assets /Loan

Generally speaking, loan is classified as non-performing loan only after it has been arrears at least 3 months. The details and classification standards of nonperforming Loan may vary from country to country as per the countries' norm as per requirements of their own banking system. In Nepalese case the three month's above overdue rule has been adopted. It is imperative to understand terms nonperforming assets (NPA) and non performing Loan (NPL). Generally, non-performing assets relates to non performing financial assets. In this context, non performing assets are defined as debt instrument whose obligors are unable to discharge their liabilities as they become due. The term debt instrument refers to both Loan and bonds. Therefore, non performing assets comprise the wider area of asset portfolio where as the non performing loan is referred to distressed Loan classified as per regulation of central bank. Loan means Loan and bills purchased and discounted by banks and financial institutions. Since the loan being the significant component on financial asset's portfolio, although non performing Loan and non performing assets are use interchanging, but if there is no other asset other than Loan to denote, it will be better to say non performing Loan. A loan is classified as nonperforming assets if the borrower doesn't pay dues in the form of principal and interest for a period of 90 days past due. With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days overdue' norm for identification of NPAs, with effective from March 2004, default status would be given to borrower if dues are not paid for 90 days. Non Performing Asset means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by central bank of the country.

One should also not forget that the banks are faced with the problem of decreasing liquidity in the system. Further, central Bank is increasing the liquidity in the system through various refinancing scheme and rate cuts. Although banks can get rid of decreasing liquidity by controlling its lending but this is not an option due to the long run impact of landing on the profitability. Further lending to the borrowers without the proper analysis of loan proposal increases the chances of bad loan to the banks.

An amount due under any credit facility is treated as "past due" when it has not been paid from the due date. Due to the improvement in the payment and settlement systems, recovery climate, up gradation of technology in the banking system, etc., it was decided to dispense with 'past due' concept.

"An asset is classified as NPA if the borrower does not pay dues in the form of principal and interest for a period of 90 days. NPA could wreck bank's profitability both through loss of interest income and write off the principal loan amount. It tackles the subject starting from the stage of their identification of non-performing Loan vary from country to country as the country put in place norm as per requirements of their own banking system. Generally speaking, a loan is classified, as non performing Loan only arrears at least 3 months. In Nepalese case too, the same rule has been adopted. So we can say that NPA is that portion of lending or Loan which is irrecoverable by banks in the specific period as marked up by central bank," *(Timilsina; 2003: 82-84).*

Non-performing asset could wreck bank's profitability both through a loss of interest income and write off the principal loan amount. In the context of Nepal, Loan classified as substandard, doubtful and bad are regarded as non-performing asset.

Mr. Peter S. Rose in his book "Commercial Bank Management" has discussed about the non performing asset and its impact on bank's financial position.

"Non-performing assets are non income generating assets, including loan that is past due for 90 days or more change off, on the other hand loan that have been declared worthless by the banks and written off from its books. If some of these loans ultimately generate income for the banks, the amount recovered is deducted from gross change-off to yield net change off. As both of above ratios rise, the bank's exposure to credit risk grows and bank failure may be just around the corner. The final two credit risk indicators ratios reveal the extent to which a bank is preparing for loan losses by building up its loan 1005 reserve through annual charge against current income," *(Rose; 2005: 118).*

2.1.6 Major Causes of NPLs

NPL can't be considered as good symbol of banking system. The causes behind such higher NPL may vary. Some of major causes are as follows.

a. Lack of Adequate Analysis

Adequate analysis is the essence of every project before providing loan and advances. If management fails to analyze the expected performance, returns and market risk of the project than generally such credit will be converted into NPL future. So a major cause of NPL in case of Nepalese banking system is the banks are failed to conduct an appropriate and adequate analysis of every loan proposal.

b. Lack of Effective Credit Policy

Every bank must have its own credit policy containing the details of different procedures and documents required for different types of credit. Due to lack of such effective policies the volume of NPL increases.

c. Concentration of Corporate Finance

Corporate finance includes credit to different industries and trades such as tourism, hotels, manufacturing industries, and import and air lines. These sectors are highly interrelated in some way with political and economic situation which may raise NPL.

d. Lack of Good Governance

In banking system good governance is a subject of crucial importance because banks deals with the other fund i.e. depositor's fund. If credit is provided to any person or organization with the motive of personal and financial benefits of either staff or management then recovery of such loan is unthinkable.

e. Moral Hazard

A moral hazard is dishonest or character defects in an individual that increases the frequency of losses. It is the problem created by asymmetric information after the transaction occurs. Moral hazard in financial markets is the risk (hazard) that the borrower might engage in activities that are undesirable (immoral) for the lender's point of view because they make it less likely that the loan will be paid back. Because moral hazard lowers the probability that the loan will be repaid, lenders may decide that they would rather not make a loan.

f. Adverse Selection

Adverse selection is the problem created by asymmetric information before the transaction occurs. Adverse selection in banking industry occurs when the potential borrowers who are the most likely to produce an undesirable (adverse) outcome-the bad credit risks are the one who most activity seek out a loan and are thus most likely to be selected. Because adverse selection makes it more likely that loans might be made to bad credit risks, lenders may decide not to make any loans even though there are good credit risks in the marketplace.

g. Lack of Screening and Monitoring

Adverse selection in loan markets requires that financial institutions screen out the bad credit risks from the good ones so that loans will be profitable. Financial institutions must collect reliable information from prospective borrowers to minimize the non-performing loans. Selection of ultimate and ethical borrowers is a major challenge to the financial institutions and loan.

After the loan had been obtained the borrowers may have an incentive to take on risky activities that make it less likely that the loan will be paid off. To reduce moral hazard, financial institutions and loan manager must adhere to the principle for managing credit risk of writing provisions into the loan contracts that prevent borrowers for engaging in overly risky activities. There should be higher chances that the loan will be converting non-performing loans if the lenders or financial institutions should not monitor on borrowers activities.

h. Lack of Ethical Commitment

It should be occurs when borrows would not have any ethical commitment towards the repayment of loans. In some cases borrowers will not ready to repay the loan due ethical problems. So this should be increasing the non performing assets of financial institutions.

i. Worth of Collateral

Collateral is a property promised to the lender as compensation if the borrowers defaults. It reduces the lender's losses in the case of a loan default. If a borrowers defaults on a loan with collateral, the lenders can sell the collateral and use the proceeds to make up for its losses on the loan. But in some case of flexible wealth of collateral lender will not intentionally ready to repay the loan, if the wealth of collateral decreases than the borrowed amount.

j. Lack of Credit Culture in Major Financial Institutions

The increase numbers of financial institutions creates huge problems and unfair competition to attract customers. So, more banks and financial institutions are ready to provide loans to customers because of greater competitions among to each other's due to this, they are ready to provide loans without proper documentations and effective supervisions.

2.1.7 Impact of NPAs

Financial crisis emerged from Thailand in South East Asian countries largely is considered to be due to higher level of NPAs existed with the FIs. The situation was grave when the assets stopped to repay Loan to credit agencies which were borrowed from overseas capital market. Investment in domestic market did not provide returns, hence the amount involved turned into non-performing while repayment schedule to lending agency overseas was matured. Failure to honors the repayment on due time was the principal reason to result in financial crisis that terminated into economic crisis in South East Asian countries. Financial crisis occurred in Asia had the higher proportion of NPAs emanate from Loan which constituted highest share in the total assets of FIs. Countries with higher proportion of loan in the total assets of banks and finance companies became vulnerable while institutions with lower share of Loan in the total assets were affected less. Of the total assets of commercial banks in India, total credit accounted 40.2% in the fiscal year 1997/98, in Nepal. Similarly Shrilanka had the proportion of loan in the total assets as 42.0% while those figures for Thailand, Indonesia and Malaysia were 78%, 70%, and 69 percent respectively.

Empirically, it has been seen that India having lower proportion of loan in respect of total assets provided cushion to make ample provision and therefore were least affected by the financial crisis. On the other hand the South East Asian with relatively higher proportion of Loan in the total assets of the FIs fell victim of the shock of regional crisis.

The credit institutions are repelled from further investment after the interest accrual or due principal repayment has stopped. Interest incomes from such assets are reduced to the extent of declared amount as NPAs. As the assets declared NPA emanate from the deposits, it puts the depositors fund at risk. The credit agencies are put to an extra amount of liability by regulatory authorities in the form of provision. The amount required for provision depends on the level of NPAs and their quality. Rising level of NPAs create a psyche of worse environment especially in the financial sector. Depositors are not interested to save. Rather the hard earned savings are diverted to consumptions. Consequently the savings pattern hence investment is affected thereby creating an unhealthy atmosphere in the financial sector, *(Mehata; 2009: 45-46).*

So we can conclude that the impact of NPA is in wide range. However, the major impacts are listed below;

a. **High Cost of Fund:** "Quite often genuine borrowers face the difficulties in raising funds from banks due to mounting NPAs. Either the bank is reluctant in providing the requisite funds to the genuine borrowers or if the funds are provided, they 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 (CPs) where the interest rate on working capital charged by banks is higher.

   What banks should ensure is that they should move with speed and charged with momentum in disposing off the assets. This is because as uncertainty increases with the passage of time, there is all possibility that the recoverable value of asset also reduces and it cannot fetch good price. If faced with such a situation than the very purpose of getting protection would be defeated and the hopes of seeing a must have growing banking sector can easily vanish," *(Meheta; 2009: 62).*

With the NRB directives effective from fiscal year 2058/59 in Nepal, banks can issue notices to the defaulters to pay up the dues and the borrowers will have to clear their dues. Once the borrower receives a notice from the concerned bank and the financial institution, the secured assets mentioned in the notice cannot be sold or transferred without the consent of the lenders.

The main purpose of this notice is to inform the borrower that either the sum due to the bank or financial institution is paid by the borrower or else the former will take action by way of taking over the possession of assets. Besides assets, banks can also take over the management of the company. Thus the bankers will have much needed authority to either sell the assets of the defaulting companies or change their management.

b. **Profitability:** NPA is a booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the prodigality of bank decreases not only by the amount of NPA but NPA lead 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 stream of profit, which may lead to loss of some long term beneficial opportunity. Another impact of reduction in profitability is low ROI (Return on investment), which adversely affect current earning of bank. Then when an advance become NPA interest due for last 3 month and future accruals are required to transfer in to interest in suspense and it decreases the profit of the bank. The enormous provisioning of NPA together with the holding cost of such non- productive assets over the years had acted as a severe drain on the profitability of the banks. In turn, PSBs were started to be seen as poor performers and were unable to approach the market for raising additional capital. Equity issues of nationalized banks that had already tapped the market were quoted at a discount in the secondary market. Other banks hesitated to approach the market to raise new issues. This had alternatively forced PSBs to borrow heavily from the debt market to build tier capital to meet capital adequacy norms putting severe pressure on their profit margins else they had to seek the bounty of the Central Government for repeated recapitalization.

In the face of the deregulated banking industry, an ideal competitive working is reached, when the banks are able to earn adequate amount of non-interest income to cover their entire operating expenses i.e. a positive burden. In that event the spread factor i.e. the difference between the gross interest income and interest cost will constitute its operating profits. Theoretically even if the bank keeps 0% spread, it will still break even in terms of operating profit and not return an operating loss. The net profit is the amount of the operating profit minus the amount of provisions to be made including for taxation. On account of the burden of heavy NPA, many nationalized banks have little option and they are unable to lower lending rates competitively, as a wider spread is necessitated to cover cost of NPA in the face of lower income from off balance sheet business yielding non-interest income.

c. **Lending Power of Banks:** The efficiency of a bank is not always reflected only by the size of its balance sheet but by the level of return on its assets. NPAs do not generate interest income for the banks, but at the same time banks are required to make provisions for such NPAs from their current profits.

NPAs have a deleterious effect on the return on assets in several ways:

- They erode current profits through provisioning requirements.
- They result in reduced interest income.
- They require higher provisioning requirements affecting profits and accretion to capital funds and capacity to increase good quality risk assets in future, and
- They limit recycling of funds, set in asset-liability mismatches, etc.

Thus, largely the problem of NPAs could be attributed to defective accounting standards. Prior to reforms, the environment of Indian Banking was insulated from the global context and was dominated by State control of directed lending, regulated interest rates, etc. Indian Banking was lacking objective and prudential systems of business leading from early stagnation to eventual degeneration and reduced or negative profitability. Continued political interference, absence of competition, and a total lack of scientific decision making, led to the consequences, just the opposite of what was happening in western countries. It was in the backdrop of these circumstances, that the Government introduced the economic reforms from 1991 onwards. Today government has divested much of the controls, quotas and permits. Quantitative import restrictions have been withdrawn and industrial-licensing systems has been liberalized to a very large extent. Inefficient public enterprises boarding corrupt public servants are being dismantled progressively through the process of corporatization of public enterprises. Industry has to compete at the global level and capital has to be sourced from large number of investors at the national or international level. Corporate governance and corporate ethics have become essential for business success and to infuse confidence with the stakeholders. Banks have been freed from all kinds of regulations. They have to compete with each other, public sector banks, new private sector banks and old private sector banks and foreign banks. Government banks have to turn to the market for fresh capital. There can be no more burkha to hide their weaknesses and failure through shady balance-sheets

d. **Liquidity:** Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for short period of time which lead to additional cost to the company. Difficulty in operating the functions of bank is another cause of NPA due to lack of money in routine payments and dues.

e. **Involvement of management**: Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now day’s banks have special employees to deal and handle NPAs, which is additional cost of the bank.

f. **Credit Loss:** NPA adversely affect the value of bank in terms of market credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting their money in the banks.

g. **Unemployment and Development:** When funds to lend become scare due to NPAs, country's development will get effected. Similarly businesses ceased to exist due to inability to meet its repayment obligations. This will create unemployment.

h. **Negative Image and Instability in Banking System**: In the long run bank will have a negative image due to NPAs & due to high NPA position if liquidity crisis arises and bail out is required, that has huge impact on whole banking sector.

2.1.8 Credit Risk of NPAs

The Most of the public sector banks are incapable of visualizing the risk they are going to face in emerging global economic scenario. The risk management machinery adopted requires a comprehensive overhaul of the system by the banks in this changing condition. The second consultative document on the New Basle capital accord on banking supervision has given a stress on the risk management as impact of the banks by introducing a more risk sensitive standardized approach towards capital adequacy. In spite of the stringent recommendations and NBs apprehensions of the adequate preparedness of the banking sector in adopting instructions, it is quite clear about the willingness of the banks to vigorously pursue effective credit risk management mechanism by visualizing the magnitude of credit risk management to curtail the growth of mounting NPAs. The concept of recovering debts through Debt Recovery Tribunals has become a grand failure. The concept of establishing Asset Reconstruction Company (ARC) has greatly benefited the banks in containing the NPAs at a manageable level. The ARC is to take over the bad debts of the public sector. These banks have the option of either liquidating the assets of defaulting companies or writing off these bad depts. Altogether. The viable solution available to the public sector banks is to go for a better credit risk management scheme, which may be considered as difficult preposition. However a clear understanding of the concept of risk, availability of instruments to curtail risk and the strategies required to be adopted for implementing a risk management system are considered to be the call of the hour.

"Quite often credit risk management (CRM) is confused with managing non-performing assets (NPAs). However there is an appreciable difference between the two. NPAs are a result of past action whose effects are realized in the present i.e. they represent credit risk that has already materialized and default has already taken place.

On the other hand managing credit risk is a much more forward-looking approach and is mainly concerned with managing the quality of credit portfolio before default takes place. In other words, an attempt is made to avoid possible default by properly managing credit risk," *(Meheta; 2009: 109-110).*

Considering the current global recession and unreliable information in financial statements, there is high credit risk in the banking and lending business. To create a defense against such uncertainty, bankers are expected to develop an effective internal credit risk models for the purpose of credit risk management.

2.1.9 Risk in Non- Performing Loan

A realistic valuation of the financial institution's/bank's assets is essential to measure its net worth; but it is extremely difficult to get such a valuation in instances of severe corporate and financial distress, like the world economic downturn in 2001 or in a world of transition.

"The valuation of non-performing Loan (NPL) is particularly hampered by the lack of clear market values and continuously changing economic conditions. The management of NPL and other value impaired bank assets is one of the most critical aspects of bank supervision. A widely accepted method is to hive-off the NPL of banks to a separate asset management company. Countries have taken different views on the role of asset management companies. Indonesia, Korea and Malaysia have opted for centralized public asset management companies that buy assets from private banks to help them clear their balance sheets. Thailand has aggressively liquidated the impaired assets of closed banks and financial institutions through a central agency but does not permit public sector purchases of impaired assets from private banks. They also encourage each bank to establish its own asset management company. The key to successful asset management companies is the realistic valuation of assets but it should not be a tool for the indirect bailout of existing shareholders. Sri Lanka's banking industry too is hampered by in average of 16% NPL. To clear balance sheets of banks/financial institutions, a significant amount of public resources would be necessary which is best avoided through detailed regulatory procedures.

As evidenced in the Asian crisis a few years ago, and in 2009 in US, the problems of banks also reflect the profound problems of the corporate sector. Hence, resolving banking problems should go hand to hand with corporate debt restructuring. Widespread corporate insolvencies and weaknesses are much more difficult to solve and it is time consuming. The same is true for Sri Lanka's state banks which a saddled with large public enterprise debts. The supervisory authorities alone cannot restructure banks. Bankruptcy laws, appropriate judicial systems and institutional structures are needed for this task. Until the corporate restructuring is done, there is no meaning to restructuring of insolvent banks because the complexities of the corporate would inevitably filter into banks' books. Banking industry worldwide still believes that they are better run than in previous crises as their capital bases are stronger and their earnings are more diversified. Yet, the supervisor and regulators cannot be complacent as the aftermath a corporate failures can become far more complex than one thinks,"*(Patel; 2008: 10-11).*

Non-Performing Loan reduces the liquidity of banks, credit expansion; it slows down the growth of the real sector with direct consequences on the performance of banks, the firm which is default and the economy as a whole. According to the theory of finance, there are various risks facing financial institutions. They include credit risk, liquidity risk, market risk, operating risk, reputation risk and legal risk. The system is highly sensitive while the activities of the operators need to be conducted within the laid down and agreed rules and procedures, in order to achieve a reasonable level of efficiency.

2.1.10 Nepalese Economy and NPA

Undoubtedly the world economy has slowed down, recession is at its peak, globally stock markets have tumbled and business itself is getting hard to do. The Nepalese economy has been much affected due to high fiscal deficit, poor infrastructure facilities, unstable political system, cutting of exposures to emerging markets by etc.

"Further, international rating agencies like, Standard & Poor have lowered Nepal's credit rating to sub-investment grade. Such negative aspects have often outweighed positives such as increasing forex reserves and a manageable inflation rate.

Under such a situation, it goes without saying that banks are no exception and are bound to face the heat of a global downturn. One would be surprised to know that the banks and financial institutions in Nepal hold non-performing assets about 50% of total loan in government owned bank, however it is low in private sector bank. Bankers have realized that unless the level of NPAs is reduced drastically, they will find it difficult to survive," *(Khanal; 2010: 46).*

2.1.11 NPA in Nepalese Financial System.

In June 2010 there were 27 commercial banks 76 development banks, 77 finance companies. Besides, these organization regulated by NRB, there are other players with this growth in the number of banks and financial institutions, one could argue that the impact of domestic conflict and political instability in the country caused less impact in the financial sector compared to other sectors of the economy like tourism, industrial production and development.

First of all let us review the domestic problems and challenges of the financial system in Nepal. First, the capital fund of the banking sector shows negative balance of 5447.57 thousand in mid-July 2008. This is particularly the result of the poor performance of the Rastriya Banijya Bank and Nepal Bank limited. Even some joint venture banks are not performing at a satisfactory level. Although some progress had been made in the areas of downsizing the staff, establishing system and procedures and reducing the operational costs in these banks, the main problems of overdue Loan remain still crucial issues in both the banks.

In Nepalese case, the quality of Loan has been deteriorated neither unfavorable economic condition of the nation nor bad intention of the borrower. This is because, if we study the defaulted loan of the bank we can find that most of the loan had been defaulted from the long back when the economic situation was favorable to the borrowers and also economy was achieving a higher level of economic growth. Their track record is not good and even in that time they have not paid to the bank as per agreement. It is business principle that entrepreneur has full right over profit and responsibility to bear losses of the business if any. If there will be a continuous loss in the business or any symptoms of losses are envisaged then borrower should either change the business or stop the operations to control further losses. This is because; borrower has to meet the obligation to loss from its own resources. In such cases, borrower needs to liquidate their assets for debt servicing. If we see the scenario to repay the Loan, they would have been using available options such as liquidation of their personal assets and cut for luxurious life in order to repay the bank's debt.

The government of Nepal has been made a lot of efforts to make the Nepalese financial sector healthy and prudent through various reforms, the level of NPL in the Nepalese

Banking system has not come down to an acceptable level. The efforts to date succeeded only to reduce the NPL to some extent but sufficient to maintain the sound health of the system to the desire level.

Table: 2.1

Level of NPL in the Banking System

	July 2009	July 2010
Commercial Banks	14.22%	12.25%
Development Banks	4.91%	5.26%
Finance Companies	8.46%	8.96%

(Source: NRB statistics 2010)

On the other hand, the level of NPL is still increasing in the Development Banks and Finance Companies. Therefore, we can see that the finance discipline and level of NPL is improving in banks, where as the problems in Development Banks and Finance Companies are deteriorating. The table provides above highlights the facts. In the healthy financial system the level of NPL should be contained within 5%. The financial sector reforms programs as focused its efforts at reducing the level of NPL to this minimum level. Therefore it has still been a challenging task for Nepalese authorities to data.

2.1.12 Problems of NPL in Nepalese Financial System

While analyzing the overall scenario and the trend of NPL of Nepalese financial system, it has been observed that the level of NPA in the banking system and in the financial system is still as the high level. It is impressing that the level of NPLs is decreasing gradually with the implementation of comprehensive financial sector reform program. The level of NPL in the financial system of Nepal comprising of 26 commercial banks, 72 development banks, 16 micro credit development banks and 78 finance companies is around 3.12 percent (Rs.15.83 billion) as at July 20

Table: 2.2

Level of NPL in the Nepalese Financial System (July 2010)

Excluding ADBL and NIDC (In Rs. '0,00,000')

Level of NPL	Commercial bank	Development Bank	Micro Finance Development Bank	Finance companies	Total
Total Loan and Advance (Rs.)	398,143.00	43,077.8	5,878.3	60,078.1	507,177.20
Non Performing Loan (Rs.)	14,054.44	646.16	-	1135.47	15,836.07
NPA in %	3.53	1.5	_	1.89	3.12

(Source: Nepal Rastra Bank Publication; 2067:16)

To be specific on the banking system, the high level of NPL has been a chronic disease since last few years. Financial performance and soundness indicators, a World Bank's study, has highlighted that the level of NPL was at the highest level in the Nepal in 2004 than that of other South Asian countries. In 2004, the Level of NPL to total Loan in Bangladesh was 27.72%, India 8.80%, Pakistan 15.90%, Shrilanka 14.25% and Nepal 30%. With various efforts within reform program, the level of NPL in Nepalese banking system is significantly decreasing but it has not come down to an acceptable level. It is still more than 5% in July 2010 including of ADB/N and NIDC. The acute problem of NPLs within the banking system can be observed from the table provided below.

Table: 2.3

Level of NPL in Commercial Bank in Nepal (In Rs '00,00,000')

Level of NPL	2004 July	2005 July	2006 July	2007 July	2008 July	2009 July	2010 July
Total Loan & Advance	111,900.6	127,065.4	148,366.5	187,283.16	220,973.92	296,516.90	384,315.12
Non Performing loan	32,226.7	18,933.4	27,877.8	25,904.96	20,759.37	16,258.07	13,574.63
NPA in %	28.8	22.77	18.79	13.83	9.39	5.48	3.53

(Source: Nepal Rastra Bank Publication; 2067:18)

It is clear from the above table that the level of NPLs is decreasing but the existing level is still alarming in order to restore the financial sustainability in the system because there is still room for improvement in terms of quality. The level of NPL was around 29 percent in July 2004 which decreased to 22.77 percent in July 2005. Thereafter it has begun to decrease again and stood at 18.79 percent in July 2006. After 2006, it is still decreasing gradually and stood at 13.83 percent in July 2007, 9.39 percent in July 2008, 5.48 percent in July 2009 and 3.53 percent in July 2010. Although the 3.53 percent of NPLs is a small amount but it has great impact on the banking system.

Going through the banking history of south East Asian nations, we can see that problem of NPLs was a burning issue there during late 1990s. The distress situations on financial crisis of south East Asian nation can be illustrated as one of the examples in this regard. But they have been able to address the problems in time. They initiated extremely focused programs: they established AMCs, initiated corporate debt restructuring focused programs, bank capitalization program, and regulatory reform and eventually restored the system's efficiency and soundness very fast. As a result, in china the level of NPLs come down to 20 percent at the end of 2002 from the peak level of 42 percent, in Indonesia it came down to 3.9 percent from 15 percent, in Malaysia it came down to 8 percent from a peak of 30.1 percent, in Thailand it came down to 10.1 percent from a peak of 51.6 percent.

2.1.13 Global Developments and NPA

"The core banking business is of mobilizing the deposits and utilizing it for lending to industry. Lending business is generally encouraged because it has the effect of funds being transferred from the system to productive purposes which results into economic growth.

However lending also carries credit risk, which arises from the failure of borrower to fulfill its contractual obligations either during the course of a transaction or on a future obligation.

A question that arises is how much risk can a bank afford to take? Recent happenings in the business world – Enron, WorldCom, Xerox, Global Crossing and do not give much confidence to banks. In case after these giant corporate became bankrupt failed to provide investors with clearer and more complete information thereby introducing a degree of risk that many investors could neither anticipate nor welcome. The history of financial institutions also reveals the fact that the biggest banking failures were due to credit risk.

Due to this, banks are restricting their lending operations to secured avenues only with adequate collateral on which to fall back upon in a situation of default," *(Bofer; 2009: 17).*

2.1.14 BASEL Committee on Banking Supervision (BCBS)

Internationally BASEL committee has been coordinating since many years in the banking regulation, policy and directives. In 1975 the BASEL committee was established by central bank governors of ten group (G-10) countries. In 1999 New BASEL Accord was developed and published. The BASEL Committee on banking supervision has also laid down certain minimum risk based capital standards that apply to internationally active commercial banks. That is bank's capital should at least 8 Percent of their risk weighted assets. This in fact helps bank to provide protection to the depositors and the creditors. Based on the BASEL norms under the BASEL capital Afford, 1998, the Indian Banks also issued similar capital adequacy norms. According to these guidelines, the banks will have to identity Tier-I and Tier-II capital and assign risk weight to the assets. Having done this they will have to assess the capital to Risk weighted assets Ratio (CRAR).

The minimum CRAR which the India banks are required to meet is set at 9 percent. It should be taken into consideration that the bank's capital refer to the ability of bank to withstand losses due to risk exposures. In Nepal for the commercial banks, Nepal Rastra Bank adopted the BASEL accord policies and directives. According to the Nepal Rastra

Bank directives and policies under the 2060 provision to the development bank and commercial bank, at the end of the fiscal year Ashwin, Poush, Chaitra and Ashadh list of the classification of loan and Advance should send with one week.

2.2 Review of NRB Directives

The world has witnessed many financial crises and devastating consequences due to huge financial and economic losses that resulted from each episode. Every crisis was sudden in onset and theirs magnitude of losses was much larger than expected. If we go back to the history, then on 3rd march 1997; the Asian crisis began in the form of liquidity problem of two finance companies. Later this spread over to other financial institution within the Thai financial system. Simultaneously, crisis began to Cover Malaysian, Indonesian and South Korean financial statement and loomed in the form of Asian crisis. So this Asian crisis appealed the whole world for regular and timely supervision and assessment of financial system, its soundness and vulnerabilities. This event forced the regulatory authorities for the enforcement of prudential measures in order to avoid further crisis review and revision in prudential regulations such as capital adequacy ratio, asset classification. Provisioning for impaired assets, exposures limit and enforcement of international accounting standard etc have now become common issue all over the world since the late 1990s.

Similarly, in our country too commercial banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector is facing the problem of bad debts, overdue Loan, accrued interest, accumulation of non-banking assets and excess liquidity in banking system. In addition to these expected happenings new challengers are adding in Nepalese banking sector due to the adverse development in the domestic economy resulting from deteriorating peace and security situation and continuous persistence of natural calamities inside the country on one hand and the global recession primarily caused by international terrorism on the other. Viewing the needed of structural reform amidst these adverse implications, Nepal Rastra Bank (NRB) issued directives to run commercial banks and others financial institutions in a healthy competitive manner to ensure the sustainable development of the overall banking system. Review of its regulation and directives, clarification of ambiguous points and elimination and improvisation, therefore is a normal process of NRB. According a promoter of the bank holding more than 1 percent of the total share is not allowed to use loan facility from the same bank. For fiscal year 2002/03 only, banks were allowed to restrict those loans for which no interest is due. Loan Provision of 1 percent was allowed in such an instance only. Loan flow to small farmers development bank (SFDB) limited is deemed as Loan to the deprived class.

Directive No. 2.1.Ka. Pass Loan

Loan and Advance whose principal amount are not past due and past due for a period up to 3 months shall be included in this category. These are classified and defined as performing Loan.

Directive No. 2.1. Kha.Substandard Loan

It is classified as non-performing asset. All Loan and Advance that are past due for a period of 3 months to 6 months shall be included in this category.

Directive No. 2.1. Ga. Doubtful Loan

All Loan Advance which are past due for a period of 6 months to 1 year shall be classified as doubtful loan.

Directive No. 2.1. Gha. Bad Loan

All Loan and Advance which are past due for a period of more than 1 year as well as Advance have least possibility of recovery and those having thin possibility even partial recovery in future shall be classified as bad loan.

The substandard, doubtful and loss loan are known as non-performing assets.In terms of NRB guidelines, as and when an asset becomes a NPA, such Advance would be first classified as a sub-standard one for a period that should not exceed 6 month and subsequently as doubtful assets.

It should be noted that the above classification is only for the purpose of computing the amount of provision that should be made with respect to bank Advance and certainly not for the purpose of presentation of Advance in the banks' balance sheet. The directives of NRB relating to classification and provisioning of loan and Advance are changing over time. Here is the latest table which shows the loan classification criteria:

Table: 2.4

Time Table of Loan Classification

Classification	Pass Loan	Substandard Loan	Doubtful Loan	Bad Loan
For FY 2009/10	Loan not past due and past due up to 3 month.	Loan and Advance past due for a period of over 3 months to 6 months	Loan and Advance past due for a period of over 6 months to 1 year	Loan and Advance past due for a period of over 1 year.

(Source: Unified NRB Directive 2066/67:34)

Directive No. 2.2 Additional Arrangement in Respect of 'Pass Loan'

Loan and Advance fully secured by gold, silver, fixed deposit receipts and HMG securities shall be included under pass category. However, where collateral of deposit receipts or HMG securities or NRB bonds is placed as securities against loan for other purposes, such loan has to be classified on the basis of ageing.

Directive No. 2.3 Additional Arrangement in Respects of 'Loss Loan'

Even if the loan is not past due, loan having any or all of the following discrepancies shall be classified as "loss".

1. The borrower has declared bankrupt.
2. No security at all or security that is not in accordance with the borrower's agreement with bank.
3. The credit has not been used for the purpose original indented.
4. Loan provided to the borrowers included in the blacklist and where the credit information bureau blacklist the borrower.
5. Purchased or discounted bills are not realized within 90 days from the due date.
6. The borrower is absconding or cannot be found.

Directive No. 2.9.1 Loan Loss Provision

As and when an asset is classified as an NPA, the bank has to further sub-classify it into sub-standard, doubtful and bad assets. Based on this classification, bank makes the necessary provision against these assets. Nepal Rastra Bank has issued guidelines on provisioning requirements of bank Advance where the recovery is doubtful. Banks are also required to comply with such guidelines in making adequate provision to the satisfaction of its auditors before declaring any dividends on its shares.

In case of a sub-standard loan, a general provision of 25% of total outstanding should be made.

In case of doubtful loan, guidelines requires the bank concerned to provide entirely the unsecured portion and in case of secured portion an additional provision of 50% of the secured portion should be made depending upon the period for which the advance has been considered as doubtful.

In case of bad loan, guidelines specifically require that full provision for the amount outstanding should be made by the concerned bank. This is justified on the grounds that such an asset is considered uncollectible and cannot be classified as bankable asset.

The summary of provision that a bank is required to loan provision for loan Advance and purchased and discounted bill has classified as per this NRB directive follows:

Table: 2.5

Loan Classification and Loan Loss Provision

Classification of loan	Percentage of loan loss provision
Pass Loan	1%
Sub standard Loan	25%
Doubtful Loan	50%
Bad Loan	100%

(Source: Unified NRB Directive 2066/67:36)

Loan loss provision made for performing loan is called "General loan loss provision" and provision made for non-performing loan is called "specific loan loss provision".

2.2.1 Additional Provisioning in Personal Guarantee Loan

Where the loan is extended only against personal guarantee, a statement of assets and equivalent to the personal guarantee amount not claimable by any other shall be obtained. Such loan shall be classified as per above and where then Loan fall under the category of pass, substandard and doubtful loan in addition to the normal loan loss provision applicable for category , an additional provision by 20 percentage point shall be provided. Classification of such loan and Advance shall be prepared separately. Hence the loan loss provision required against the personal guarantee loan will be 21%, 45% and 70% for pass, substandard and doubtful category respectively.

2.2.2 Rescheduling and Restructuring of Loan

In respect of loan and Advance falling under the category of substandard, doubtful or loss , bank may reschedule or restructure such Loan only upon receipts of a written plan of action from the borrower citing the following reason :-

a) The reduced degree of risk inherent to the borrower determined by analyzing its balance sheet and profit and loss account in order to estimates recent cash flows and to project future ones, in addition to estimates recent Cash flows and to project future ones..

b) In addition to assessing market condition, the internal and external causes contributing to detritions of the quality of loan.

c) An evaluation of the borrower's management with particular emphasis on efficiency, commitment and high standards of business ethics.

d) Evidence of existence of adequate loan documentation.

e) Except for priority sector, in respects of all types of reschedule or restructured or swapped loan, if such credit falls under pass category according to NRB directives, loan loss provisioning shall be provided at minimum 12.5%.

f) In case of rescheduling or restructuring or swapping of insured or guaranteed priority sector credit, the loan loss provisioning shall be provided at one fourth of the percentage mentioned in clause (a).

g) In respect of swapped Loan, the bank accepting the Loan in swapping has to provide loan loss provision classifying the loan under the same classification as were existing. The bank accepting the loan in swapping shall obtain certification from the concerned bank or financial institution as to the existing classification.

2.2.3 Provision Against Priority Sector Credit

Full provisioning as per normal loan loss provisioning shall be made against three uninsured priority sector and deprived sector Loan. However in respect of insured Loan the requisite provisioning shall be 25% of the percentage of normal loan loss provisioning. The required provisioning in the case of insured priority/deprived sector credit is as follows:

Table: 2.6

Loan Classification of Priority Sector

Loan	Percentage of Provision
Pass	0.25%
Substandard	5%
Doubtful	12.5%
Bad	25%

In case of rescheduling, restructuring or swapping of insured or guaranteed priority sector, the proportion of loan loss provision would be 3.125%, I. e. 25% of 12.5%.

2.3. Review of Related studies

In this part of the study, different articles relating to the non-performing asset are reviewed and presented here.

Chawala (2000) has published an article on *"Story of Non Performing Asset."* & he has discussed about the non performing asset and its impact in that article. "Any lending involves the following three stages where discretion needs to be exercised (a) Evaluation and assessment of the proposal (b) Continuing Support during the currency of the loan by additional loan or by non-fund based activities (c) Exit decision and modality. A rule-based approach precludes reasonable application of mind. Evaluation of project idea and the management is something that most banks are least equipped for. This leads to the banker acting too liberal on all projects that are related to the flavor-of-the-month as well as to insisting on collaterals from everyone without taking into consideration any other competencies of the entrepreneur. Banks are too willing to finance against such reports to shady businessmen who may also sometimes grease their palms instead of looking for genuine project ideas backed by competent men of integrity. Herd mentality of the bankers creates excess capacity in any industry that they choose to finance thereby laying the seeds of sickness of that industry. Coupled with the in competency of the entrepreneurs and the shady intentions with which the projects were set up, the sickness spreads like wild fire. After a loan has been disbursed, it is an accepted norm that the Bank has a duty to keep smelling for and to act promptly on key signals that indicate the health of the recipient of the loan. Rule-bound bankers do collect all the necessary information and pile it up in neat reports and files. It is not unusual for bankers to even advise their clients to cook up their accounts to either satisfy the Banker's Health Code requirements or to get their unit classified as sick under the relevant laws. This having been done, the banker can sleep peacefully. Acting on the signals that emanate from these reports is none of his business. It is the entrepreneur who has to exercise to convince a long chain of stubborn bank officers to rise from their slumber. The entrepreneur is now caught in a game where almost every petty Bank officer satisfies his ego by kicking him where it hurts most before obliging him by moving the file to the next officer. Banks key decisions about nursing versus exit get influenced by this merry-go-round ego trip of the officers. The attitude that the Bank will lose more than the entrepreneur by a delay in such key decisions is completely missing who see themselves.

Dhungana (2006), stated in his article on "*Why Asset Management Company is Considered the Best Option to Resolve the Non-Performing Loan*" has tried to highlight one of the approach mainly Asset Management Company (AMC) for resolving the problem of non-performing loan (NPL). According to Mr. Dhungana, AMC is the specialized financial institutions who buy the NPL from financial institution and take necessary steps to recover the maximum value from the acquired assets. As per his view, NPL are not resolved in time there would be inherent direct cost to the economy. As stated by him NPL may rise due to the external factors like decreases in market value of collateral, deterioration in borrower's repayment capacity, economic slowdown, borrower's misconduct, improper credit appraisal system, lack of risk management practice, ineffective credit monitoring and supervision system. Hence he suggested that, NPL should be kept at minimum level and the specialized institution such as AMCs should manage the distressed Loan.

He says that, both traditional and AMC are available to deal with NPL problem. Under traditional approach, bank handless the NPL's in its own way especially through recovery unit who focus on continuing negotiation with the borrower and give top priority to the loan recovery. As per him, this approach is useful in dealing with small business Loan where personal touch is adopted but for big Loan this approach does not work. AMC seems as the only realistic option when the financial sector recovery is the underlying objective in financial system where the institution fails to resolve the NPL problem through their own effort. He stated that the main advantage of establishing AMC is that AMC is able to move in an expeditious manner removing the distraction of managing NPLs from the banking system and frees up resources within the financial institutions allowing them to concentrate on their core activities.

He concludes, as in most of the countries, Nepalese financial system is largely dominated by the banking sector. The banking sector is severely affected by the NPL problem, it is estimated the NPL of the Nepalese Banking system is around 16%. Therefore there is no doubt that it has serious implication on the economic performance of the country. It will be the eclipse in the development of financial soundness in the economy, if not controlled in time. However, traditional or AMC rot can be practiced to get recovery from this sickness of the financial system, the AMC root may be more effective approach to be quick recovery as it has been experienced around the world.

Ghimire (2005), in his article "*Credit Sector Reform and NRB*" Ghimire has tried to highlight the effects of change or amendment in NRB directives regarding loan classification and loan loss provisioning. "Although the circumstances leading to financial problem or crisis in many Nepali banks differ in many respects, what is common across most of the banks is the increased size of non - performing assets (NPAs). To resolve the problem of the losses or likely losses of this nature facing the industry, NRB has, as the central bank, amended several old directives and issued many new circulars in the recent years.

As opined by him, since majority of the commercial banks of the country as present falls under substandard, doubtful and even loss categories, loan loss provisioning now compare to previous arrangement would be dramatically higher. The new classification and provisioning norms are very lent able as they help to strengthen banks financially. He added that we also must remember that the old system remained in force from 1991 to 2001, which was probably the most volatile decade of the business operation of the country. He has indicated that Loan Loss Provisioning as a percentage of total credit of April 12, 2002 is 5.2% but as April 13, 2004 it has jumped to 18.39%. If only private banks are considered, it is 2.12% of April 2002 where as it is 6.30% as of April 13, 2004. The total increment in LLP is Rs 11,328.11 thousand and the total increment in credit is only Rs 7,976.70. He has also stated that tightening provisioning requirements on NPL is essential to ensures that banks remain liquid even during economic downturns.

In the conclusion he has mentioned that in the recent years NRB has worked for management and reform of the credit of the financial institution more seriously and NRB has adopted reforms aimed not just as dealing with problem banks but also at strengthen banking supervision to reduce the likelihood of future crisis. "All prudential directives of NRB in connection of credit sector reform have been made revised on April 2002 to adopt such changes there can be some difficulties and for a better and harmonized reform NRB should continue to be supportive, proactive and also participative to take opinion of bankers for a change in regulation, policy taking place in future.

Chhetri (2006 B.S), stated in his article titled "*Non-performing Assets: A Need for Rationalization*" that to provide connation of the NPA and its potential sources, implication of NPA in financial sector in the South East Asian Resign. He has also given possible measure to contain NPA. "Loan and Advance of financial institution are mean to be serviced either part of principle of the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan settlement. Since the date becomes past dues, the Loan becomes non-performing assets. The book of the account with lending institution should be effectively operative by means of real transaction effected on the part of the debtor in order to remain loan performing."

As per his opinion, the definition of NPA differs from country to country. In some of the developing countries of Asia Pacific Economic Cooperation (APEC) forum, a loan is classified as non-performing only after it has been arrear for at least 6 months. Similarly it is after three months in India, Loan thus defaulted are classified into different categories having their differing implication on the assets management of financial institution. He also stated that NPAs are classified according to international practice into three categories namely substandard, doubtful and loss depending upon the temporal position of loan default. "Thus the degree of NPA assets depends solely on the length of time the assets has been in the form of none obliged by the debtors. The more time it has elapsed the worsted condition of assets is being perceived and such assets are treated according."

As per Mr. Chhetri's view, failure of business for which loan was used, defective and below standard credit appraisal system, credit program sponsored by government, diversion of fund are some of the lending to accumulation of NAPs. He said that there is serious implication of NPAs, on financial institution. He further added that the liability of credit institution does not limit to the amount declared as NPA but extend to extra amount that requires by regulation of supervisory authority in the form of provisioning as the amount required for provisioning depends upon the level of NPAs create a psyche of worse environment especially in the financial institution like waiving interest, rescheduling the loan, writing off the loan, appointing private recovery agent, taking help of tribunals and law of land etc NPAs can be reduced. Finally he conclude that financial institutions are beset with the burden of mounting level of NPAs in can't be taken as stimulus but the vigilance demanded to solve the problem like this, eventually will generate vigor to gear up the banking and financial activities in more active way contributing to energizing growth.

Dhungana (2006), in his article "*NPL and its Management*" states that the position of the non performing loan and causes that results the non performing loan in Nepalese banking system. Extension of credit is one of the major activities of banks and financial institution. Credit usually represents the bulk of the institution's earning assets. Interest on credits is major source of income and profitability for the banks and financial institution. Therefore, quality credit management is a subject of crucial importance in the bank and financial institutions to maintain sustainability and improving operational efficiency. Poor credit management and deterioration in the quality of Loan give birth to NPLs. The internal measures play significant role to control the growth of NPLs. Best credit practices, culture and policies are required to strengthen the internal factors. The banks should have a proper system and competency on risk management and should insure that risk is accurately identified, assessed and controlled property. A proper risk management is undoubtedly an important tool for a good banking and NPL's management.

The problem of non-performing loan has been the major issue on banking sector reforms agenda. Nepal Rastra Bank is very much concerned with this issue and initiating various measures to enhance the risk management capacities, introducing policies and issuing regulations in this regard. However, the level of NPL's in the banking system is decreasing with the implementation of comprehensive financial sector reform program, but it is still at astounding level at around 18 percent at mid July 2005. The level of NPL in the financial system of Nepal comprising of 17 commercial banks, 25 development banks, 9 micro credit development banks and 60 finance companies is around 17 percent (Rs.29.0 billion) as at July 2005. Unless and until the problem of NPL is resolved, the growth and stability of the financial system cannot be assured. Therefore, the problem should be resolved as soon as possible. In order to resolve the problem, preventive and curative measures are required to be initiated in the system.Curative measures such as assisting the banks and financial institutions to dispose the distress Loan and facilitating to recover NPLs are also equally important when the NPL's are already at astounding level. However, various preventive and curative measure have been initiated within current comprehensive financial sector reform program but we still have to go through a long journey in strengthening both the internal factors and external factors in order to lower down the existing level of NPL's and to create such a environment where NPL's could be maintained at the tolerable limits. Therefore, both strengthening of the internal capacity of the financial institutions and improving capacity of the system as a whole is the need of the day. It can be expected that the financial sector reforms will have very positive impact in lowering down the level of NPL from the existing level and strengthening the internal capabilities of the banks and financial institutions in order to manage the credit portfolio efficiently and effectively in the days to come**.**

Pyakurel (2007), has stated in his articles entitled *"Our Econony is in a Volatile Stage"* that the banks have not able to collect their overdue to the increasing cumulative NPAs in Nepalese commercial banks. There is no additional demand of the investment due to the higher risk and present uncertainty.

He said that revenue collection is negative and regular expenditure is higher than the revenue. This indicates volatility of the economy. Even before the declaration of emergency, the government didn't have surplus revenue to pay for the remuneration and benefits of retired civil servants. The year 2002 is going to be difficult as major Loan are going to mature. Debt servicing will also demand a significant share of the budget. Up to 65% of our development expenditure is being financed by foreign aid. But if we can't meet the regular expenditure (through our revenue), it will be very difficult for us to convince the donor community. This could push our society toward what is called a 'mass unrest society.'

He also adds, "The government is about to establish an Assets Management Company to take over the non-performing assets (NPAs) of the government owned banks. On the other hand, it looks like the government's entire concentration has been on two commercial banks only (Nepal Bank Ltd. and Rastriya Banijya Bank). Due to cumulative growth of the NPAs, the banks haven't been able to collect their overdue. Due to the present uncertainty and higher risks, there is virtually on demand for new investments. That's why many bans are concentration on conventional areas. We haven't been able to explore potential areas of competitive advantage in the regional context."

Aryal (2007), the research *"Banking at Boiling Point"* was made on analysis of non performing loan of Nepalese financial sector to feature the loan position of Nepalese financial sector. It is said that the banking sector mirrors the larger economy. It's linkage to all sectors makes it a proxy for what is happening in the economy as whole. Indeed, the Nepalese banking sector today is at boiling point. The financial sector has evolved as the biggest sector in the economy. There are altogether 128 financial institutions in the country and currently more than 20000 people employed in these financials institution. These people is responsible for managing approximately NPR 221 billion worth of assets (primarily loan and Advance), out of which 50 percent comprises of two large banks- Rastriya Baninjya Bank and Nepal Bank Limited. Annual net profit of 5.89 billion generated by creating asset worth of NPR 221 billion last year means a very low return on asset (mere 2.1 percent), which is even below the average savings deposit rate in the country.

While doing root cause analysis for this scenario, two very strong reasons have evolved. The first reason is the poor quality of Loan, more particularly in government-owned banks and some private banks, due to non compliances of basic credit principles while granting Loan coupled with lack of credit skills assessment. The second reason for lower return can be attributed to the fact that almost all the financial institutions are involved only in dealing with undifferentiated vanilla banking products. An interesting example in this regard would, if someone needs a car loan, which is typically a commercial bank product, he or she can walk into any development bank in the country. Yes, in the current scenario, it is very difficult for development banks in the country to burn their fingers by going into long-term project Loan. However, they should be able to create their own niche market.

In order to create a niche market, product-specialization is a must and the banking sector is way below average in terms of introducing and implementing value-added banking products in the areas of trade finance, credit, remittance and more importantly in global market areas.

Loan is the most critical factor in determining the strength of any bank. Primary factors that can be considered are the quality of loan portfolio, mix of risk assets and credit administration system.

Loan NPL ratio indicates the better risk assessment and robust credit management systems in place and vice versa. At the same time, while higher loan loss provisions indicates poor credit management, it also indicates adequate reserve for possible loan loss and protects the balance sheets of respective banks.

In a period of three years (from 2002/03 to 2005/06), total Loan and Advance of commercial banks has increased by 46 percent. When we consider this period, we know that this phase has been hit by situations like political uncertainty, conflict and unrest in the country. Even in this kind of scenario, the overall banking sector has been able to increase its asset base by significant percentage indicates that they have been capable in switching their areas of investments.

Tiwari (2008), in this article *"Financial Sector Hobbled With Chaos, Fragility"* has stated that Nepal's financial sector is moving like a 'sinking boat'. As per his view financial institution have failed in delivering beneficial services to needy people by developing growth is credit-giving centers in rural areas without which sustained economic growth is impossible. On the other hand banks and financial institutions have enough liquidity but they are finding it difficult to find suitable places for investment.

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

The writer suggested that the forthcoming budget should not remain a document merely but should address financial sectors ills with a wide vision. He further recommended that in order to create a well regulated, prudent, market oriented, competitive and strong financial system in Nepal, the government should look to build upon its indigenous strength and improve upon its regional ties to improve its efficiencies.

Sapkota (2008), this article *“Doubtful Debtors and Changed New Provision”* relates to non performing asset. According that, the main purpose of establishment of bank in to collect idle fund general publics disburses them to needy people /institution in the form of loan and Advance. Loan and Advance are given for a certain period of time but it is not sure that all the Loan are recovered within time. Then function of any commercial bank is recovered easily within stipulated time. Hence is often said that, it is easy to disburse Loan but as much hard to recover Loan and interest.

He stated that as per new provision, Loan and Advance are classified on the basis of ageing of past dues and collateral value. On that basis Loan and Advance need to be classifying into four categories namely pass, substandard, doubtful and loss. With the change in time and demand, change was made in provision of loan classification and provisioning. He has also mentioned that previously Loan and Advance are categorized into six categories as pass, acceptable, indicative substandard, substandard, doubtful and loss. With the old provision the loan would be non-performing only if it is past due for that 1 year but as per new provision, the loan would be non-performing if the loan is past due for more than three months.

He concludes that these changed provisions would contribute to healthy, transparent and inherent risk bearing capacity of the banks. If NPL increases it affects adversely to the various sectors. Hence the writer concluded with the hope that new provision if properly implemented would help to reduce NPL and helps banks from financial crisis**.**

Basyal (2009), discussing about the financial sector reform in his article "*Financial Sector Reform Program in Nepal Prospects and Challenges*" state that the host of challenges and complexities that confront the financial system of Nepal could be categorized as the weak financial position of most of the government-owned financial institutions as reflected in their negative net worth and huge accumulated losses, higher portion of NPA, predominance of the informal financial system. It is estimated that the size of NPA in the commercial banking system is as high as 18% and 50% of this ratio we can found in the two largest banks (RBB and NBL). To tackle this problem, the financial system should be strengthened by improving its regulatory and supervisory systems. The central bank's capability for effective supervision of the financial institution should be enhanced. He gives an example of the Asian crisis of 1997-98 and suggests taking lesson from it. The crisis seriously affected the financial system and economics stability of the region. Large currency depreciation, capital market collapses, swollen NPA level of the finance system, negative economic growth rate were the immediate effects of the crisis. It is commonly believed that one of the critical factors behind the crisis was the absence of adequate central banking autonomy which substantially reduced the efficiency and effectiveness of the central banking functions and responsibilities. He suggests the concerned parties should review the measures they taken for solution of the crisis.

Neupane (2009), in article *"Bad Loan of Banking Sector – Challenges and Efforts to Resolve It"* has described some views regarding bad Loan of banking sector. As mentioned by him there was various types of risk inherent in the credit. One, who manages risk, earns profit. He further added that the recent financial crisis in banking sector is due to weak accounting procedures, defect on loan classification, lack of transparency, loss control measures etc.

Like the other author, Mr. Neupane has also stated that NPL is the indicator of financial crisis and the factor leading to NPL is economic slowdown, recession, bad intention of borrower, lack of credit policy, increase in interest rates. NPL increases resource mobilization cost and reduce profit earning capacity of the bank. He has also mentioned that the international standard of acceptable NPA is 4% but there is about 26% NPA in Nepalese banking sector which is due to the high level of NPL of two nationalized banks. As stated by him, the major implication of NPL is banks can't return depositors money on demand and it limits lending capacity of the bank. The writer has suggested internal and external measure for reducing NPL and its effect. Internal measure comprises classification of Loan and Advance and providing provision for probable loss and external measures comprises of help from Credit Information Bureau (CIB), appointment of Asset Management Company (AMC) and Debt Recovery Tribunal (DRT).

He concludes, bank must give priority for reducing NPA. He has also mention that many countries are adopting various measures for reducing loan loss. Recently the president of Philippines has announced tax rebate system for reducing NPA. Now it is high time to improve bad debts of banking sector with firm determination**.**

Ghos (2010), has pointed in article *"How Importance is Credit Rating in Assessing the Risk of Default for Lenders"* about fundamentally credit rating implies evaluating the creditworthiness of a borrower by an independent rating agency. Here objective is to evaluate the probability of default. As such, credit rating does not predict loss but it predicts the likelihood of payment problems.

Credit rating has been explained by Moody's a credit rating agency as forming an opinion of the future ability, legal obligation and willingness of a bond issuer or obligor to make full and timely payments on principal and interest due to the investors.

Banks do rely on credit rating agencies to measure credit risk and assign a probability of default.

Credit rating agencies generally slot companies into risk buckets that indicate company's credit risk and is also reviewed periodically. Associated with each risk bucket is the probability of default that is derived from historical observations of default behavior in each risk bucket.

However, credit rating is not fool-proof. In fact, Enron was rated investment grade till as late as a month prior to its filing for bankruptcy when it was assigned an in-default status by the rating agencies. It depends on the information available to the credit rating agency. Besides, there may be conflict of interest which a credit rating agency may not be able to resolve in the interest of investors and lenders.

Stock prices are an important (but not the sole) indicator of the credit risk involved. Stock prices are much more forward looking in assessing the creditworthiness of a business enterprise. Historical data proves that stock prices of companies such as Enron and WorldCom had started showing a falling trend many months prior to it being downgraded by credit rating agencies.

2.4. Review of Thesis

Ojha (2006) has conducted a study on *"Lending Practices: A study of Nabil Bank Limited, Standard Chartered Bank Nepal Limited and Himalayan Bank Limited."* His aim was to carry out the research to analyze the various aspects of bank's lending in various productive and priority sector, sample bank's performance regarding the lending quantity, quality, efficiency and its contribution in total income.ssz

Ojha has analyzed over liquidity caused due to lack of good lending opportunities, risk arising due to mismanagement of lending portfolio, increasing non-performing loan etc are some of the problems that is facing by the Nepalese banking sector. Mr. Ojha concluded in his research that the highest growth rate, proportionately high volume of Loan and Advance, the best contribution in agriculture and priority sector and the level of deposit mobilization of HBL had put the bank in top position in the lending function. However the better activity ratio of Standard Chartered Bank has proved the bank as the best in managing the lending portfolio according to the demand of profit oriented organization. The high volume of lending activities and high level of productive sector loan of Nabil has put the bank in the top position in absolute terms. The increasing loan loss provision and high volume of non performing loan of HBL and Nabil is the serious matter. The high volume of the NPA of HBL may have caused due to the failure of industrial and agriculture sectors. Nabil's increased NPA may have caused due to the accumulated bad debts that is kept behind the curtain to show the high efficiency of management. As per his opinion, lack of proper credit appraisal, default by blacklisted borrower and professional defaulter, over confidence in commercial banks regarding credit appraisal efficiency and negligence in taking the credit information relating to borrowers etc has caused many of bad debts in these banks.

By conducting the research work on lending practices, he suggests the following points to the financial sectors.

- Financial sectors (banks in this study) should be more cautious and realistic while granting Loan and Advance.
- To reduce the risk of high NPA, the banks should avoid lending in more risk area until the bank doesn't fully satisfy itself regarding the future viability of

Asset Management Company which helps commercial banks in collecting their debts and improving their credit rating efficiency.

- To lower the level of NPA, the commercial banks should take necessary information from the Credit Information Bureau.ss
- Commercial banks should be utilized it deposits in to productive sectors of the economy. However the commercial banks should not neglect the priority sectors to lend.

Singh (2007), has said ineffective credit policy, political pressure to lead to uncredit worthy borrower; over valuation of collateral are the major causes of mounting non-performing assets of the banks in her thesis title "*A Study of the Non-performing Assets of Nepalese commercial Banks" t*o identify effects of NPA on ROA and ROE, to solve one of the case of the NPA i.e. analysis and interpretation of the case and to find out the factors behind the accumulation of NPA. She state present loan classification and provisioning directives seems more stringent than previous one. She further says adequate provisioning strengthens the financial health of the banks and makes them able to face any kind of future contingencies. She recommends that there should be regular supervision and follow up for proper utilization of loan. On the way of conducting her research, she follows analytical and descriptive research design in research methodology. Different kinds of appropriate mathematical, statistical and financial tools have been applied for analysis purpose. Correlation analysis, ratio analysis and different diagrams and graphs are used in her research as tools and techniques.

Shrestha (2007), in her study "*A Study on Non-Performing Loan and Loan Loss Provisioning of Commercial Banks; with Reference to NBL, NABIL and SCBNL*" has taken the main objectives to analyze the various aspects of non-performing loan in the commercial bank. The main specific objectives of the study are.

- To find out the proportion of non-performing loan.
- To examine the factors lending to accumulation of non-performing loan.
- To analyze the relationship between loan and loan loss provision.
- To find out the impact of loan loss provision on profitability of the commercial bank.

The major findings of the study are;

- Increasing non-performing loan is the serious problem of the banking sector in Nepal.
- NBL has very high portion of non-performing loan. Hence, even the bank has the highest investment in the most income generating assets i.e. loan and Advance it is in loss.
- Even the private sector bank like NABIL has higher non- performing loan and according higher provision NABIL's average proportion on non-performing loan during the study period is higher than acceptable.

Pradhan (2008) has conducted a study on "*A Study on Non- Performing Assets of Commercial Banks with References to SCBNL. RBB & EBL"* The Main objectives of his study were to find out the proportion of non-performing loan and the level of NPA in total assets, total deposit and total lending in the selected commercial banks relationship between loan loss provisions in the commercial bank impact of non-performing assets in the performance of commercial bank.

He has concluded improper credit policy, political pressure to lend, lack of supervision and monitoring, economic slowdown overvaluation of collateral are the major cause of occurring NPA. In recent year, not only the private sector's bank but also public sector's banks are also trying to maintain their loan and Advance to control over becoming the non performing assets. To overcome the NPA from public banks, they should try to recover their loan and interest amount on time and also make a suitable loan loss policy.

He has concluded "High levels of non-performing assets not only decrease the profitability of the banks but also affect the entire financial as well as operational health of the organization. If the NPA doesn't control immediately, it will be main causes for shutdown of banks in future.

He suggested that reduce the NPA problem immediate remedial action for taking enough collateral, so that the bank at least can able to recover its principle and interest amount in case of being unable to repay by the borrower, proper financial analysis should be done before lending to the borrowers bank should provide appropriate training regarding loan management, risk management, credit appraisal etc to the employee. Bank should apply precautions before granting any loan and Advance to decrease the bad Loan.

Aryal (2008), in his study, "*Impact of NPA on Commercial Banks with Special Reference of NABIL , SCBNL, EBL, NBL, RBB and NBBL*" has the main objectives to analyze and identify the impact of NPA on profitability. The other specific objectives of the study are;

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

The major findings of the study are;

- The average loan and Advance to total assets ratio on NABIL, SCBNL, EBL, NBL, RBB, and NBBL are 50.38%, 29.16%, 59.62%, 32.25%, and 64.64% respectively during the study perio. The relatively low ratio of SCBNL is the indication of risk averse attitude of the management or they have the policy of investing low in the risky assets like loan and Advance.
- The loan and Advance to total deposit of NABIL, SCBNL, EBL, NBL, RBB and NBBL during the study period are 58.70%, 36.85%, 73.79%, 57.79%, 70.56% and 79.42% respectively. The NBBL has the highest average ratio but SCBNL has the relatively lower ratio.
- The average ratio of non-performing assets to total loan and Advance of NABIL, SCBNL, EBL, NBL, RBB, and NBBL are 7.43%, 4.43%, 2.73%, 48.83%, 56.95%, 16.34% respectively.
- The average return on total Loan and Advance ratio of NABIL, SCBNL, EBL, NBL, RBB and NBBL are 4.62%, 7.73%, -3.99%, -15.67% and 1.42%

respectively. The return on loan and Advance revealed that RBB seems to be failure to earn return on loan and Advance.

Pandey (2009) has carried out study on *"Nepal Rastra Bank- Directives Their Implementation and Impact on the Commercial Banks- A Case Study of Himalayan Bank Limited."* The main objective of his study to find out the impact of changes in NRB directives on the performanc4e of the commercial banks and also find out whether the directives were implemented or not. The directives if not properly addressed have potential to wreck the financial system of the country as they are only tool of the NRB to supervise and monitor the financial institutions. The directives in themselves are not that important unless properly implemented. The implementation part depends on the commercial banks. In case of commercial banks are making such huge profit with full compliance of NRB directives, then the commercial banks would votes of praise because they would then be instrumental in the economic development of the country. All the changes in NRB directives made impacts on the bank and the result are the followings:-

- A short term decrease in profitability which result to lesser dividends to shareholders and lesser bonus to employees.
- Increase protection to money of the depositors through increased capital adequacy ratios and more stringent loan related document.
- Increase in operational procedures of the bank which increases the operational cost of the bank.
- Reduction in the loan exposure of the bank, which decreases the interest income but increases the protection of depositor's money.
- All the aforesaid results lead to one direction, the bank will be financial healthy and stronger in the future.

HBL will be able to withstand tougher economic situation in the future with adequate capital and provision for losses. The tough time through which bank is undergoing at present will prevail only for a couple of years but in the long run, it will be strong enough to attract more deposits and expose itself to more risk with capital cushion behind it. The quality of the assets of the banks will become better as banks will be careful before creating credit. Ultimately, the changes in the directives will bring prosperity not only to the shareholders but also to the depositors, the employees and the economy of the country as a whole.

Mr. Pandey recommends that the bank has to make its monitoring and follow up department stronger to give priority in human resource development through training to its staffs and make them efficient enough to monitor and collect already disbursed Loan.

Lamichhane (2010), this study "*Non Performing Assets and Profitability of Nepalese Public & Private Sector Commercial Banks*" has the main objectives of the study are to examine and study the non-performing assets in total assets, total deposit and total lending of the Nepalese commercial banks. The other specific objectives of the study are.

- To analyze the non-performing assets of the banks under study.
- To compare the status of Non-performing assets between Public banks and Private Banks in Nepal.
- To evaluate the relationship between profit and loan loss provision.

The major findings of the study are,

- Non-performing assets of entire Nepalese commercial banks is in increasing order.
- Public sector's banks are sicker than private banks by Non performing assets.
- Return on assets of banks has been affected because while the total assets include the NPA they do not contribute to profits which are the numerator in the ratio.

Research Gap

The purpose of this research is to develop some expertise in one's area, to see what new contribution can be made and to receive some ideas, knowledge and suggestions in relation to 'Non Performing Assets of HBL and NCCBL'. Thus, the previous studies can't be ignored because they provide the foundation to the present study. In other words, there has to continuity in research. This continuity in research is ensured by linking the present study with the past research studies. To fulfill this gap, this research is selected. To complete this research work: many books journals, articles and various published and unpublished dissertations are followed as guideline to make the research easier and smooth. By the study of various research and articles, it has been found that higher non-performing asset followed by higher loan loss provision is one of the challenges faced by commercial banks in the present context. Some researches were done on relating to loan loss provisioning but no research was found in detailed analysis of non-performing loan and loan loss provisioning. Hence this research has attempted to fill this research gap by taking reference of Himalayan Bank Limited and Nepal credit and commerce Bank Limited. This research will be able to deliver some of the present issues, latest information and data regarding loan classification and loan loss provisioning. Effort on this particular subject will be found properly genuine and it will be recognized valuable study in this particular subject.

CHAPTER - III

RESEARCH METHODOLOGY

Research methodology is the method to solve the research problem systematically. It may regard as a science of studying how research is done to conduct the research. It is very important to conduct the research. In research methodology various sequential steps that are generally adapted by the researcher, studying his research problem among with certain objectives in view are studied. Research methodology helps us to find out accuracy, validity and suitability. Research is a systematic inquiry of any particular topic and the methodology is a method of doing research n a well manner. Hence research methodology is the systematic study of research problem that solves them with some logical evidence. The research methodology adopted in present study as discussed below:-

3.1 Research Design

Research design is the plan, structure and strategy of investigation conceived so as to obtain to research question and control variances. The plan is the overall scheme or programmed of a research. This research is aimed at studying the non-performing asset and loan loss provisioning of Himalayan Bank Limited and Nepal Credit and Commerce Bank Limited. For this purpose, this research will follow analytical and descriptive design.

3.2 Population and Sample

Population refers to the entire group people, events or things of interest but that a researcher wishes to investigate. There are 31 commercial banks as total population but this study is concentrated on only two commercial banks. This study is about non-performing asset and loan loss provisioning of Himalayan Bank Limited and Nepal Credit and Commerce Bank Limited.

3.3 Sources of Data

The data used in this research is secondary. The sources of the secondary data are as follows:-

- Annual reports, newsletter, broachers etc of concerned banks.
- Laws, guidelines and directives regarding the subject matter.
- Text books
- Article published in newspaper, journal, magazine and other publication.
- Various reports published by NRB, CIB, HBL, NCCBL etc.
- Various related websites

3.4 Data Collection Technique

The technique used to obtain the secondary data is the annual reports of HBL and NCC Bank Limited which were obtain from the concerned banks and other reports were downloaded from the websites. Various publication of NRB was collected from concerned department of Nepal Rastra Bank Baluwatar. Similarly reports of Credit Information Bureau (CIB) have been collected from office of CIB, Thapathali. The references of NRB directives and guidelines have been obtained from NRB Office and websites of NRB. Various reports, textbooks, journal and unpublished dissertation have been obtained by visiting Tribhuwan University central library and library of Shanker Dev Campus.

3.5 Data Analysis Tools

The data collected from different sources are recorded systematically and identified. The available information is grouped as per the need of the research work in order to meet research objectives. The collected data are presented in appropriate forms of table and charts. For analysis purpose different kind of appropriate mathematical, statistical and financial tools have been applied. Furthers represent the data in simple form diagrams and graphs have also been used.

3.5.1 Financial Tools

While adopting financial tools, a ratio is used as benchmark for evaluating the financial position and performance of any firm. “Financial analysis is the process of identifying the financial strength and weakness of the firm by properly establishing relationship between the items of the balance sheet and profit and loss account.” Financial analysis is the use of financial statements to analyze a company’s financial position and to assess future financial performance.

3.5.1.1 Ratio analysis

Ratio analysis is widely used tool of financial analysis. A ratio is simply one number expressed in terms of another and as such it express the numerical or quantitative relationship between two variables. Ratio analysis reflects the relative strength and weakness of any organization and also indicates the operating and financial growth of the organization. "Ratios help to summarize large quantities of financial data and to make quantitative judgment about the firm's financial performance. The relationship between two accounting figures expressed mathematically is known as financial ratio". Even though there are many ratios, only those ratios has been calculated which are related to the subject matter. Following ratios have been computed and analyzed in this study

a) Loan and Advance to Total Asset Ratio

Loan and Advance of any commercial banks represent the major portion in volume of total assets. The ratio of Loan and Advance to total assets measures the volume of Loan and Advance in the structure of total assets. The high degree of ratio indicates the good performance of the banks in mobilizing its fund by way of lending functions. However in its reverse side, the high degree is representative of low liquidity ratio. Granting Loan and Advance always carries a certain degree of risk. Thus this asset of banking business is regarded as risky assets. Hence this ratio measures the management attitude towards as risky assets. The low ratio is indicative of low productivity and high degree of safety in liquidity and vice versa. This ratio is calculated as follows

$$\text{Loan and Advance to Total Asset Ratio} = \frac{\text{Loans and Advances}}{\text{Total Asset}}$$

b) Loan and Advance to Total Deposit Ratio (CD Ratio)

The core banking function is to mobilize the funds obtained from the depositors to borrowers and earn profit and CD ratio is the fundamental parameter to ascertain fund deployment efficiency of commercial bank. In other words this ratio is calculated to find out how successfully the banks are utilizing their total deposits on credit or Loan and Advance for profit generating purpose as Loan and Advance yield high rate of return. Greater CD ratio implies the better utilization of total deposits and better earning, however, liquidity requirements also needs due consideration. Hence 70%-80% CD ratio is considered as appropriate. This ratio is calculated by dividing total credit by total deposit of the bank.

$$\text{Loan and Advance to Total Deposit Ratio} = \frac{\text{Loans and Advances}}{\text{Total Deposit}}$$

c) Non-Performing Loan to Loan and Advance Ratio

This ratio determines the proportion of non-performing Loan in the total loan portfolio. Higher ratio implies the bad quality of assets of banks in the form of Loan and Advance. Hence lower NPL to total credit ratio is preferred. As per international standard only 5% NPL is allowed also in the context of Nepal 5% NPL is acceptable. It is calculated as follows:

$$\text{Non-Performing Loan to Loan and Advance} = \frac{\text{Non-Performing Loan}}{\text{Loans and Advances}}$$

d) Loan Loss Provision to Loan and Advance Ratio

This ratio describes the quality of assets in the form of Loan and Advance that a bank is holding. Since there is risk inherent in Loan and Advance, NRB has Directed commercial banks to classify its Loan into different categories and accordingly to make provision for probable loss. Loan loss provision signifies the cushion against future contingency created by the default of the borrower in payment of Loan and ensures the continued solvency of the banks. Since high provision has to be made for non-performing loan, higher provision for loan reflects increasing non-performing loan in volume of total Loan and Advance. The low ratio signifies the good quality of assets in the volume of Loan and Advance. It indicates how efficiently it manages loan and Advance and makes efforts to cope with probable loan loss. Higher ratio implies, higher portion of NPL in the total loan portfolio. This ratio is calculated as follows:

$$\text{Loan Loss Provision to Loan and Advance Ratio} = \frac{\text{Loan Loss Provision}}{\text{Loan and Advance}}$$

e) Loan Loss Provision to Non-Performing Loan

This ratio determines the proportion of provision held to non-performing loan of the bank. This ratio measures up to what extent of risk inherent in NPL is covered by the total loan loss provision. Higher ratio signifies that the banks are safeguarded against future contingencies that may create due to non-performing loan or in other words banks have cushion of provision to cope the problem that may be cause to NPL. Hence higher the ratio better is the financial strength of the bank. This ratio is calculated as follows:

$$\text{Loan Loss Provision to Non- Performing Loan Ratio} = \frac{\text{Total Loan Loss provision}}{\text{Non Performing Loan}}$$

f) Net Profit to Loan and Advance Ratio

This ratio indicates how efficiently the bank has employed its resources in the form of Loan and Advance. It is the ratio of net profit and total Loan and Advance of a bank. Net profit refers to that profit which is obtained after all types of deduction like employee bonus, tax, Provision etc. Hence this ratio measures bank's profitability with respect to Loan and Advance. Higher the ratio better is the performance of the ban. It is calculated as below:

$$\text{Net Profit to Loan and Advance Ratio} = \frac{\text{Net Profit}}{\text{Loan and Advance}}$$

3.5.2 Statistical Tools

Statistical tools are the mathematical techniques used to facilitate the analysis and interpretation of numerical data. "Statistical Analysis is one particular language, which describes the data and makes possible to talk about the relations and the difference of the variables." Following statistical tools have been used in this study.

3.5.2.1 Percentages

A percent is a number of hundredth parts one numbers to another. Uses of percentages make the data much simpler and grasp. It is the simplest statistical device used in interpretation of phenomenon. It can reduce everything to a common base and thereby helps in meaningful presentation. Mathematically, let a represent the base used for comparison of given number in the base may be calculated as:

$$\text{Percentage (\%)} = B \times \frac{100}{A}$$

3.5.2.2 Measures of Central Tendency

Measures of central value are simple statistical treatments of distribution that attempts to find the single figure to describe the entire distribution. It is the best possible value of a group of variables that singly represents to whole group. In the statistical analysis the central value falls with in the approximately middle value of the whole data. Among the several tools of measuring central value, the mean has been used in this analysis where and when necessary. The mean is the arithmetic average of a variable.

Arithmetic Mean of a series is given by

$$\text{Mean } \left(\overline{X}\right) = \frac{\sum X}{N}$$

3.5.2.3 Measures of Dispersion

Dispersion measures the variation of the data from the central value. The central value alone is not enough to analyze the quality of data regarding its variability. With the light of dispersion, an average becomes more powerful and meaningful. Following tools of measuring dispersion has been used in this study.

a) Standard Deviation

Standard Deviation (S.D.) is the most popular and the most useful measure of dispersion. It indicates the ranges and size of deviance from the middle or mean. It measures the absolute dispersion. Higher the value of standard deviation higher is the variability and vice versa. It is the positive square of average sum of squares of deviations of observations from the arithmetic mean of the distribution. It can be calculated as follows

$$\text{Standard Deviation}(\sigma) = \sqrt{\frac{\sum\left(X - \overline{X}\right)^2}{N}}$$

b) Coefficient of Variation

The percentage measure of coefficient of standard deviation is called coefficient of variation. The less is the C. V. then more is the uniformity and consistency and vice versa. Standard deviation gives an absolute measure of dispersion. Hence where the mean of the variable is not equal it is not appropriate to compare two pairs of variables based in S.D.

only. The coefficient of variation measures the relative measures of dispersion, hence capable to compare two variables independently in terms of their variability.

$$Coefficient of Variation (C.V.) = \frac{\sigma}{\overline{X}} \times 100$$

c) Correlation Coefficient (r)

Correlation refers to the degree of relationship between two variables. Correlation coefficient determines the association between the dependant variable and independent variable. If between the variables, increase or decrease in one cause increase or decrease in another, then such variables are correlated variables. "Correlation may be defined as the degree of linear relationship existing between two or more variables. Two variables are said to be correlated when the changes in the value of one is accompanied by the change of another variable." There are different techniques of calculating correlation coefficient. Among various techniques we have used Karl Pearson coefficient of correlation. It is calculated as follows:

$$\text{Correlation in Coefficient (R)} = \frac{\sum xy}{N\sigma_x\sigma_y}$$

Where, $x = X - \overline{X}$ $y = Y - \overline{Y}$

σ_x = standard deviation of series X

σ_y = standard deviation of series Y

N = Numbers of pairs of observation

On simplification of the equation of r, we obtain the formula for computing r.

$$r = \frac{\sum xy}{\sqrt{\sum X^2 \sum Y^2}}$$

The Karl Pearson Coefficient of correlation always falls between -1 to +1. The value of correlation in minus signifies the negative correlation and in plus signifies the positive correlation.

If,

r = 0, there is no relationship between the variables

$r < 0$, there is negative relationship between the variables

$r > 0$, there is positive correlation between the variables

$r = +1$, the relationship is perfectly positive

$r = -1$, the relationship is perfectly negative

The reliability of the correlation coefficient is judged with the help of probable error (P.E.). It is calculated as follows:

$$\text{Probable Error (P.E.)} = \frac{0.6745(1-r^2)}{\sqrt{N}}$$

Where,

r = correlation coefficient

N = No. of pairs of observation

If r > 6 P.E., then the correlation coefficient is Significant and reliable

If r < P.E., then the correlation coefficient is insignificant and there is no evidence of correlation

3.5.3 Trend Analysis

Trend analysis is one of the statistical tools, which is used to determine the improvement or determination of its financial situation. Trend analysis informs about the expected future values of various variables. The least square method has been adopted to measure the trend behaviors of these selected banks. The method is widely used in practices. The formula of square method for the straight line is represented by the following formula:

$$Yc = a + bX$$

Where,

Yc	=	Trend Values
A	=	Y intercept or the computed trend figure of the Y variable, when X = 0
B	=	slope of the trend line of the amount of change in Y variable that is associated with change in 1 unit in X variable.
X	=	Variable that represent time i.e. time variable

The value of the constants a and b can be determined solving the following two normal equations

$\sum Y = Na + b \sum X$

$\sum XY = a\sum X + b \sum X^2$

Where, N = number of years

But for simplification, if the time variable is measured as a deviation from its mean i. e. mid point is taken as origin, the negative value in the first half of the series balance out of the positive values in the second half of so that the values of constant a and b can easily determined by using following formula

$$a = \frac{\sum Y}{N}$$

$$b = \frac{\sum XY}{\sum X^2}$$

3.5.4 Diagrammatic and Graphical Representation

Diagrams and graphs are visual aids that give a bird eye view of a given set of numerical data. They represent the data in simple and readily compromise form. Hence various bar diagrams, pie charts and graph have been used for presentation and analysis of data.

After highlighting the research methodology, the next chapters content the presentation and analysis of data of concerned financial institution.

CHAPTER – I V

DATA PRESENTATION AND ANALYSIS

This section of research includes the conversion of collected raw data from various resources into an understandable presentation using financial as well as statistical tools supported by diagrams and graphs as mentioned in the previous chapter. This chapter of the thesis is main chapter as all the findings, conclusions and recommendations are going to be derived from the calculations and analysis done in this section.

4.1 Analysis of Assets Composition

Assets something possessed by a business entity from which future economic benefits may be obtained. Any item of economic value owned by an individual or corporation, especially that which could be converted to cash is called assets. On a balance sheet assets are equal to the sum of liabilities, common stock and retained earnings.

Assets composition consists of cash and Bank balance, Money at call and short Notice, Investments, Loan and Advance, Fixed Assets, Non-Banking Assets and other Assets. In balance sheet, the assets side shows the funds entrusted to the bank in which they are deployed. As balance sheet is prepared with a view to know the exact financial position of the business on the last date of every finance year. Assets composition helps to determine the soundness of a bank also it provide to determine the capability of the bank to earn profit

Table: 4.1

Assets Composition of HBL (Rs In'000')

Fiscal Year / Assets	2005/06		2006/07		2007/08		2008/09		2009/10	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Cash and Bank Balance	17,17,352	5.6	17,57,341	5.12	14,48,142	3.9	30,48,527	7.6	38,66,491	8.8
Money at Call and Short Notice	10,05,280	3.3	17,10,024	4.98	5,18,530	1.4	11,70,794	2.9	3,08,840	0.7
Investment	1,08,89,031	35.6	1,18,22,985	34.45	1,33,40,177	36.2	87,10,691	21.8	84,44,910	19.3
Loan and Advance	1,57,61,977	51.5	1,77,93,724	51.85	2,01,79,613	54.8	2,55,19,519	63.7	2,91,23,755	66.4
Fixed Assets	5,40,825	1.8	5,74,060	1.67	7,95,310	2.2	9,52,196	2.4	10,61,871	2.5
Non-Banking Assets	-	-	15633	0.0	28455	0.1	22964	0.1	-	-
Other Assets	6,65,343	2.2	6,41,101	1.87	5,47,397	1.5	6,21,995	1.6	10,54,384	2.3
Total Assets	**3,05,79,808**	**100**	**3,43,14,868**	**100**	**3,68,57,624**	**100**	**4,00,46,686**	**100**	**4,38,60,251**	**100**

(Source: Appendix-1)

The above table presents the assets composition of HBL from the fiscal year 2005/06 to 2009/10. As shown in above table, the value of assets combinations are in fluctuating positions. Cash and bank balance is in increasing trend but in 2007/08 it decreased. Money at call or short Notice is also more fluctuating first two year it is in increasing trend and in 2007/08 it has gone decreased and same fluctuating can be seen in last two years also. Investment is one of the major components of assets. It is increasing up to 2007/08 after that it is going decreasing. The others two components Loan & Advance and Fixed Assets of the bank are in increasing trend in every subsequent year. Similarly although none banking assets and others assets take tiny space in assets combination but they have also irregular.

Figure: 4.1

Assets Combination of HBL

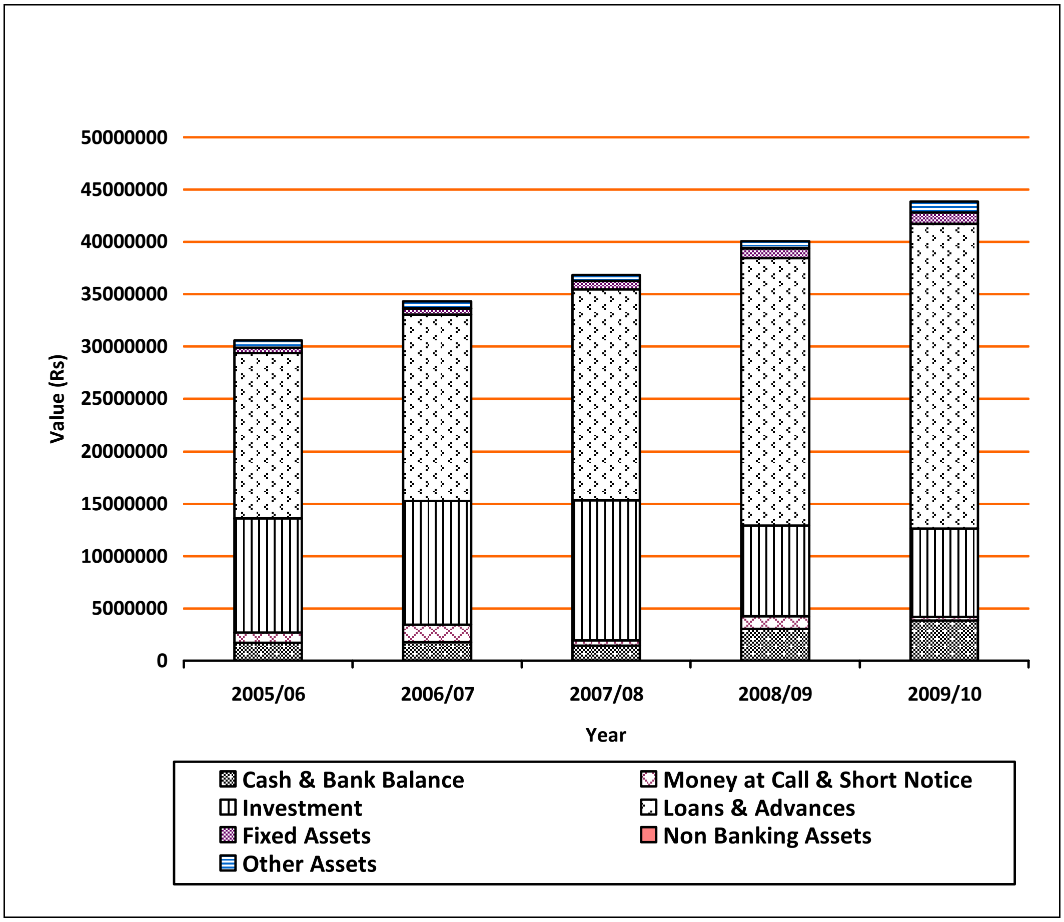


Table: 4.2

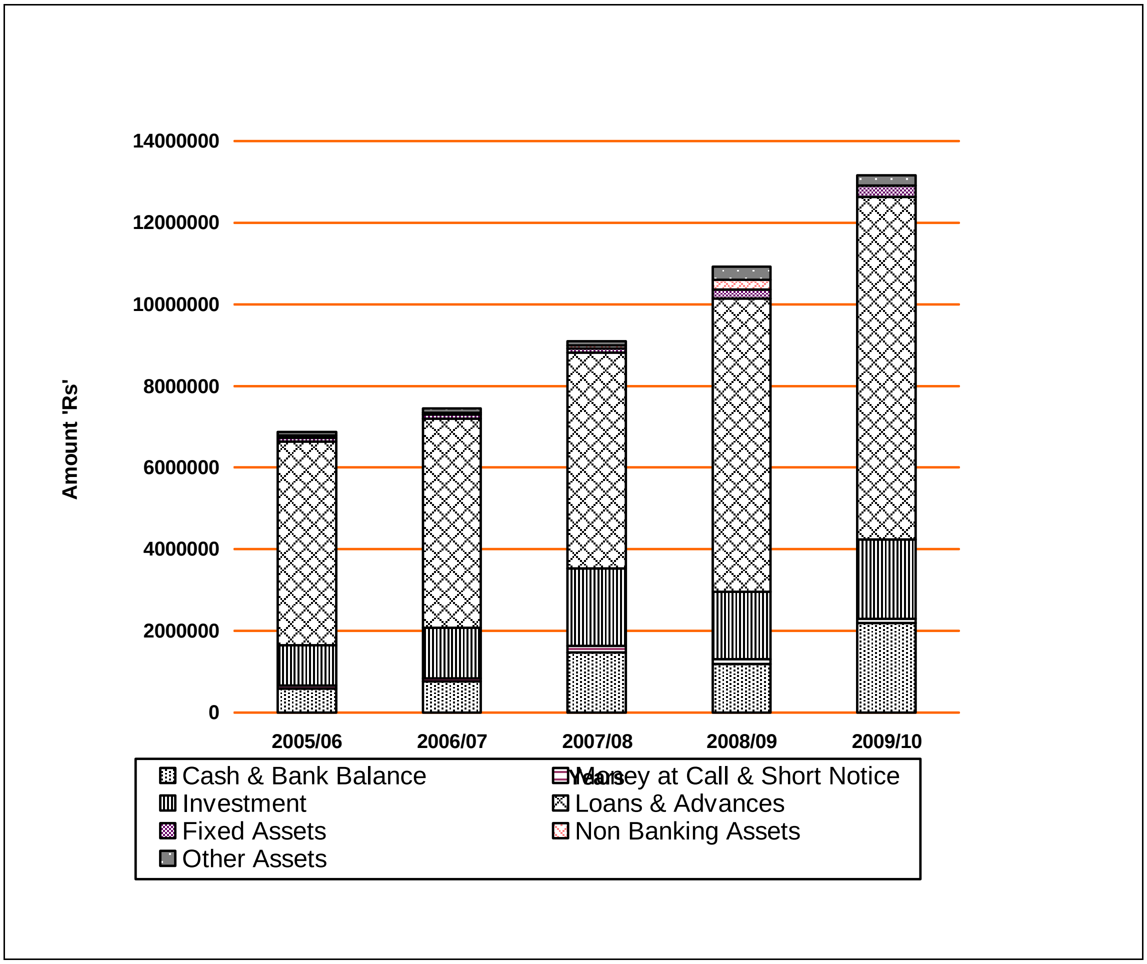
Assets Composition of NCCBL (Rs In '000')

Fiscal Year / Assets	2005/06 (62/63)		2006/07 (63/64)		2007/08 (64/65)		2008/09 (65/66)		2009/10 (66/67)	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Cash and Bank Balance	5,88,657	8.56	7,58,163	10.13	14,77,833	16.23	11,87,005	10.87	21,96,348	16.07
Money at Call and Short Notice	72,461	1.05	75,665	1.01	1,54,406	1.70	1,26,402	1.16	99,951	0.76
Investment	9,85,832	14.34	12,36,621,	16.53	19,00,758	20.88	16,43,103	15.05	19,47,614	14.81
Loan and Advance	49,88,672	72.58	51,22,221	68.45	52,81,051	58.00	71,83,680	65.81	83,87,897	63.77
Fixed Assets	86,615	1.26	1,04,233	1.52	1,14,064	1.25	2,16,858	1.99	2,84,166	2.16
Non-Banking Assets	58,832	0.86	46,556	0.80	59,963	0.66	2,35,574	2.19	-	
Other Assets	92,566	1.35	1,07,796	1.56	1,16,453	1.28	3,23,712	2.97	2,38,277	1.81
Total Asset	**68,73,635**	**100**	**74,83,150**	**100**	**9104528**	**100**	**10916334**	**100**	**13064253**	**100**

(Source: Appendix – 1)

Similarly likes in HBL, Loan and advance takes the major position in assets composition of NCC bank also. Cash and bank balance, Money at call and short notice, Investment & Non banking assets have irregular fluctuation. Loan and Advance, fixed assets & other assets have regular fluctuation. Total amount of these components are regularly increasing but in ratio they also vary in up & down. In the comparison of HBL & NCC, HBL has higher degree ration in cash and bank balance, lower in money at call and short notice and others are almost equal.

Figure: 4.2
Asset Combination of NCCBL



4.2 Non-Performing Loan

Loan and Advance are the most profitable of all the assets of a bank. Banks universally seeks after the assets. Non-performing loan measures the extent to which the banks have been unsuccessful in utilizing their assets for the profit generating purpose. Non-performing loan reflects the quality of assets that a bank is holding. Higher non-performing loan reflects the bad performance of the bank and bad recovery of the bank. Lending can be said to be the major source of generating income of the bank. However, it is very important to be remanded that most of the banks are failures in the world due to the shrinkage in the value of the loan and Advance. Hence, loan is known as risky assets.

Table: 4.3

Non Performing Loan (In Rs '000')

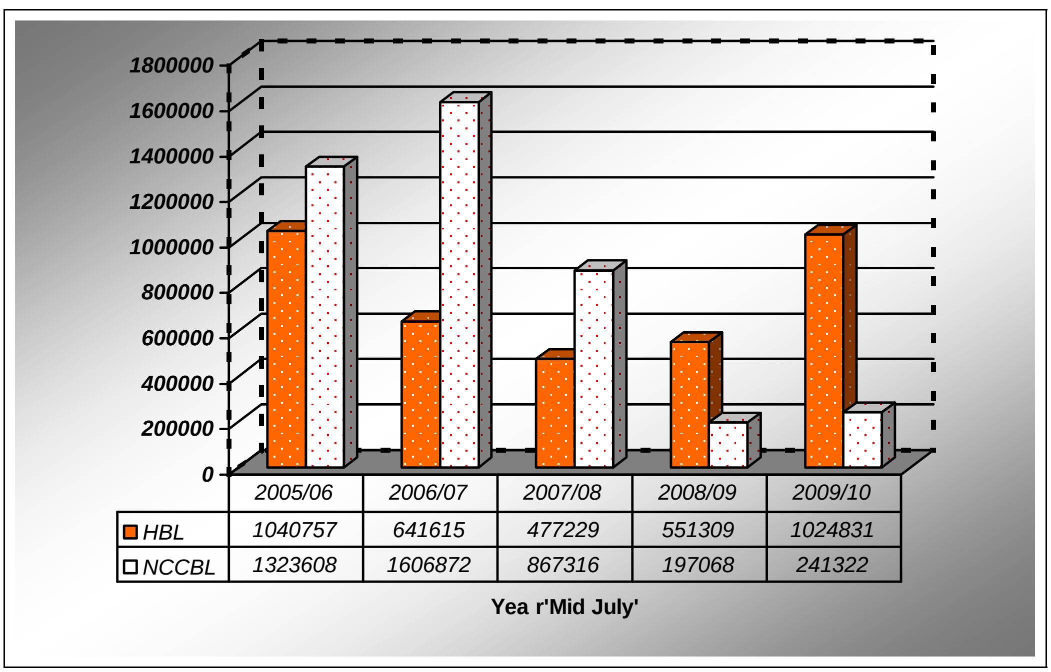
Bank	2005/06	2006/07	2007/08	2008/09	2009/10
HBL	10,40,757	6,41,615	4,77,229	5,51,309	10,24,831
NCCBL	13,23,608	16,06,872	8,67,316	1,97,068	2,41,322

(Source: Appendix – 1)

Table 4.5 depicts the non-performing loan for the study period, although single figure of NPL doesn't give any meaning but also viewing above table HBL is gradually decreasing its NPA from 2005/06 to 2007/08 which is a good symbol of bank's credit recovery power but comes at 2008/09 it is increase and stay same trend in 2009/10. Similarly, non-performing loan of NCCBL is also in fluctuation. Since 2006/07 to 2008/09, in three year non performing loan of NCCBL is rapidly decreases, which shows the bank is able to recover the loan in somewhat, but it is not complete saying because NPL ration with loan should be decreases to show the bank's loan recovery capacity. Coming in 2009/10 it increased again.

Figure: 4.3

Non Performing Loan



Above diagram 4.5 represents the comparative study of HBL and NCCBL in terms of non-performing loan. The non-performing loan of HBL is higher than the CCBL. In the comparison of HBL, NCCBL's NPA is more volatile.

4.3 Ratio Analysis between Different Variables

Ratios help to summarize large quantities of financial data and to make quantitative judgment about the firm's financial performance. The relationship between two accounting figures expressed mathematically is known as financial ratio. Even though there are many ratios, only those ratios has been calculated which are related to the subject matter. Following ratios have been computed and analyzed in this study

4.3.1 Loan and Advance to Total Asset Ratio

The ratio of Loan and Advance to total assets measures the volume of Loan and Advance in the structure of total assets. The high degree of ratio indicates the good performance of the banks in mobilizing its fund by the angle of lending functions. However in its reverse side, the high degree is representative of low liquidity ratio. Granting Loan and Advance always carries a certain degree of risk. Thus this asset of banking business is regarded as risky assets. Hence this ratio measures the management attitude towards risky assets. The low ratio is indicative of low productivity and high degree of safely in liquidity and vice versa.

Table: 4.4

Loan and Advance to Total Assets Ratio (In Rs '000')

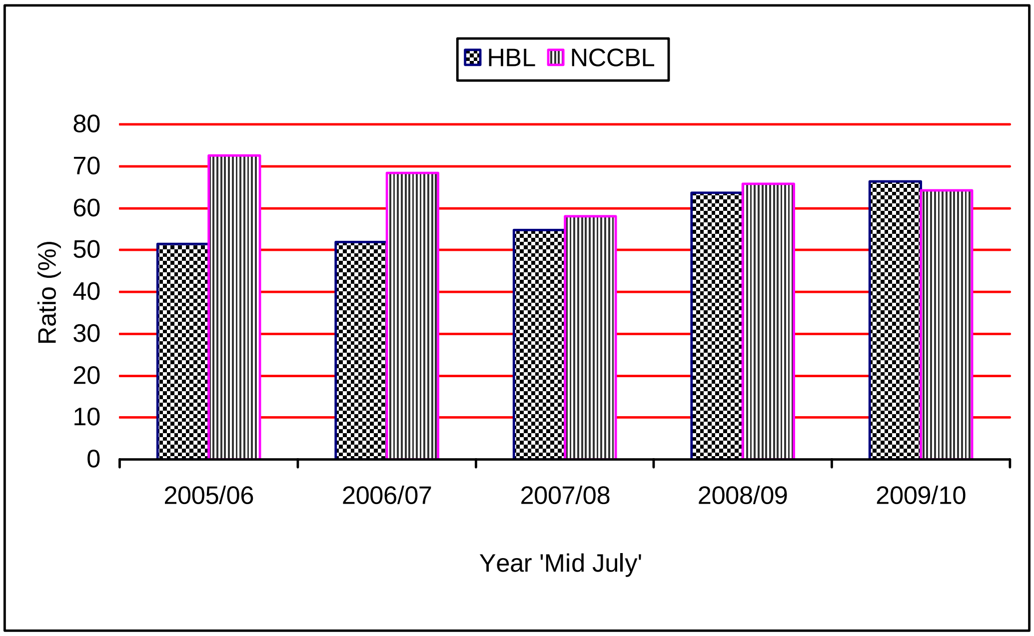
Year	HBL			NCCBL		
	Loan & Advance	Total Asset	Ratio (%)	Loan and Advance	Total Asset	Ratio (%)
2005/06	1,57,61,977	3,05,79,808	51.54	49,88,672	68,73,635	72.58
2006/07	1,77,93,724	3,43,14,868	51.85	51,22,221	74,83,150	68.45
2007/08	2,01,79,613	3,68,57,624	54.75	52,81,051	91,04,528	58.04
2008/09	2,55,19,519	4,00,46,686	63.72	71,83,680	1,09,16,334	65.81
2009/10	2,91,23,755	4,38,60,251	66.40	83,87,897	1,30,64,253	64.20
Mean			**57.65**	**Mean**		**65.82**
S. D.			**6.94**	**S. D.**		**5.38**
C. V.			**12.04**	**C. V.**		**8.17**

(Source: Appendix – 1, 2 &3)

The table no.4.4 shows the Loan and Advance to total asset of the two banks for five consecutive years. The ratio is in the fluctuating Trend. NCCBL has more irregular fluctuating then HBL. The overall ratio of the two banks has been ranged from 51.54% of HBL in 2005/06 to 66.40% in 2009/10 and 58.04% of NCCBL in 2007/08 to 72.58% in 2005/06. The mean ratio of HBL and NCCBL is 57.65% and 65.82% respectively. Hence among two banks NCCBL has the highest proportion of Loan and Advance in the total asset structure. It means the HBL has the lowest degree of investment in risky asset. Coming in latest years HBL's ration is going over then NCCBL's ratio. The Directors' Credit Committee (DCC) of HBL puts in a place a suitable monitoring mechanism ensuring a healthy loan portfolio limiting concentration risk and the same time providing an independent review of the credit portfolio of the bank. The standard deviation of HBL and NCCBL is 6.94 % & 5.38% and C.V is 12.04% & 8.17% respectively. Thus it can be interpreted that HBL has the higher deviation with high degree of variation in this ratio. NCCBL has the most consistent ratio and the least deviation during the study period. The ratio of NCCBL is higher than the HBL because of increasing and decreasing trend of Loan and Advance than HBL. Following figure no. 4.4 shows the Loan and Advance to total asset ratio of HBL and NCCBL.

Figure: 4.4

Loan and Advance to Total Assets Ratio



4.3.2 Loan and Advance to Total Deposit Ratio

This ratio is often called Credit Deposit ratio (CD ratio). The core banking function is to mobilize the funds obtained from the depositors to borrowers and earn profit and CD ratio is the fundamental parameter to ascertain fund deployment efficiency of commercial bank. In other words this ratio is calculated to find out how successfully the banks are utilizing their total deposits on credit of Loan and Advance for profit generating purpose. Greater CD ratio implies the better utilization of total deposits and better earning, however, liquidity requirements also needs due consideration. Hence 70%-80% CD ratio is considered as appropriate. This ratio is calculated by dividing total credit of Loan and Advance by total deposit of the bank.

Table: 4.5

Loan and Advance to Total Deposit Ratio (In Rs. '000')

Year	HBL			NCCBL		
	Loan & Advance	Total Deposit	Ratio (%)	Loan and Advance	Total Deposit	Ratio (%)
2005/06	1,57,61,977	2,64,90,852	59.50	49,88,672	66,18,031	75.38
2006/07	1,77,93,724	3,00,48,418	59.22	51,22,221	65,00,343	78.80
2007/08	2,01,79,613	3,18,42,789	63.37	52,81,051	73,20,236	72.14
2008/09	2,55,19,519	3,46,81,345	73.58	71,83,680	91,27,749	78.70
2009/10	2,91,23,755	3,76,11,207	77.43	83,87,897	1,08,24,693	79.54
Mean			**66.62**	**Mean**		**76.71**
S. D.			**8.39**	**S. D.**		**3.11**

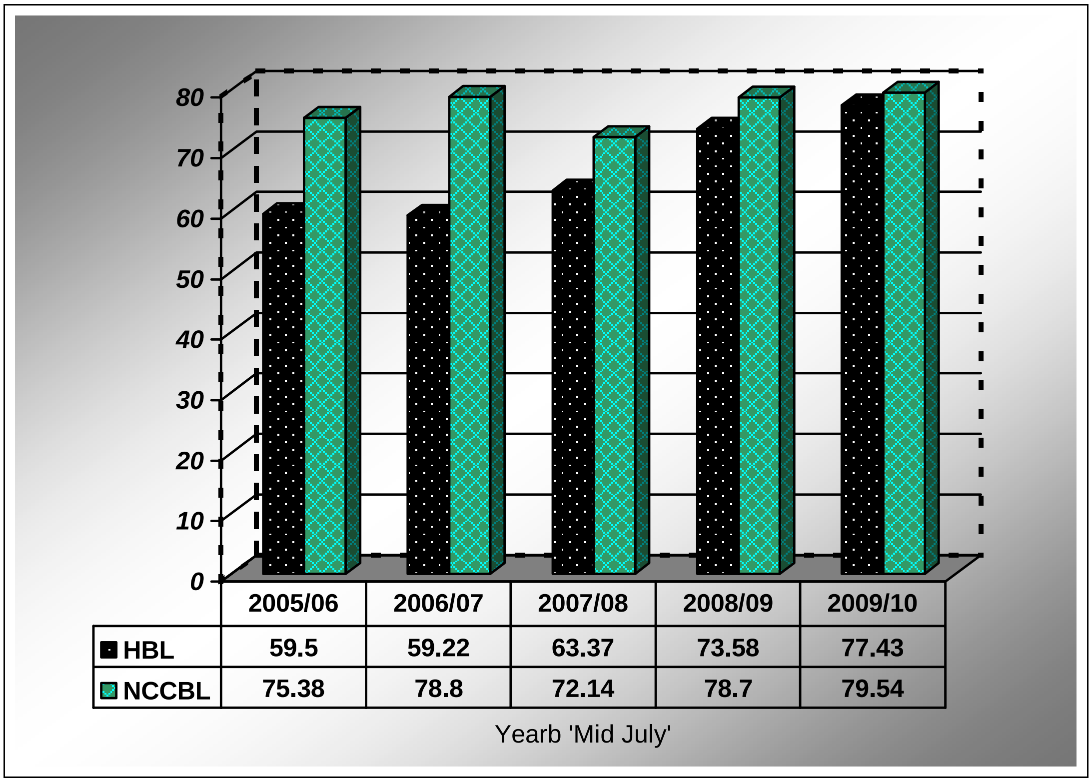
(Source: Appendix – 1, 2 & 3)

The table no. 4.5 shows the Loan and Advance to total deposit of two banks for five consecutive years. The ratio of the selected banks is fluctuating all over the observation period. The ratio of HBL is least I. e. 59.22 and highest I. e. 77.43% similarly the ratio of NCCBL is least i.e. 72.14 and highest i.e. 79.54 %.The mean ratio is 66.62% and 76.71% of HBL and NCCBL respectively. It shows that HBL could not meet the standard of C.D. ratio & NCCBL meet that. But coming in latest years HBL has also meet the standard of C.D. ratio. However NCCBL has the highest proportion of Loan and Advance in the total deposit. It signifies that NCCBL has been ahead in utilizing depositors' money on Loan and Advance with the objective of profit maximization.

The standard deviation of HBL and NCCBL is 8.39 &3.11.Thus it signified that HBL has higher deviation with higher degree of variation in this ratio than HBL. Following figure no. 4.4 shows the Loan and Advance to total deposit ratio of HBL and NCCBL.

Figure: 4.5

Loan and Advance to Total Deposit Ratio



4.3.3 Non-Performing Loan to Total Loan and Advance Ratio

This ratio is the proportion of non-performing Loan in the total loan portfolio. As per NRB directives the Loan falling under category of substandard, doubtful and loss are regarded as non-performing loan. Higher ratio implies the bad quality of assets of banks in the form of Loan and Advance. Hence lower NPL to total credit ratio is preferred. As per international standard only 5 % NPL is allowed.

Table: 4.6

NPL to Loan and Advance Ratio (In Rs '000')

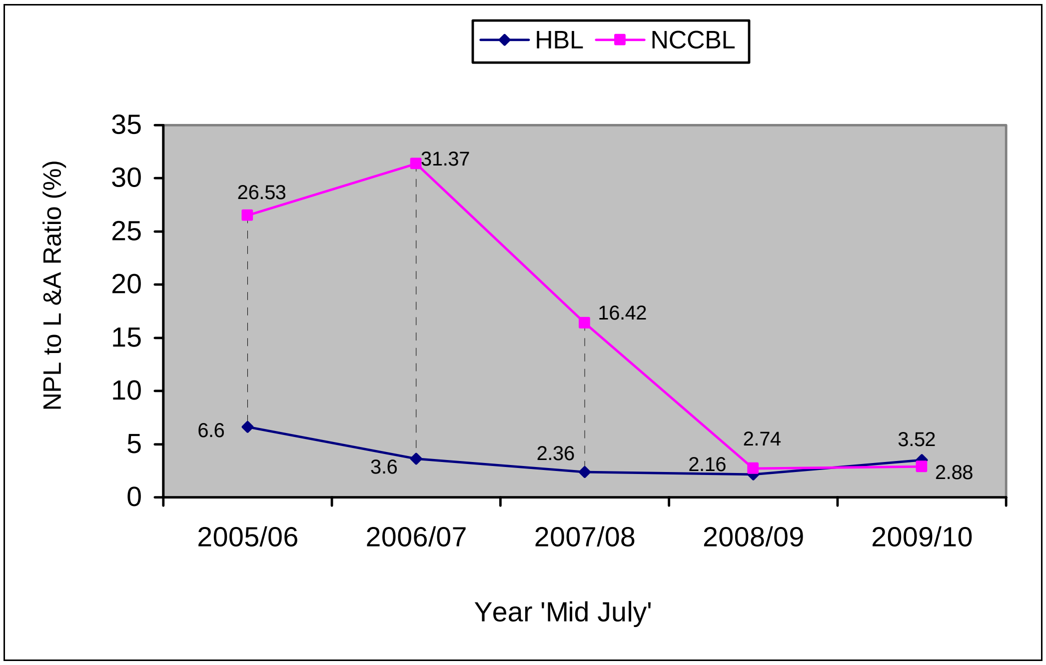
Year	HBL			NCCBL		
	NPL	Loan and Advance	Ratio (%)	NPL	Loan and Advance	Ratio (%)
2005/06	10,40,757	1,57,61,977	6.60	13,23,608	49,88,672	26.53
2006/07	6,41,615	1,77,93,724	3.60	16,06,872	51,22,221	31.37
2007/08	4,77,229	2,01,79,613	2.36	8,67,316	52,81,051	16.42
2008/09	5,51,309	2,55,19,519	2.16	1,97,068	71,83,680	2.74
2009/10	10,24,831	2,91,23,755	3.52	2,41,322	83,87,897	2.88
Mean			**3.62**	**Mean**		**15.99**
S. D.			**1.78**	**S. D.**		**13.18**

(Source: Appendix – 1, 2 & 3)

The table no. 4.6 exhibits the ratio of non-performing Loan to Loan and Advance of HBL and NCCBL for five consecutive years. The figure presents in the above table shows that HBL has the lower degree of NPL to loan and advance ratio than then NCCBL. But coming at latest year NCCBL server reduce this ratio. Decreasing trend of NPL is the result of effective credit management of banks and its efforts of recovering bad debts through establishment of recovery cell. The overall ratio has been ranged from 6.6% to 2.16% of HBL and from 31.37% to 2.87% of NCCBL. It means HBL has almost acceptable of NPL to loan ration in each study year. But NCCBL had unacceptable range in beginning of study period. NCCBL has also decrease this ration later. The ratio of FY 2008/09 & 2009/10 of NCCBL is also in acceptable figure. The mean of nonperforming loan to total loan ratio of HBL and NCCBL is 3.62 % and 15.99% respectively. The standard deviation of HBL and NCCBL is 1.78% and 13.18% and CV is 48.66% & 82.46% respectively. Following figure no. 4.5 shows the NPL to Loan and Loan and Advance ratio.

Figure: 4.6

NPL to Total Loan and Advance Ratio



4.3.4 Loan Loss Provision to Total Loan and Advance Ratio

This ratio describes the quality to assets in the form of Loan and Advance that a bank is holding. Since there is risk inherent in Loan and Advance, NRB has directed commercial banks to classify its Loan into different categories and accordingly to make provision for probable loss. Loan loss provision signifies the cushion against future contingency created by default of the borrower in payment of Loan and ensures the continued solvency of the banks. Since high provision has to be made for non-performing loan, higher provision for loan loss reflects increasing non-performing loan in volume of total Loan and Advance. It indicates how efficiently it manages loan and Advance and makes efforts to cope with probable loan loss. Higher ratio implies, higher portion of NPL in the total loan portfolio.

Table: 4.7

LLP to Loan and Advance Ratio (In Rs '000')

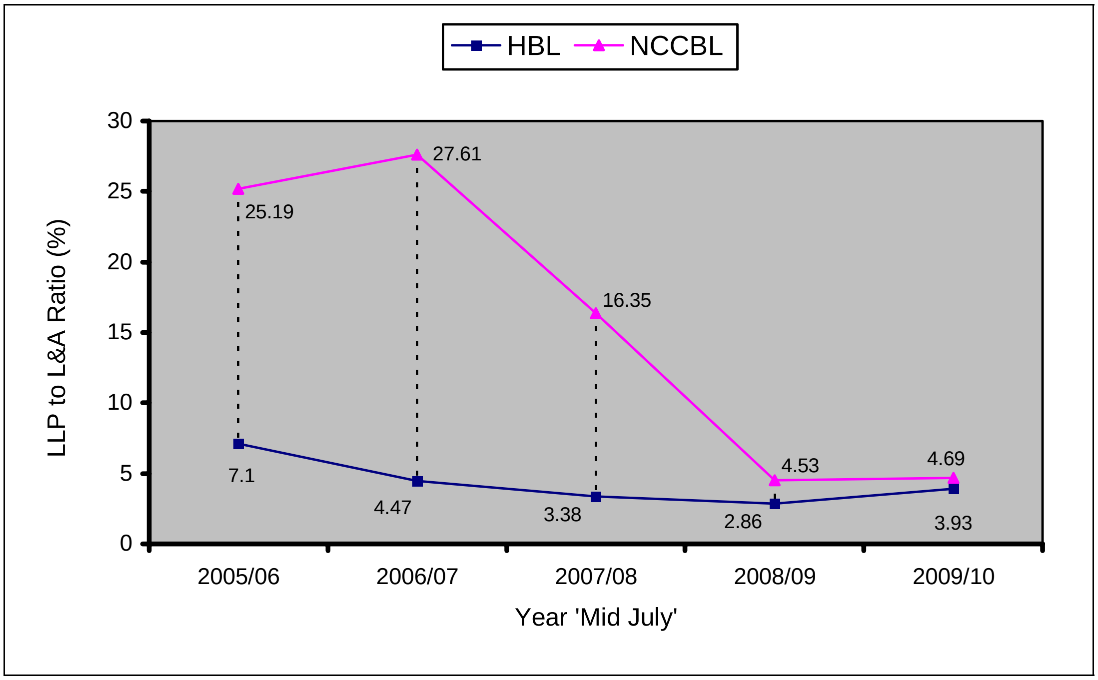
Year	HBL			NCCBL		
	LLP	Loan and Advance	Ratio (%)	LLP	Loan and Advance	Ratio (%)
2005/06	11,19,416	1,57,61,977	7.10	12,56,477	49,88,672	25.19
2006/07	7,95,727	1,77,93,724	4.47	14,14,579	51,22,221	27.61
2007/08	6,82,093	2,01,79,613	3.38	8,63,194	52,81,051	16.35
2008/09	7,26,363	2,55,19,519	2.86	3,25,486	71,83,680	4.53
2009/10	11,43,126	2,91,23,755	3.93	3,93,180	83,87,897	4.69
Mean			**4.35**	**Mean**		**16.35**
S. D.			**1.65**	**S. D.**		**11.70**

(Source: Appendix – 1, 2 & 3)

The table no. 4.7 exhibits the ratio of loan loss provision to Loan and Advance of HBL and NCCBL for five consecutive years. The figure amount presented in the above table shows that NCCBL has the highest ratio during the study period. But coming in latest years NCCBL also severely decreased this ratio. The overall ratio of HBL has been ranged from 7.10% in 2005/06 to 2.86% in 2008/09 and 27.61% in 2005/06 to 4.53% in 2008/09 of NCCBL. The mean ratio of LLP to Loan and Advance of HBL and NCCBL is 4.35% and 16.35% respectively. Higher LLP is indicative of poor and ineffective credit policy, higher proportion of non performing loan and poor performance of the economics. The greater ratio of NCCBL in 2005/06 & 2006/07 shows the higher proportion on non performing loan in total Loan but it is decreasing in the remaining years. Loan loss provision of HBL is in decreasing trend but coming in last year it is quite increased. So it can be explain that HBL has been successful to control its non performing loan resulting to decreasing loan loss provision than NCC bank. The standard deviation of HBL and NCCBL is 1.65% and 11.70% respectively. Between two banks, HBL has least deviation and least degree of variability of ratio during the study period. Following figure no. 4.7shows the relation of LLP to Loan and Advance ratio.

Figure: 4.7

Loan Loss Provision to Loan and Advance Ratio



4.3.5 Loan Loss Provision to Non-Performing Loan Ratio

This ratio determines the proportion of provision held to non-performing loan of the bank. This ratio measures up to what extant of risk inherent in NPL is covered by the total loan loss provision. As per the direction of NRB, each bank has kept 1% of the pass loan 25% of sub standard loan, 50% of doubtful loan & 100% of loss loan provision. Higher ratio signifies that the banks are safeguarded against future contingencies that may create due to non-performing loan or in other words banks have cushion of provision to cope the problem that may be cause due to NPL. Although high level of loan loss provision give negative impact in the profitability of bank but to meet future contingencies liabilities higher the ratio could take a better signal.

Table: 4.8

LLP to NPL Ratio (In Rs '000')

Year	HBL			NCCBL		
	LLP	NPL	Ratio (%)	LLP	NPL	Ratio (%)
2005/06	11,19,416	10,40,757	107.56	12,56,477	13,23,608	94.93
2006/07	7,95,727	6,41,615	124.02	14,14,579	16,06,872	88.03
2007/08	6,82,093	4,77,229	142.93	8,63,194	8,67,316	99.52
2008/09	7,26,363	5,51,309	131.75	3,25,487	1,97,068	165.16
2009/10	11,43,126	10,24,831	111.54	3,93,180	2,41,322	162.93
Mean			**123.56**	**Mean**		**122.12**
S. D.			**14.52**	**S. D.**		**38.50**

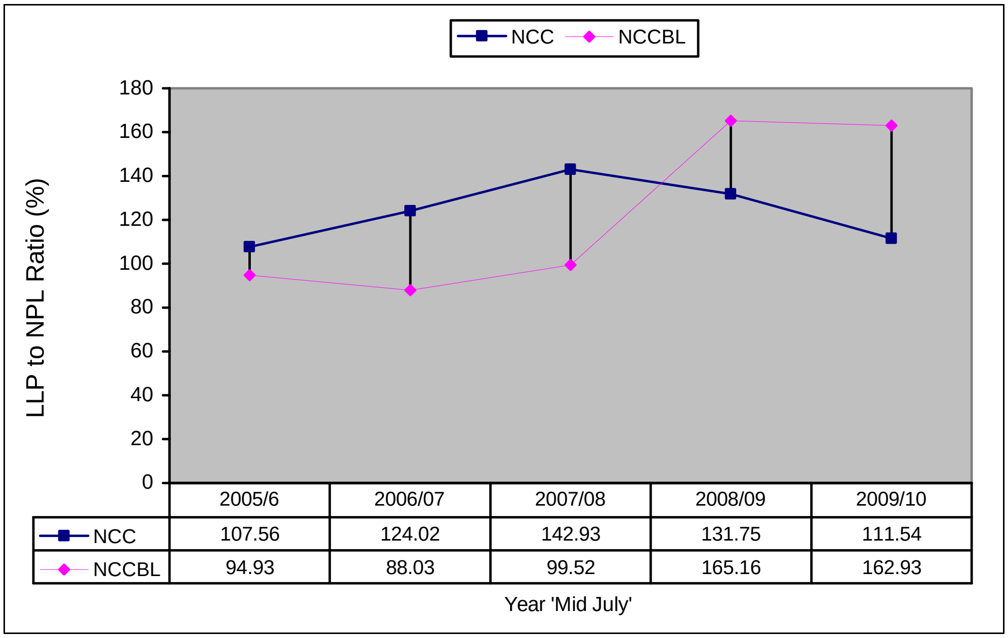
(Source: Appendix – 1, 2 & 3)

The table no. 4.5 exhibits the ratio of provision held to non performing loan of HBL and NCCBL for the five consecutive years. The figure represented in the above table shows that HBL has the highest ratio than NCCBL leaving the FY year 2004/05. The overall ratio has been ranged from 207.92% to 121.36% of HBL and 181.56% to 105.52% of NCCBL. The mean ratio of HBL and NCCBL is 163.27% and 128.08% respectively. The ratio of HBL is significantly higher in comparison of NCCBL and portrays that the banks has adequate provision against non performing loan. *(Although at here Loan loss provision figure is the total provisional figure of performing and non-performing loan)*

The standard deviation of HBL and NCCBL is 41.61% & 31.93% and CV is 25.48% and 24.92 respectively. Thus it signifies that HBL has highest deviation along with the highest degree of variation in this ratio. Following figure no. 4.8 shows the Loan Loss Provision to Non-Performing Asset ratio of above table.

Figure: 4.8

Loan Loss Provision to Non- Performing Loan Ratio



4.3.6 Net Profit to Loan Loss Provision

This ratio shows the relationship of non-performing loan with loan loss provision of the company. It shows that how is the provision of unproductive (non-performing) loan's portion in company's net profit. Higher the non performing assets pull higher value on its provision and higher provisions push its net profit below. So net profit and non performing assets are directly related. This ratio is calculated by dividing net profit of the bank by total LLP. Net profit refers to that profit which is obtained after all types of deduction like employee's bonus, tax, provision etc. Hence this ratio measures bank's profitability with respect loan loss provision. Higher the ratio shows the better performance of the bank.

Table: 4.9

Net Profit to LLP Ratio (Rs. '000')

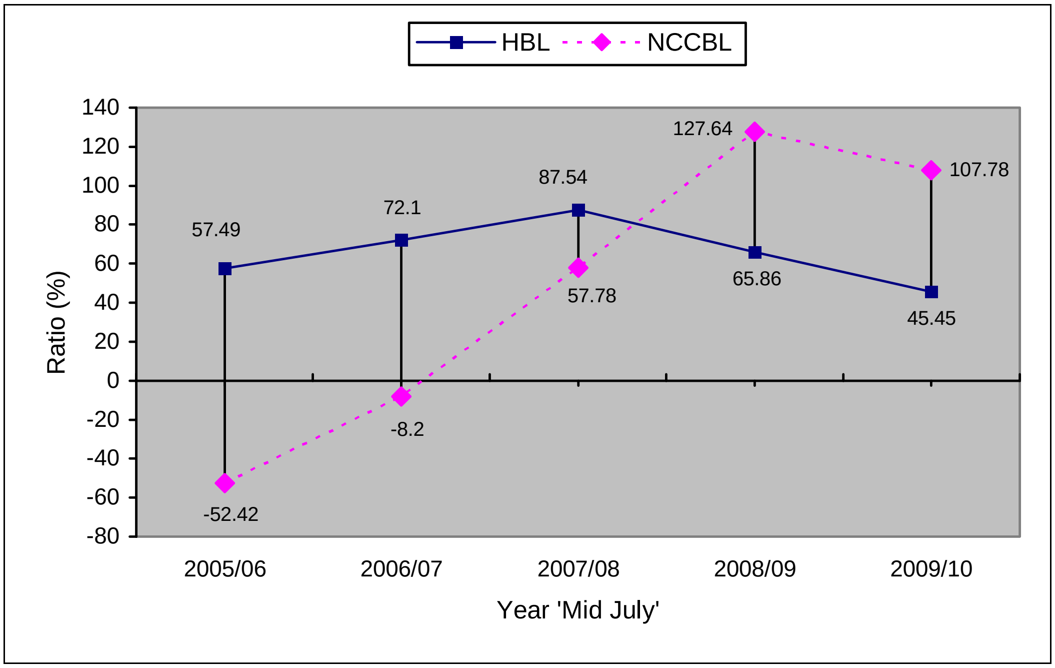
Year	HBL			NCCBL		
	Net Profit	Loan Loss Provision	Ratio (%)	Net Profit	Loan Loss Provision	Ratio (%)
2005/06	4,57,458	7,95,727	57.49	(6,58,614)	12,56,477	(52.42)
2006/07	4,91,823	6,82,093	72.10	(1,15,928)	14,14,579	(8.20)
2007/08	6,35,869	7,26,363	87.54	4,98,755	8,63,194	57.78
2008/09	7,52,835	11,43,126	65.86	4,15,461	3,25,487	127.64
2009/10	5,08,798	11,19,416	45.45	4,23,773	3,93,180	107.78
Mean			**65.69**	**Mean**		**70.76**
S. D.			**15.78**	**S. D.**		**47.50**

(Source: Appendix – 1, 2 & 3)

The table no. 4.6 exhibits the ratio of net profit to loan loss provision of HBL and NCCBL for five consecutive years. The figure represented in the above table shows that HBL has the highest ratio during the study period. The ratio of both banks is fluctuating. The ratio of HBL has 57.49% in 2005/06, 72.10% in 2006/07, 84.54% in 2007/08, and 65.18% in 2008/09, 45.45% in 2009/10. The ratio of NCCBL is in negative trend in first two years because the bank has negative profit these years that's why the ration is also in negative figure. The overall ratio of NCCBL is ranged from –(52.42%) in 2005/06 to 127.64% in 2008/09. The mean ratio of both banks is 65.69 and 70.76 respectively. Only seen mean of ratio NCCBL gives better result than HBL but it is not perfect analysis we should watch figure amount also. The standard deviation of HBL and NCCBL is 15.78 & 47.50 y. It shows that NCCBL has higher ratio fluctuation than HBL in net profit to loan loss provision. One reason of higher fluctuation is higher uncertainty level that's why higher fluctuation can't take a good symbol. Following figure no. 4.9 shows the net profit to loan loss provision ratio in chart.

Figure: 4.9

Net Profit to Loan Loss Provision Ratio



4.4 Correlation Analysis

The correlation analysis generally used to describe to which one variable is related to another. In statistics it is used in order to depict the covariance between two or more variables (dependent & non dependent variable). It helps to determine whether;

- positive or negative relation exit
- relation is significant or not.
- establish cause and relation if any

The statistical tool, 'correlation analysis' is preferred in this study to identity relationship between loan & advance and deposit, loan loss provision and loan and advance, NPL and Net profit, whether the relation is significant or not.

4.4.1 Correlation between Total Deposit and Loan & Advance

Deposit is one of the major items of liability side and Loan and Advance is the major item of the asset side of balance sheet of bank. The correlation coefficient between Loan and Advance and deposit describes the degree of relationship between these two variables. Here deposit is the independent variable and Loan and Advance is dependent variable. Hence how a unit increase in deposit impact in the volume of Loan and Advance is exhibited by this correlation coefficient. (Appendix 4, 5)

Table: 4.10

Correlation between Total Deposit and Loan & Advance

Bank	Correlation coefficient(r)	Probable Error(P.E.)	6* P. E.
HBL	0.980	0.012	0.072
NCCBL	0.991	0.005	0.030

(Source: Appendix – 4 & 5)

The table no. 4.10 shows the correlation coefficient, probable error and six times value of P.E. of two banks for loan & advance and deposit. It shows there is highly positive correlation between Loan and Advance and deposit of HBL and NCCBL. The respective value of correlation coefficient of HBL 0.980 and 0.991 which are greater than six times value of P. E. hence it can be concluded that correlation between these two variables in HBL and NCCBL are significant. That means increment in volume of deposit leads to increment in Loan and Advance. However the deposit and Loan and Advance of HBL have lesser degree of relationship in comparison to NCCBL.

4.4.2 Correlation between Loan & Advance and Non Performing Loan

The correlation between NPL and loan and Advance shows the degree of relationship between these two items. How a unit increment in Loan and Advance affect the non performing loan measured by this correlation. Here Loan and Advance is independent variable and NPL is dependent variable. (Appendix 4, 5)

Table: 4.11

Correlation between Loan & Advance and Non Performing Loan

Bank	Correlation coefficient(r)	Probable Error(P.E.)	6* P. E.
HBL	0.07	0.30	1.80
NCCBL	-0.88	0.068	0.405

(Source: Appendix – 4 & 5)

The table no. 4.11 explains that the relationship Loan and Advance and LLP. Here the correlation of HBL is 0.07. Looking only correlation it can say that NPL and Loan and advance has positive correlation but correlation (r) is less than 6 times the value of its P.E. and even less than P.E, so the correlation coefficient is insignificant. In other words, the total NPL of HBL is not correlated with the Loan and Advance during the study period. In NCCBL, correlation coefficient is negative (-0.88). Although NPL and loan and advance does not have negative relation but here this is because of irregular and severe increasing and decreasing trend of NPL. It shows perfectly negative correlation or insignificant.

4.4.3 Correlation between Non Performing Loan and Loan Loss Provision

The correlation between LLP and non performing loan describes the relationship between LLP and NPL. How a unit increases in NPA effect the LLP is exhibited by this correlation. Here non performing asset is independent variable and LLP is dependent variable. As earlier mentioned NPA are the loan falling on the category of substandard, doubtful and bad loan and the respective provisioning requirement is 25%, 50% and 100%. Higher the NPL higher will be the provisioning amount. (Appendix 4, 5)

Table: 4.12

Correlation between Non Performing Loan and Loan Loss Provision

Bank	Correlation coefficient(r)	Probable Error(P.E.)	6* P. E.
HBL	0.997	0.002	0.012
NCCBL	0.998	0.001	0.006

(Source: Appendix – 4 & 5)

The table no.4.12 explains the relationships between LLP and NPL (Appendix) Here both of banks have positive correlation between NPL and LLP. That means increment in NPL leads to increment in LLP. The correlation coefficient of HBL is 0.997 and it's P.E and 6.P, E is 0.002 and 0.012 The correlation coefficient is higher than the value of P.E and six times the value of P.E. Hence there is positive perfect correlation between NPL and LLP of HBL. In the case of NCCBL correlation is also higher than P.E and six items the value of P.E .The value of correlation coefficient is 0.998.The value of P. E and 6.P.E of NCCBL are 0.001 and 0.006 respectively. Hence its correlation coefficient is said to be significant and reliable. So it can be interpreted that there is high degree of positive correlation between NPL and LLP on NCCBL.

4.4.4 Correlation between Loan Loss Provision and Net Profit

The correlation between Net profit and loan loss provision describes the relationship between net profits. Although increasing or decreasing of LLP decreased and increased in total profit. So net profit & LLP has negative relation but some time due to the major effect of other factors in net profit the effect of LLP became less. Here net profit is dependent and LLP is in dependent variable. (Appendix 4, 5)

Table: 4.13

Correlation between Loan Loss Provision and Net Profit

Bank	Correlation coefficient(r)	Probable Error(P.E.)	6* P. E.
HBL	-0.714	0.148	0.887
NCCBL	-0.756	0.129	0.774

(Source: Appendix – 4 & 5)

The table no.4.13 explains the relationships between LLP and NPL. Here HBL shows the positive correlation and NCCBL shows the negative correlation between net profit and loan loss provision. The correlation coefficient of HBL is -0.714. It shows negative correlation between net profit and loan loss provision. It means LLP effects in net profit. Increasing in LLP would decreased total net profit and vice versa. But r < 6PE (-0.714 < 0.887). So there is insignificant relation between net profit and LLP. And similarly correlation of net profit and LLP in NCCBL is -0.756. It is high degree negative correlation. r<PE, (-0.756<0.129) so it is also insignificant. It means that increasing or decreasing of LLP brought opposite effect in net profit.

4.5 Trend Analysis

Trend analysis is a statistical tool, which helps to forecast the future values of different variables on the basis of past tendencies of variable. Trend analysis informs about the expected future values of various variables. Amongst the various methods to determine trend the least square method is widely used in practices. Hence in this study also least square method has been adopted to measure the trend behaviors of these selected banks. However, trend analysis is based on the assumption that past tendencies continues in the future. Under this heading the effort has been made to calculate trend values of following variables from mid July 2006 to mid July 2012.

4.5.1 Trend Analysis of Loan and Advance

Assuming value of loan and advance as a depending variable (Y) and time variable, year in non depending variable (X), Values of average Loan and Advance (a) is constant value & changes rate of Loan and Advance (b) and trend values of Loan and Advance of two banks for five years from mid July 2005/06 to mid July 2011/12 are as follows. (Appendix 6, 7)

Table: 4.14

Trend Values of Loan and Advance (In Rs'000')

Fiscal Year (Mid July)	Year (X)	HBL a = 1,82,30,782 b = 34,44,935	Annual % Change	NCCBL a = 35,34,734 b =8,85,990	Annual % Change
2005/06	1	2,16,75,717		44,20,724	
2006/07	2	2,51,20,652	15.89	53,06,714	20.04
2007/08	3	2,85,65,587	13.71	61,92,704	16.70
2008/09	4	3,20,10,522	12.06	70,78,694	14.31
2009/10	5	3,54,55,457	10.76	79,64,684	12.52
2010/11	6	3,89,00,392	9.72	88,50,674	11.12
2011/12	7	4,23,45,327	8.86	97,36,664	10.01
Mean			11.83	Mean	14.12
S.D			2.63	S.D.	3.75

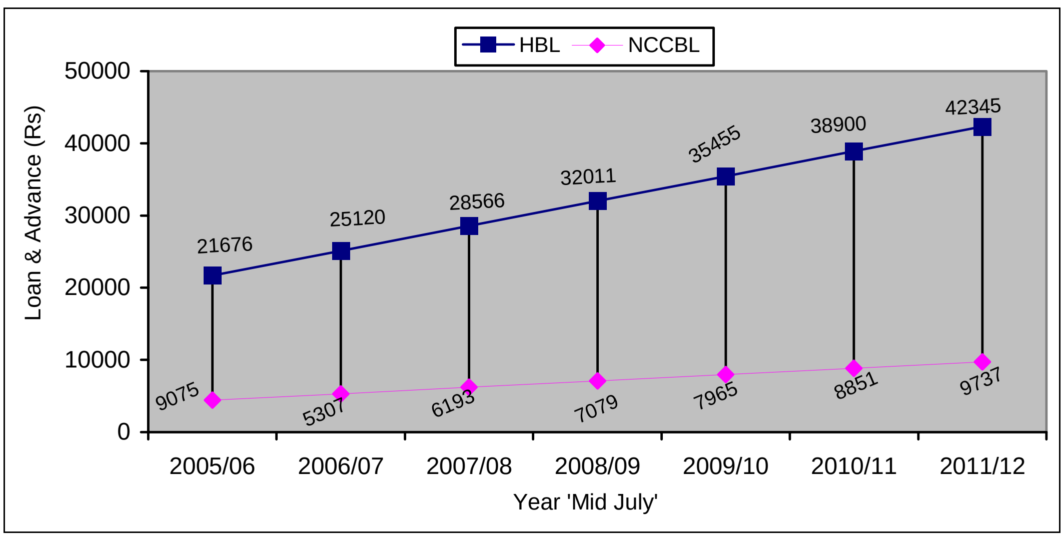
(Source: Appendix -6 & 7)

The table no. 4.14 shows that both banks have the increasing trend of Loan and Advance. Hence expected Loan and Advance of HBL are supposed to increase from Rs. 2,16,75,717 thousand in 2006 to Rs 4,23,45,327 thousand in 2012. The average Loan and Advance of NCCBL is Rs. 35,34,734 thousand. Accordingly Loan and Advance of NCCBL is expected to increase from Rs. 44,20,724 thousand in 2006 to Rs. 97,36,664 thousand in 2012.

Both of the bank's trend line of Loan and Advance show fluctuate trend. From above table it can be conclude that the amount of loan and advance has increased every year but this increment is in decreasing trend. Both of them have almost equal degree of increment ratio but NCCBL has higher rate (11.83%) of increment than that of HBL (14.12%). Following figure no 4.10 & 4.11 represent the trend line of Loan and Advance of two banks seven consecutive years.

Figure: 4.10

Trend of Loan and Advance



4.5.2 Trend Analysis of Non Performing Loan

The calculated values of average Non Performing Loan (a), rate of change of NPL (b) and trend values of NPL for next 5 years from mid July 2005/06 to mid July 2011/12 are as follows (Appendix 6, 7)

Table: 4.15

Trend Value of Non-Performing Loan
(In Rs '000')

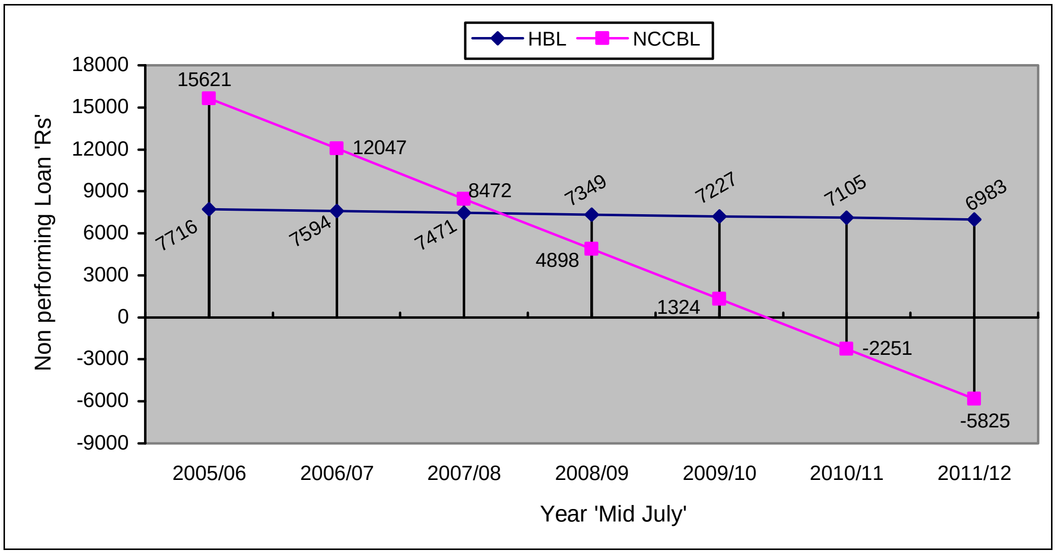
Year (Mid July)	Year	HBL a = 7,83,796 b = -12,216	Annual % Decrease of NPL	NCCBL a = 1919550 b = -3,57,437	Annual % Decrease of NPL
2005/06	1	7,71,579		15,62,112	
2006/07	2	7,59,364	-1.58	12,04,675	-22.88
2007/08	3	7,47,148	-1.61	8,47,237	-29.67
2008/09	4	7,34,932	-1.63	4,89,800	-42.19
2009/10	5	7,22,717	-1.66	1,32,362	-72.98
2010/11	6	7,10,500	-1.69	0	-100.00
2011/12	7	6,98,285	-1.72	0	0
Mean			**-1.65**	**Mean**	**-53.54**
S.D			**0**	**S.D**	**32.31**

(Source: Appendix- 6 & 7)

The table no. 4.15 shows that both bank HBL & NCCBL has decreasing trend of Non Performing Loan. , the average NPL of HBL is Rs. 7,83,796 thousand which is decreasing every year at the rate of Rs.12,216 thousand. The expected NPL of HBL is Rs.7, 71,579 thousand in 2005/06, which is decrease to Rs 6,98,285 thousand in 2012. The expected NPL decreasing trend ratio of HBL is -1.65 & consistent with 0 standard deviation. If this trend may goes continues, HBL will severally affected by the problem of slow trend of decreasing non-performing loan. Similarly the average fixed NPL of NCCBL is Rs.19,19,550 thousand, which is decreasing at the rate of Rs.-3,57,437 thousand each year. The expected NPL of NCCBL is supposed to decrease from Rs 15,62,112 thousand in 2005/06 and after 2009/10 this trend show it will go down then zero. It means there will no NPL in bank after 2009/10. Due to NCCBL's recovery efforts through establishment of recover cell, its NPL has goes down in recent years. The average NPL decreasing ratio of NCCBL is -53.54, with standard deviation 32.31% respectively, where this ration on HBL is -1.65 with 0 standard deviation. It shows that NCCBL's controlling system of NPL is going more effective than HBL. This may be due to good credit control system of NCCBL. Following figure no. 4.11 represents the trend line of non-performing loan of two banks.

Figure: 4.11

Trend of Non Performing Loan



4.5.3 Trend Analysis of Loan Loss Provision

The calculated values of average loan loss provision (a) rate of change of LLP (b) and trend values of LLP for 5 years from mid July 2005/06 to mid July 2011/12 of the two banks are as follows (Appendix 6, 7)

Table: 4.16
Trend Value of Loan Loss Provision (In Rs. '000')

Year (Mid July)	Year (X)	HBL a =8,99,928 b = -2,194.4	Annual % decreases in LLP	NCCBL a = 16,95,289 b = -2,81,568	Annual % decreases in LLP
2005/06	1	8,97,734		14,13,721	
2006/07	2	8,95,539	-0.2444	11,32,152	-19.91
2007/08	3	8,93,345	-0.2450	8,50,583	-24.87
2008/09	4	8,91,151	-0.2456	5,69,015	-33.10
2009/10	5	8,88,956	-0.2462	2,87,446	-49.48
2010/11	6	8,86,762	-0.2469	5,877	-97.95
2011/12	7	8,84,567	-0.2475	0	0
		Mean	**-0.2459**	**Mean**	**-45.06**
		S.D	**0.00**	**S.D**	**31.62**

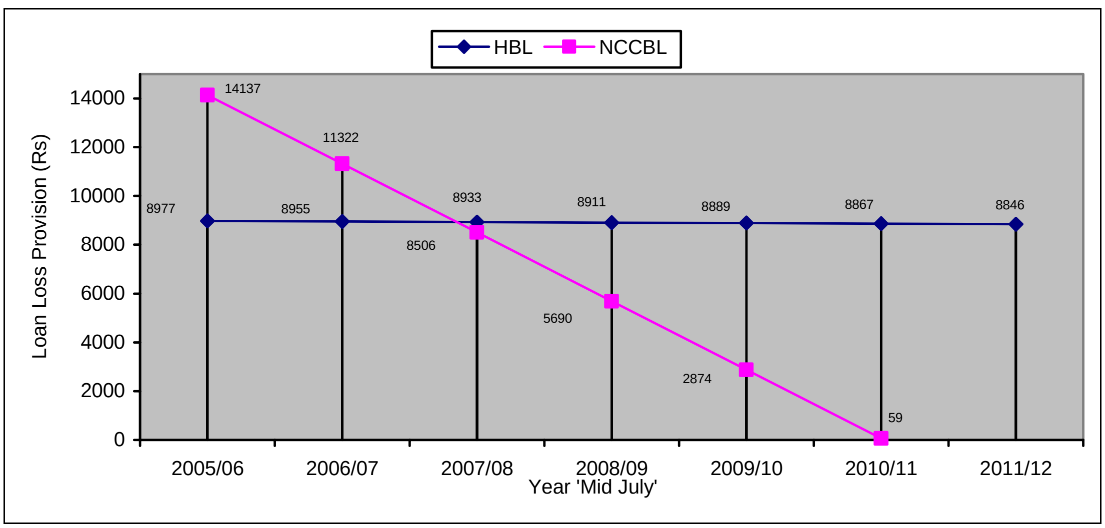
(Source: Appendix – 6&7)

The table no. 4.16 shows that both banks have decreasing trend of LLP while NCCBL has aggressively reduce its LLP & HBL has low trend of decreasing of LLP. The average LLP of HBL is Rs. 8,99,928 thousand which is decreasing every year at the rate of Rs. -2,194.4 thousand. Hence the expected LLP of HBL is supposed to decrease from Rs 8,97,734 thousand in 2005/06 to Rs. 8,84,567 thousand in 2011/12. The average LLP of NCCBL is Rs. 16,95,289 thousand which is decreasing every year at the rate of Rs. -2,81,596 thousand. Hence the expected LLP of NCCBL is supposed to Rs. 5,877 thousand in 2010/11 which is decreased to Rs. 0 in 2010/11 and after that.

The slow decreasing trend value of LLP of HBL indicates the high level of provision should be deducted from profit. Following figure no. 4.12 shows the trend line of LLP of the both banks for 5 consecutive years.

Figure: 4.12

Trend of Loan Loss Provision



4.5.4 Trend Analysis of Net Profit

The calculated values of average Net Profit (a), rate of change of Net Profit (b) and trend values for 7years from mid July 2005/06 to mid July 2011/12 of the two banks are as follows (Appendix 6, 7).

Table: 4.17

Trend Value of Net Profit (In Rs. '000')

Year (Mid July)	HBL a= 460249 b=36,369	Annual Net Profit Change %	NCCBL a= ,-6,96,156 b=,2,69,616	Annual Net Profit Change %
2005/06	4,96,618		-4,26,543	
2006/07	5,32,987	7.32	-1,56,927	-63.20
2007/08	5,69,357	6.82	1,12,689	-171.81
2008/09	6,05,726	6.38	3,82,306	239.26
2009/10	6,42,095	6.00	6,51,922	70.52
2010/11	6,78,464	5.66	9,21,538	41.36
2011/12	7,14,833	5.36	1,191,155	29.26
Mean		**6.26**	**Mean**	**24.23**
S.D.		**0.73**	**S.D.**	**137.68**

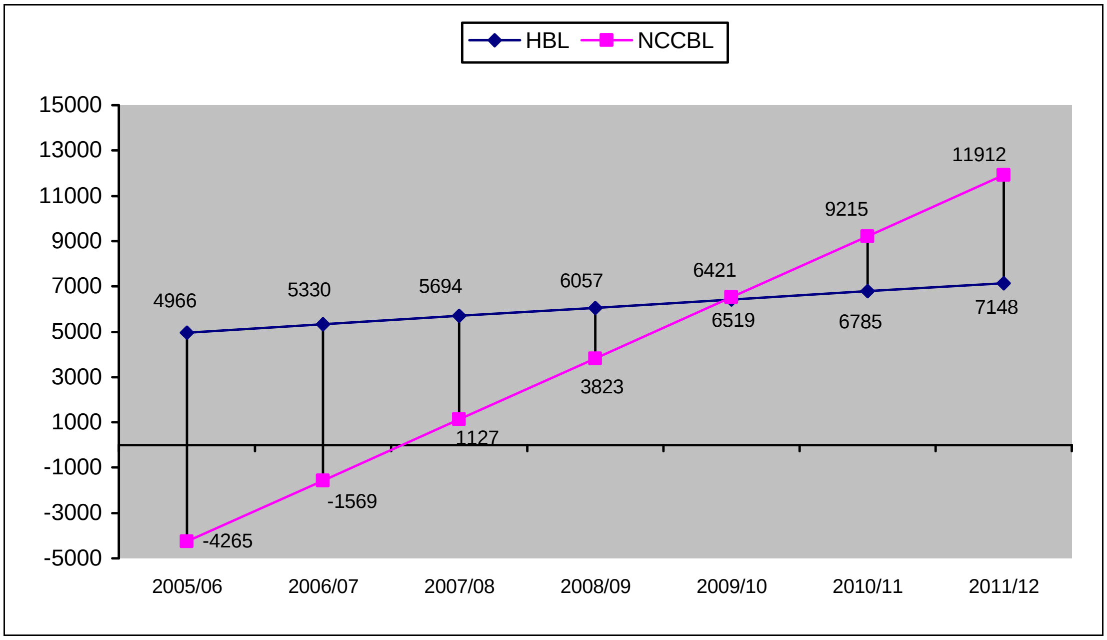
(Source: Appendix – 6&7)

The table no. 4.17 shows that both banks have the increasing trend of net profit. The average net profit of HBL is Rs. 4,60,249 thousand and increasing every year at the rate of Rs.36,369 thousand. Hence expected net profit of HBL is supposed to increase from Rs.4,96,618 thousand in 2005/06 to Rs.7.14.833 thousand in 2011/12. The average net profit of NCCBL is Rs. -696159.5 thousand, it is constant in graph which increase by Rs. 2,69,616 thousand every year. Hence expected that net profit of NCCBL is supposed to increase from Rs. -4, 26,543 thousand in 2005/06 & Rs.11,91,154 thousand in 2011/12. The 7 years average net profit increment of HBL is 6.26% & NCCBL is 24.23% with standard deviation 0.73 & 210.84 respectively.

The above table depicts that NCCBL is ahead of in generating net profit and its rate of increment of net profit is higher than that of HBL in terms of rapidly increases in net profit of previous years. Following figure no. 4.13 represent the trend line of net profit of two banks for 7 consecutive years and another shows the trend of Net profit change in %.

Figure: 4.13

Trend of Net Profit



4.6 Analysis of Loan Classification and Provisioning as per NRB Directives

As per the latest directive, Loan and Advance are to be classified into four categories of Pass, Substandard, Doubtful and Loss with respective provisioning 1%, 25%, 50% and 100% on the basis of ageing of past dues. Besides this in case of insured priority and deprived sector loan, the provisioning requirement is one-fourth of that of normal loan loss provisioning requirement. Hence the respective provisioning requirement for pass, substandard, doubtful and loss loan are 0.25%, 6.25%, 12.5% and 25% of the outstanding loan. In case of rescheduled or restructured or swapped loan, if such Loan fall under pass category, the minimum provisioning requirement is 12.5%and if this is the case of priority sector loan, 3.125% provisioning should be provided for probable loss. Further if the loan is granted only against personal guarantee, where the loan falls under the category of pass, substandard and doubtful, in addition to the normal loss provision applicable for the category, an additional 20% must be provided. Hence in this case the provisioning required for pass, substandard and doubtful is 21%, 45% and 70% respectively. Hence it can be concluded that loan loss provision required for different category of loan ranges as follows:

Loan Category	**Loan Loss Provision** (Ranges From)
Pass	0.25% to 21.00%
Substandard	6.25% to 45.00%
Doubtful	12.50% to 70.00%
Loss	25.00% to 100.00%

In addition to overdue basis, Loan and Advance have to be classified as loss on the basis of other factors like credit information beraue (CIB) blacklisting, collateral value, misuse of fund, bankruptcy of the borrower etc. The loan falling under pass category is termed as performing loan and the loan falling under remaining three categories is termed as non performing loan. The LLP set aside for performing loan is defined as General Loan Provision (GLLP) and LLP aside for non performing loan is defined as Specific Loan Loss Provision (SLLP). Besides this, if a bank provides any provision in excess of the proportion as required under the directives of NRB, the whole amount of such additional provision may be included in GLLP.

The directive issued in 2001, regarding loan classification and provisioning was effective from the fiscal year 2001/02. Here the five year data regarding loan classification and provisioning of two banks as per the directive issued in 2001 has been analyzed as follows.

Table: 4.18

Loan Classification and Provisioning of HBL as on Mid July 2006 (In Rs '000')

Particulars	**As on mid July 2005/06**				
	Loan	**% of Total Loan**	**LLP**	**% of Total LLP**	**% of LLP to Loan**
Performing Loan					
Pass	1,40,55,104	89.17	1,41,355	12.63	**1**
Restructure	6,66,114	4.23	53,456	4.77	**8**
Total performing Loan	*1,47,21,218*	*93.40*	*1,94,811*	*17.40*	
Non performing Loan					
Sub standard	1,07,228	0.68	61,954	5.53	**58**
Doubtful	2,28,498	1.45	1,55,755	13.91	**68**
Loss	7,05,032	4.47	7,06,896	63.15	**100**
Total Non performing Loan	*10,40,758*	*6.60*	*9,24,605*	*82.60*	
Total	1,57,61,977	100.00	11,19,416	100.00	

(Source: Appendix – 1)

The table no. 4.18 shows different categories of Loan and Advance and the provision provided to each category of Loan and Advance of HBL for the fiscal year 2005/06. In 2005/06, the total loan outstanding of HBL was Rs. 1,57,61,977 thousand. Out of the total loan, pass, rescheduling & restructured, substandard, doubtful and loss loan comprises 89.17%, 423%, 0.68%, 1.45%, 4.47% & 6.67% respectively. Hence it is clear that 93.40% of total loan is performing loan and remaining 6.40% is non performing loan. Similarly out of total provision provided of Rs.1119416 thousand, 12.63% comprises for pass loan and 4.78% comprises for rescheduling/restructure loan and the provision provided for substandard, doubtful and loss loan comprises 5.53%, 13.91% and 63.15% respectively of total LLP. Hence it can be understood that the General LLP comprises 17.40% and Specific LLP comprises 82.60% of total LLP. Similarly the LLP ratio with different classes of loan, pass loan, restructure loan, sub-standard loan, default loan and loss loan are 1%, 8%, 58%, 68%, 100%. Following figures 4.14 & 4.15 show the loan categorization of HBL loan and provision for fiscal year 2005/06.

Figure: 4.14

Loan Categorization of HBL as on Mid July 2006

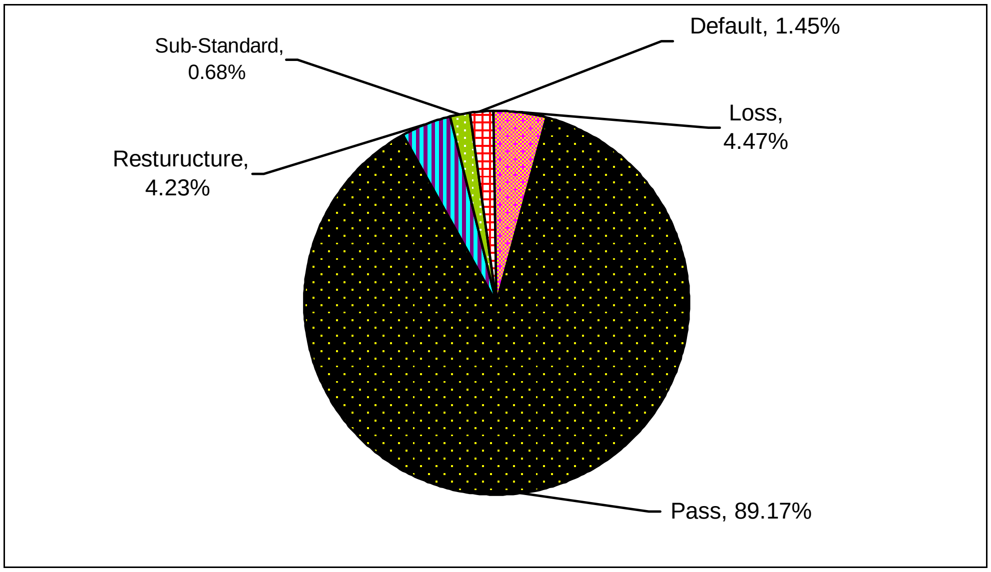


Figure: 4.15
LLP Categorization of HBL as on Mid July 2006

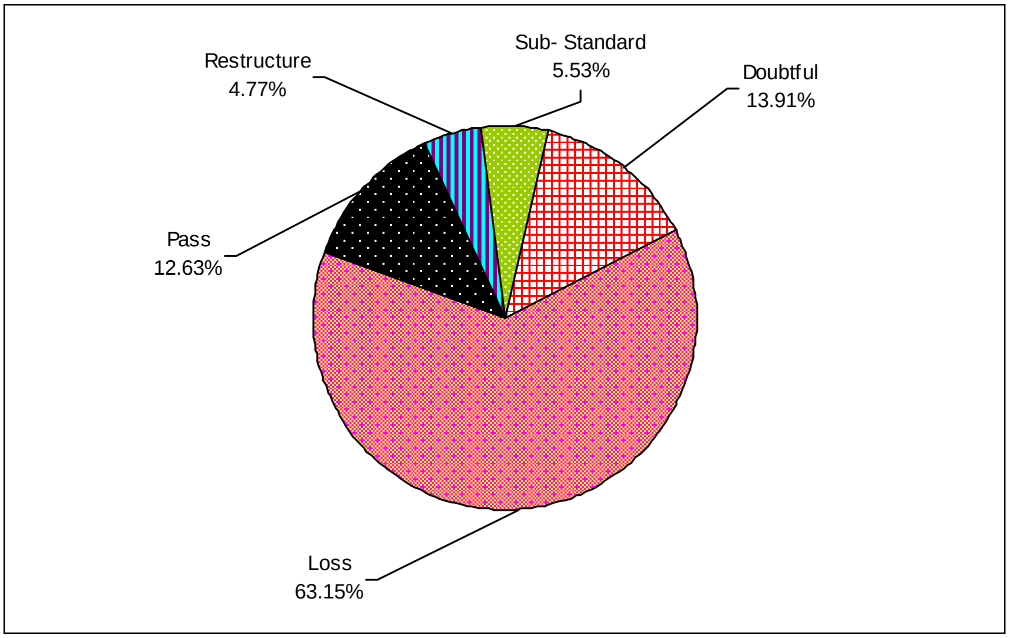


Table: 4.19

Loan Classification and Provisioning of HBL as on Mid July 2007 (In Rs '000')

Particulars	**As on mid July 2006/07**				
	Loan	**% of Total Loan**	**LLP**	**% of Total LLP**	**% of LLP to Loan**
Performing Loan					
Pass	1,66,97,714	93.84	1,67,225	21.02	**1**
Restructure	4,54,394	2.25	1,40,064	17.60	**31**
Total performing Loan	*1,71,52,108*	*96.39*	*3,07,289*	*38.62*	
Non performing Loan					
Sub standard	72,076	0.41	18,349	2.39	**25**
Doubtful	1,94,976	1.10	97,489	12.20	**50**
Loss	3,74,563	2.11	3,72,599	46.79	**100**
Total Non performing Loan	*6,41,615*	*3.61*	*4,88,437*	*61.38*	
Total	1,77,93,724	100.00	7,95,726	100.00	

(Source: Appendix – 1)

As shown in earlier table, table no.4.19 also shows different categories of Loan and Advance and the provision provided to each category of Loan and Advance of HBL for the fiscal year 2006/07. In 2006/07, the total loan outstanding of HBL was Rs.1,77,93,724 thousand. Out of the total loan, pass, restructure, sub-standard, doubtful and loss loan comprises 93.85%, 2.55%, 1.10% and 2.11% respectively. Hence it is clear that 96.39% of total loan is performing loan and remaining 3.61% is non performing loan. Similarly out of total provision provided of Rs.7,95,726 thousand, 21.02%, comprises for pass loan, 17.60% for restructure loan and the provision provided for substandard, doubtful and loss loan comprises 2.39%, 12.20% and 46.79% respectively making provision for non performing loan 61.38% of total LLP. Hence it can be understood that the General LLP comprises 38.62% and Specific LLP comprises 61.38% of total LLP. Similarly the LLP ratio with different classes of loan, pass loan, restructure loan, sub-standard loan, default loan and loss loan are 1%, 8%, 58%, 68%, 100%. Following figures 4.16 & 4.17 show the loan categorization of HBL and loan loss provision for fiscal year 2006/07.

Figure: 4.16

Loan Categorization of HBL as on Mid July 2007

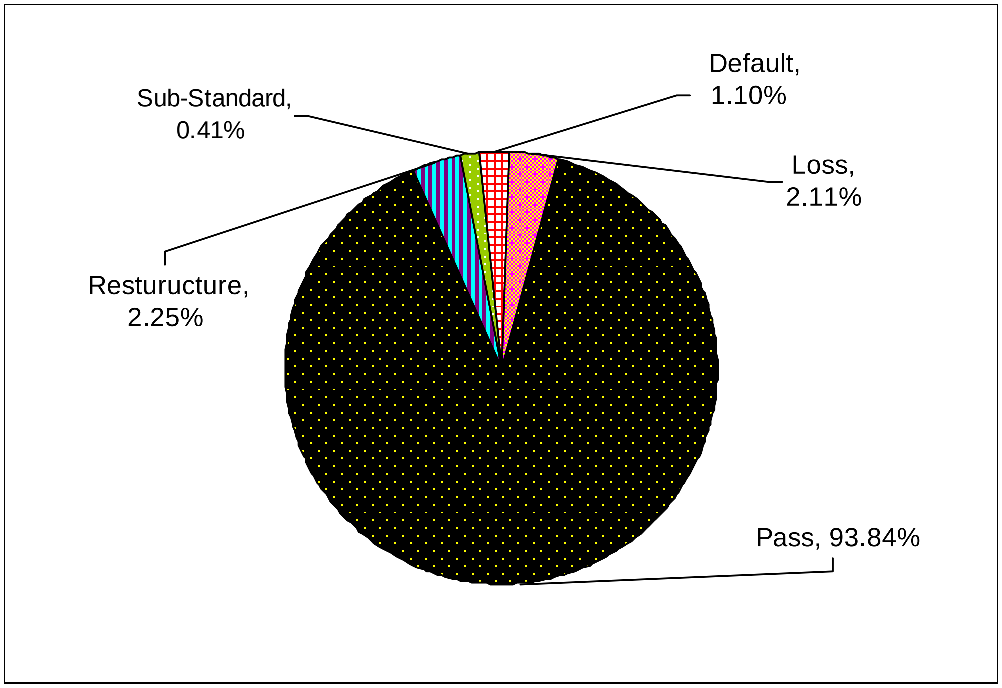


Figure: 4.17

LLP Categorization of HBL as on Mid July 2007

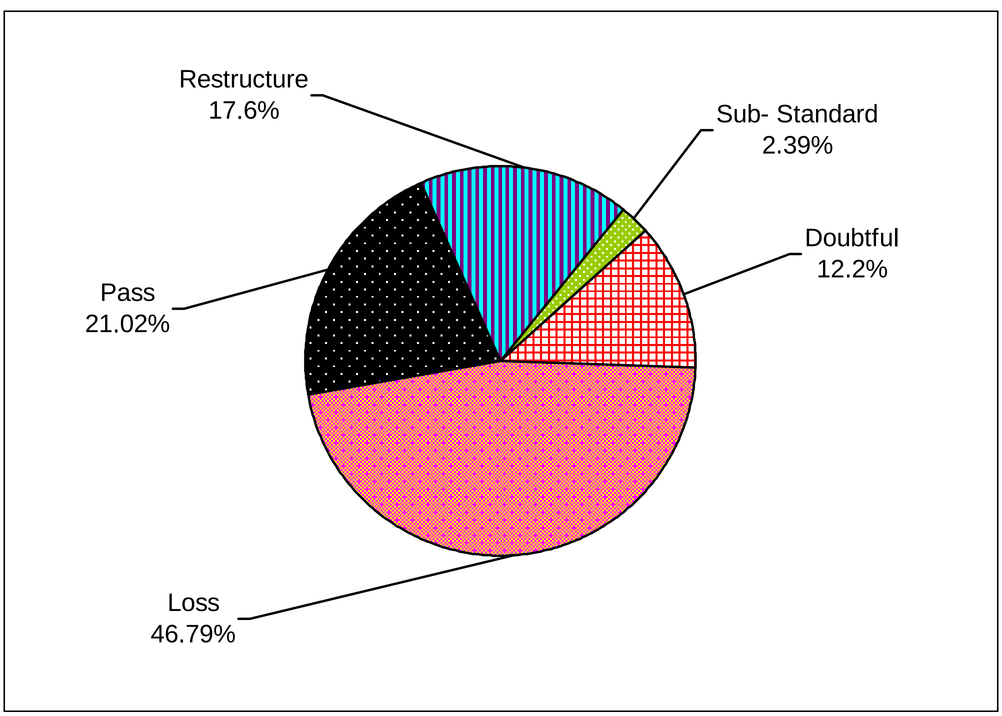


Table: 4.20

Loan Classification and Provisioning of HBL as on Mid July 2008 (In Rs. '000')

Particulars	As on mid July 2007/08				
	Loan	**% of Total Loan**	**LLP**	**% of Total LLP**	**% of LLP to Loan**
Performing Loan					
Pass	1,93,57,600	95.93	1,96,490	28.81	**1**
Restructure	3,44,783	1.71	1,56,137	22.89	**45**
Total performing Loan	1,97,02,383	*97.64*	*3,52,627*	*51.70*	
Non performing Loan					
Sub standard	*53,920*	0.27	13,480	1.98	**25**
Doubtful	2,14,477	1.06	1,07,238	15.72	**50**
Loss	2,08,833	1.03	2,08747	30.60	**100**
Total Non performing Loan	*4,77,230*	*2.36*	*3,29,465*	*48.30*	
Total	2,01,79,613	100.00	6,82,092	100.00	

(Source: Appendix – 1)

The table no.4.20 shows different categories of Loan and Advance and the provision provided to each category of Loan and Advance of HBL for the fiscal year 2007/08. In 2007/08, the total loan outstanding of HBL was Rs. 20,179,613 thousand. Out of the total loan, pass, sub-standard, doubtful and loss loan comprises 95.93%, 0.27%, 1.06% and 1.03% respectively. Out of performing loan pass loan compromises 95.93% and restructured loan is 1.71%.Hence it is clear that 97.64% of total loan is performing loan and remaining 2.36% is non performing loan. Similarly out of total provision provided of Rs. 6,82,092 thousand, 51.76% comprises for performing loan and the provision provided for sub-standard, doubtful and loss loan comprises 1.91%, 15.69% and 30.65% respectively making provision for non performing loan 48.24% of total LLP. Hence it can be understood that the General LLP comprises 51.70% and Specific LLP comprises 48.30% of total LLP. Following figures 4.18 & 4.19 show the loan & LLP categorization & level of HBL for fiscal year 2007/08.

Figure: 4.18

Loan Categorization of HBL as on Mid July 2008

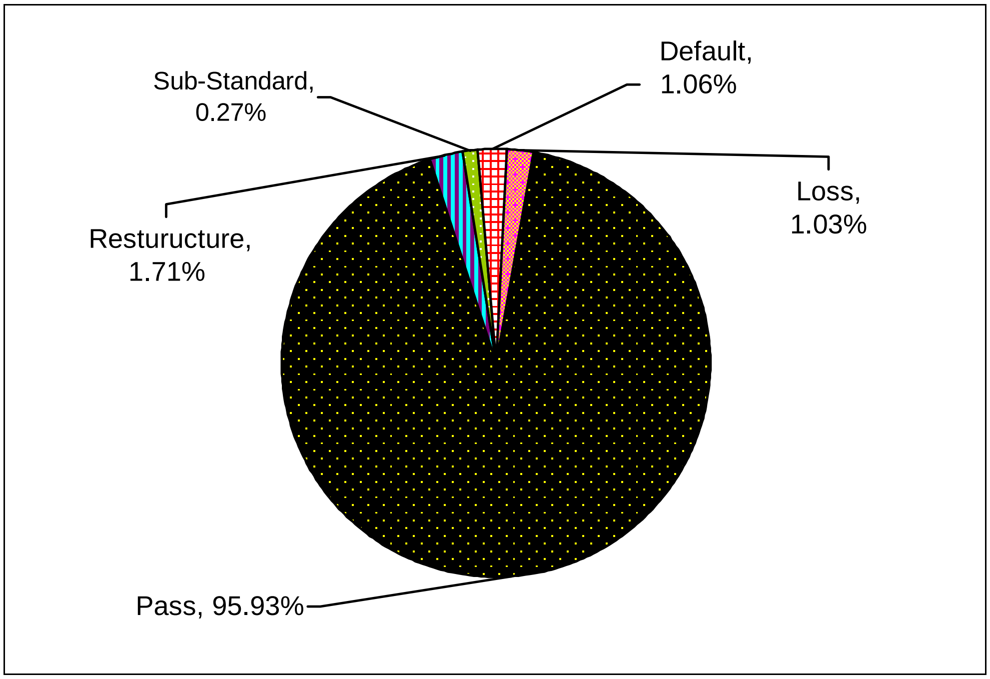


Figure: 4.19

LLP Categorization of HBL as on Mid July 2008

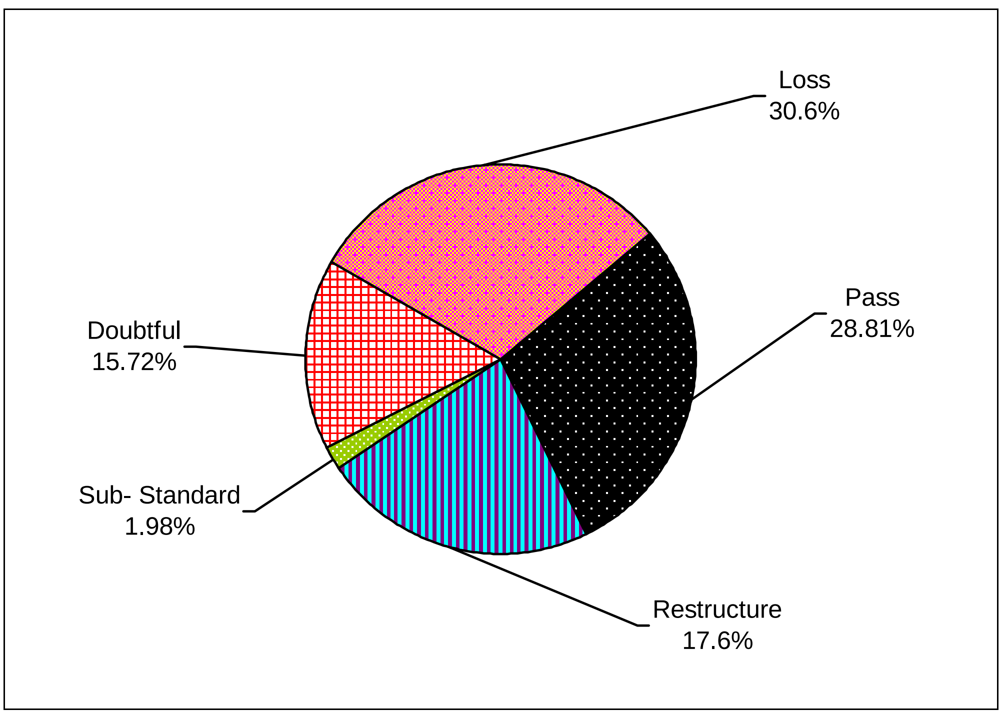


Table: 4.21

Loan Classification and Provisioning of HBL as on Mid July 2009 (In Rs. '000')

Particulars	**As on mid July 2008/09**				
	Loan	**% of Total Loan**	**LLP**	**% of Total LLP**	**% of LLP to Loan**
Performing Loan					
Pass	2,46,66,641	96.66	2,47,686	34.10	**1**
Restructure	3,01,568	1.18	1,17,613	16.19	**39**
Total performing Loan	*2,49,68,209*	*97.84*	*36,599*	*50.29*	
Non performing Loan					
Sub standard	1,67,832	0.66	74,158	10.20	**44**
Doubtful	1,94,699	0.76	99,025	13.63	**51**
Loss	1,88,779	0.74	1,87,881	25.87	**100**
Total Non performing Loan	*5,51,309*	*2.16*	*3,61,064*	*49.71*	
Total	2,55,19,519	100.00	7,26,363	100.00	

(Source Appendix- 1)

The table no.4.21 shows different categories of Loan and Advance and the provision provided to each category of Loan and Advance of HBL for the fiscal year 2008/09. In 2008/09, the total loan outstanding of HBL was Rs.2,55,19,519 thousand. Out of the total loan, pass, restructure, sub-standard, doubtful and loss loan comprises 96.66%, 1.18%, 0.66%, 0.76% and 0.74% respectively. Out of performing loan pass loan comprises 96.66% and restructured loan is 1.18%. Hence it is clear that 97.84% of total loan is performing loan and remaining 2.16% is non performing loan. Similarly out of total provision provided of Rs.7,26,363 thousand 50.29% is for performing loan (34.10% for pass loan & 16.19% for restructure loan) and the provision provided for substandard, doubtful and loss loan comprises 10.20%, 13.63% and 25.87% respectively making provision for non performing loan 49.71% of total LLP. Hence it can be understood that the General LLP comprises 50.29% and Specific LLP comprises 49.71% of total LLP. Following figures 4.20 & 4.21 show the loan & loan loss provision categorization of HBL for fiscal year 2008/09.

Figure: 4.20

Loan Categorization of HBL as on Mid July 2009

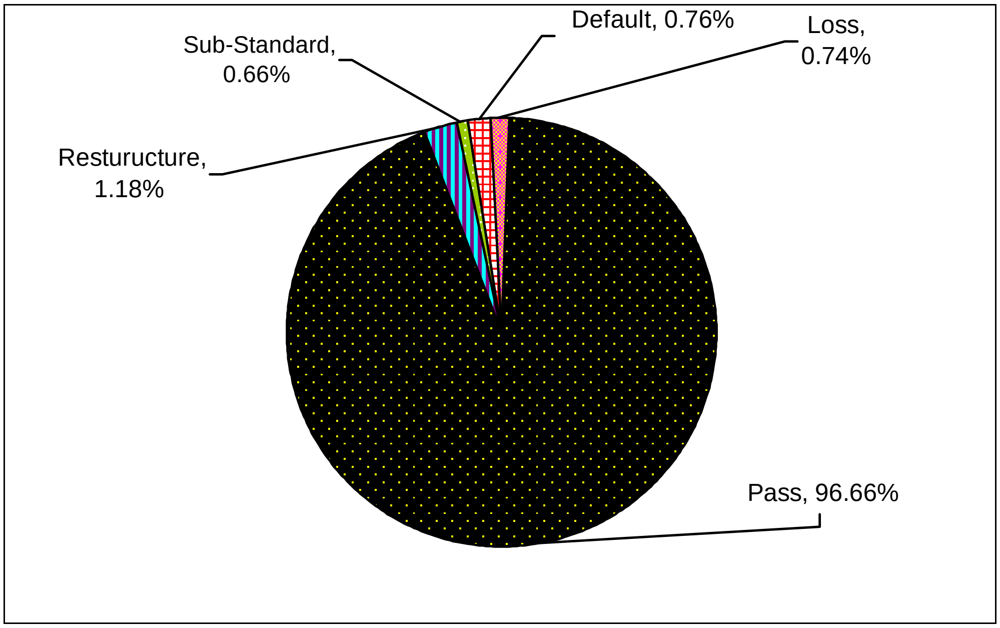


Figure: 4.21

LLP Categorization of HBL as on Mid July 2009

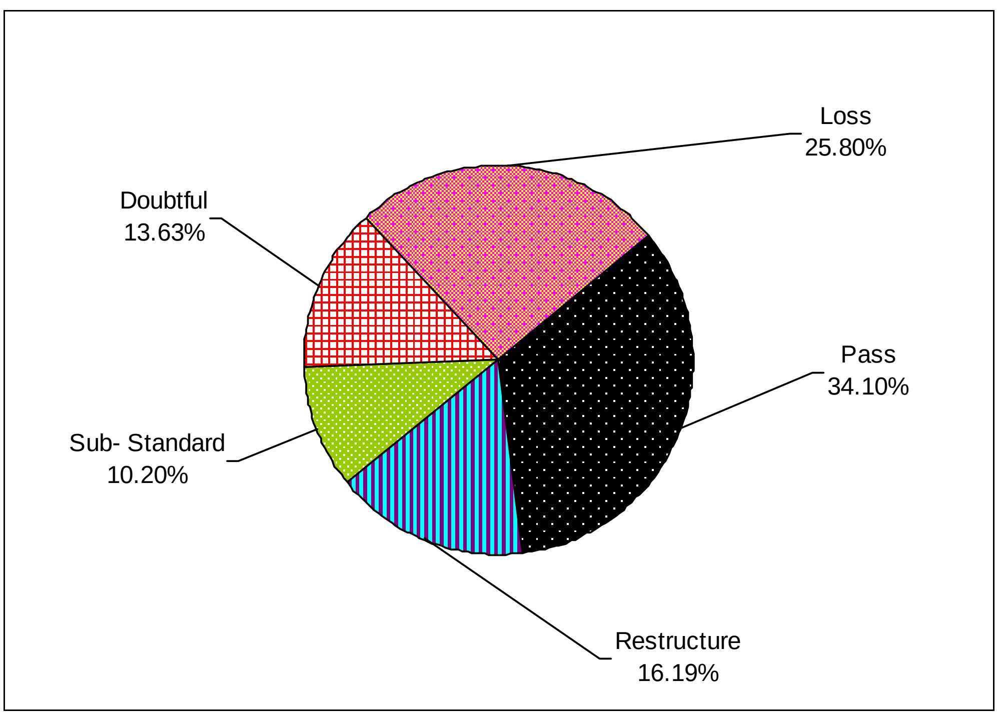


Table: 4.22

Loan Classification and Provisioning of HBL as on Mid July 2010 (In Rs. '000')

Particulars	**As on mid July 2009/10**				
	Loan	**% of Total Loan**	**LLP**	**% of Total LLP**	**% of LLP to Loan**
Performing Loan					
Pass	27915637	95.85	2,82,483	24.72	**1**
Restructure	183285	0.63	22,910	2.00	**12**
Total performing Loan	28098922	*96.48*	*3,05,393*	*26.72*	
Non performing Loan					
Sub standard	122760	0.42	46,818	4.10	**38**
Doubtful	220520	0.76	1,10,259	9.65	**50**
Loss	681553	2.34	6,80,353	59.53	**100**
Total Non performing Loan	*1024833*	*3.52*	*8,37,430*	*73.28*	
Total	2,91,23,755	100.00	11,42,823	100.00	

(Source Appendix- 1)

The table no. 4.22 shows different categories of Loan and Advance and the provision provided of different categories of Loan and Advance of HBL for the fiscal year 2009/10. In 2009/10, the total loan outstanding of HBL has increased to Rs.29123,755 thousand. Out of the total loan, pass, restructure, sub-standard, doubtful and loss loan comprises 95.85%, 0.63%, 0.42%, 0.76% & 2.34 respectively. Similarly out of total provision provided of Rs.11,42,823 thousand, the respective percent of Pass, restructure, Sub-standard, doubtful and l loss loan provision are 24.72%, 2.00%, 4.10% ,9.65 and 59.73%. Hence it can be understood that the General LLP comprises 26.72% and specific LLP comprises remaining 73.28%. Similarly the LLP ratio with different classes of loan, pass loan, restructure loan, sub-standard loan, default loan and loss loan are 1%, 12%, 38%, 50%, 100% Following figures 4.22 & 4.23 show the loan categorization and LLP in different loan categories of HBL for fiscal year 2009/10.

Figure: 4.22

Loan Categorization of HBL as on Mid July 2010

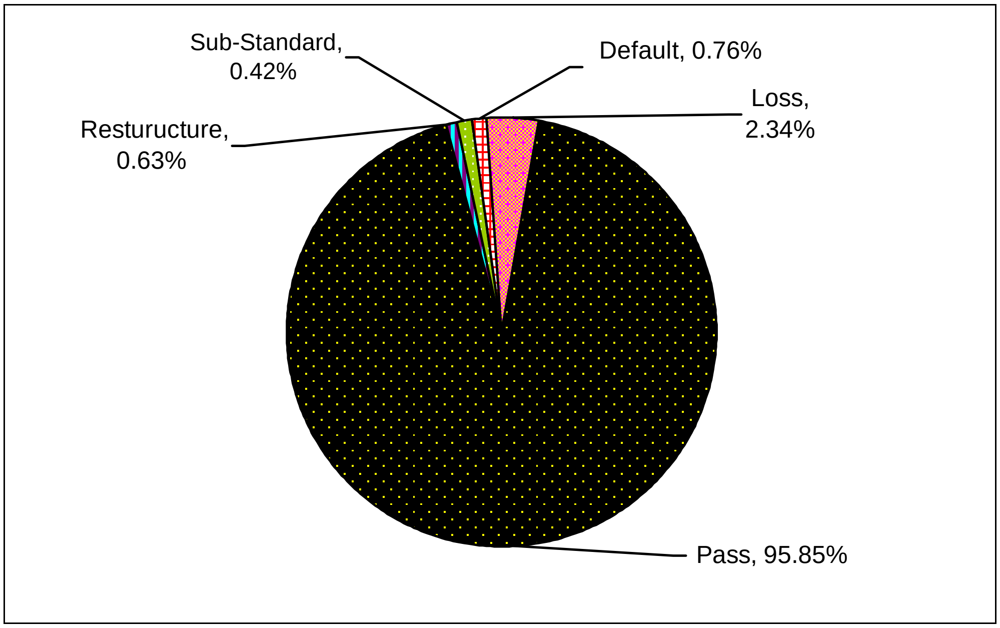


Figure: 4.23

LLP Categorization of HBL as on Mid July 2010

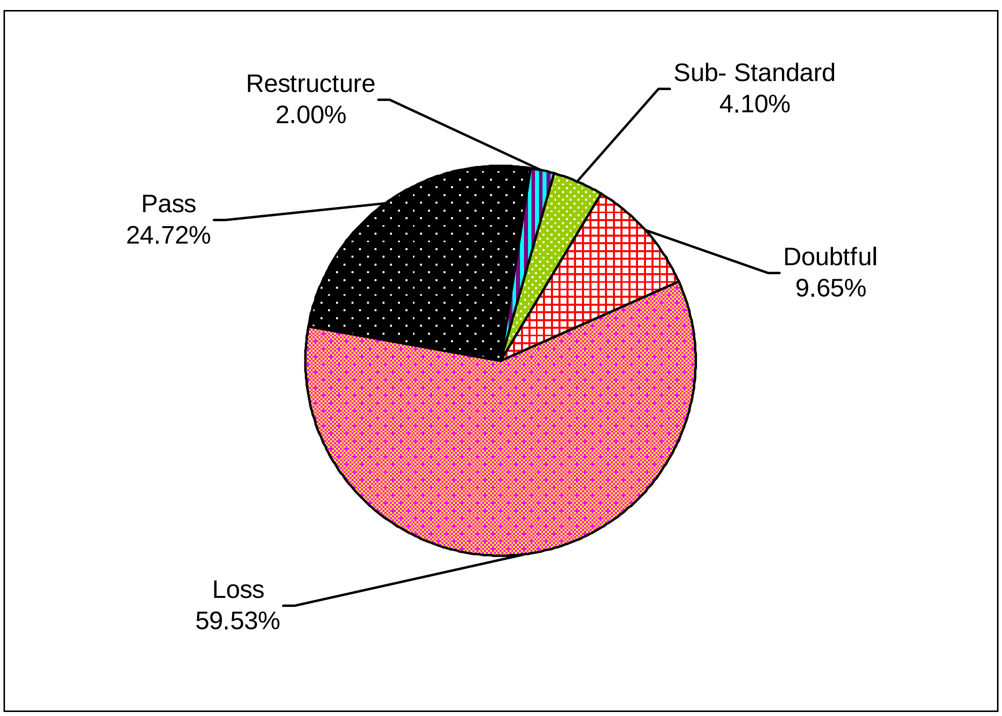


Table: 4.23

Loan Classification and Provisioning of NCCBL on Mid July 2006(In Rs '000')

Particulars	As on mid July 2005/06				
	Loan	**% of Total Loan**	**LLP**	**% of Total LLP**	**% of LLP to Loan**
Performing Loan					
Pass	29,86,049	70.64	51,515	4.10	**1**
Restructure	3,16,612	7.49	65,337	5.20	**20**
Total performing Loan	*33,02,661*	*78.13*	*1,16,852*	*9.30*	
Non performing Loan					
Sub standard	64,675	1.53	22,616	1.80	**35**
Doubtful	1,05,256	2.49	70,362	5.60	**67**
Loss	7,54,544	17.85	10,46,645	83.30	**122**
Total Non performing Loan	924475	*21.87*	*11,39,625*	*90.70*	
Total	42,27,136	100.00	12,56,477	100.00	

(Source Appendix- 1)

The table no. 4.23 shows different categories of Loan and Advance and the provision provided to each category of Loan and Advance of NCCBL for the fiscal year 2005/06. In 2005/06, the total loan outstanding of NCCBL is Rs. 42,27,136 thousand. Out of the total loan, pass, restructure, substandard, doubtful and loss loan comprises 70.64%, 7.49%, 1.53 %, 2.49% and 17.85% respectively. Similarly out of total provision provided of Rs.1,255.00 thousand, the respective of Pass, restructure, Substandard, Doubtful and Loss loan is 4.1%, 5.20%, 1.80%, 5.60% and 83.30%. Hence it can be understood that the General LLP comprises 9.30% and specific LLP comprises remaining 90.70%. Following figure no. 4.17 shows the loan categorization of NCCBL of fiscal year 2005/06. The ratio of particular loan categories, of Pass, restructure, sub-standard, doubtful and Loss loan with their provision are 1%, 20%, 35%, 67% & 122%. Following figures 4.24 show the loan categorization of NCCBL for fiscal year 2005/06 and their LLP level in different loan categories.

Figure: 4.24

Loan Categorization of NCCBL as on Mid July 2006

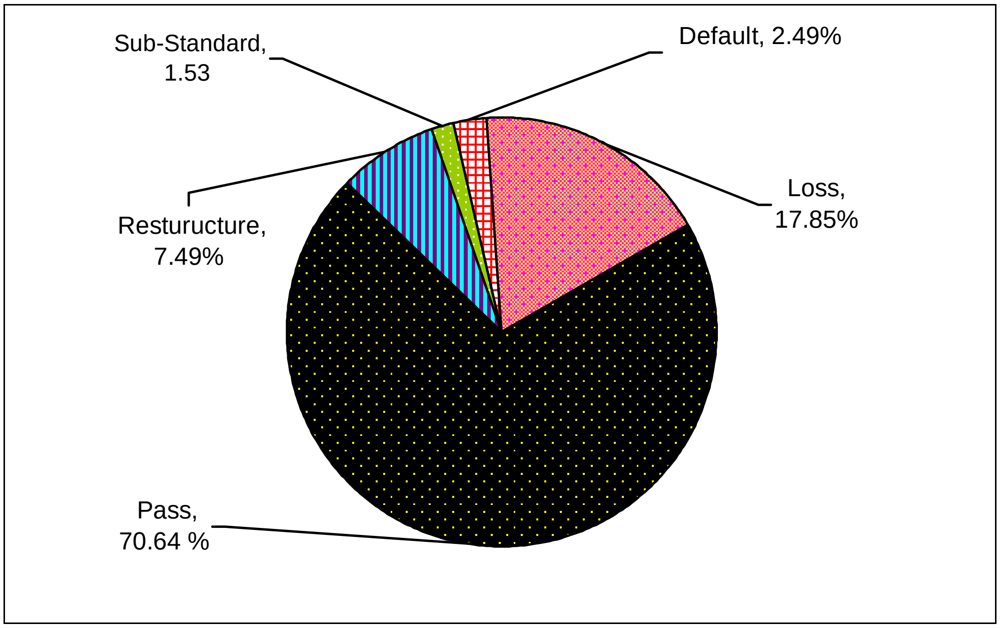


Figure: 4.25

LLP Categorization of NCCBL as on Mid July 2006

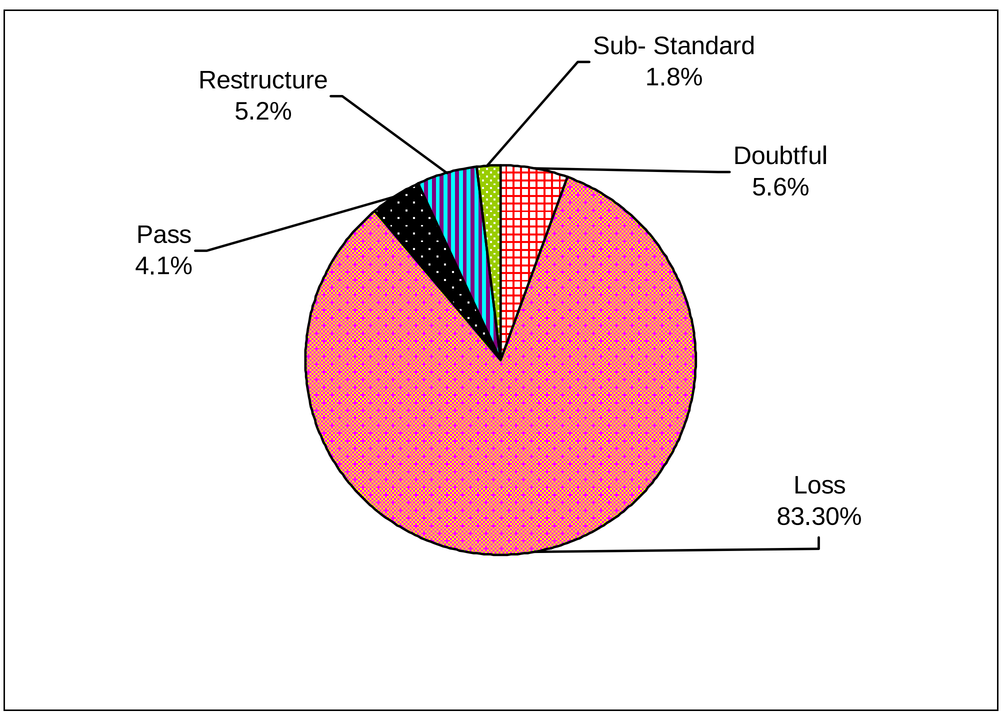


Table: 4.24

Loan Classification and LLP of NCCBL as on Mid July 2007 (In Rs '000')

Particulars	As on mid July 2006/07				
	Loan	% of Total Loan	LLP	% of Total LLP	% of LLP to Loan
Performing Loan					
Pass	31,83,329	62.15	31,805	2.25	**1**
Restructure	3,32,020	6.48	42,091	2.98	**13**
Total performing Loan	35,15,349	*68.13*	*73,896*	*5.23*	
Non performing Loan					
Sub standard	*85,582*	1.67	21,394	1.51	**25**
Doubtful	3,88,064	7.58	1,94,032	13.72	**50**
Loss	11,33,226	22.12	11,25,257	79.55	**100**
Total Non performing Loan	16,06,872	*31.37*	*13,40,683*	*94.78*	
Total	51,22,221	100.00	14,14,579	100.00	

(Source Appendix- 1)

The table no.4.24 shows different categories of Loan and Advance and the provision provided to each category of Loan and Advance of NCCBL for the fiscal year 2006/07. In 2006/07, the total loan outstanding of NCCBL was Rs.51,22,221 thousand. Out of the total loan, pass, restructure, restructure, substandard, doubtful and loss loan comprises 65.15%, 6.48%, 1.67%, 7.58% and 22.12% & respectively. Hence it is clear that 68.63% of total loan is performing loan and remaining 31.37% is non performing loan. The loan loss provision provided for the year 2006/07 is Rs.1,414,579 thousand. Out of the total provision provided, 2.25%, 2.98% comprises for pass loan and restructure then the provision provided for substandard, doubtful and loss loan comprises 1.51%, 13.72% and 79.55% respectively. That makes total provision for non performing loan 94.77% of total LLP. Hence it can be understood that the General LLP comprises 5.23% and Specific LLP comprises 94.78% of total LLP. Following figures no. 4.26 & 4.27 show the loan categorization & loan loss provision level of NCCBL for fiscal year 2006/07.

Figure: 4.26

Loan Categorization of NCCBL as on Mid July 2007

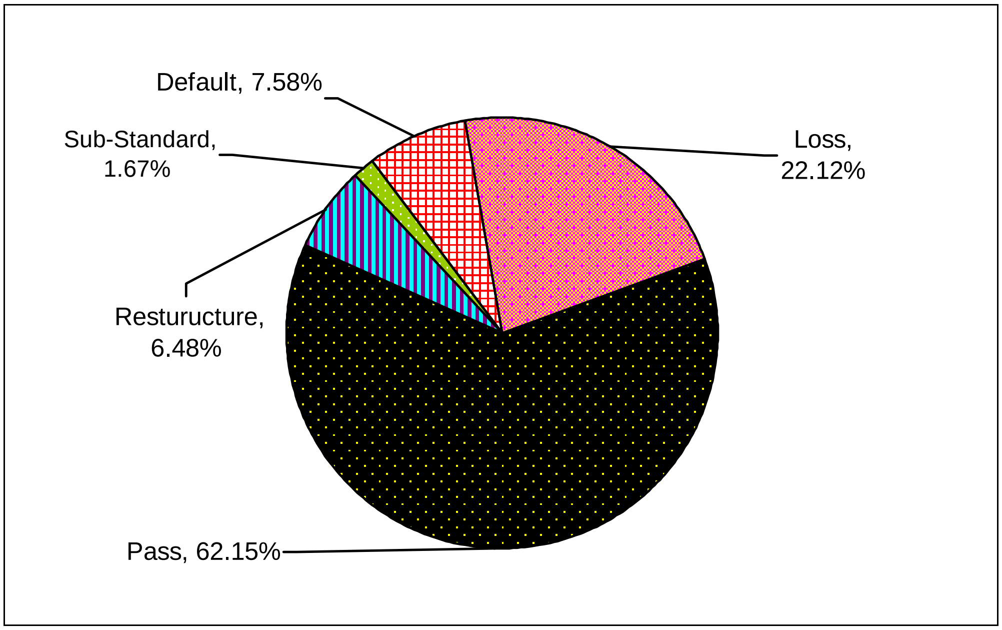


Figure: 4.27

LLP Categorization of NCCBL as on Mid July 2007

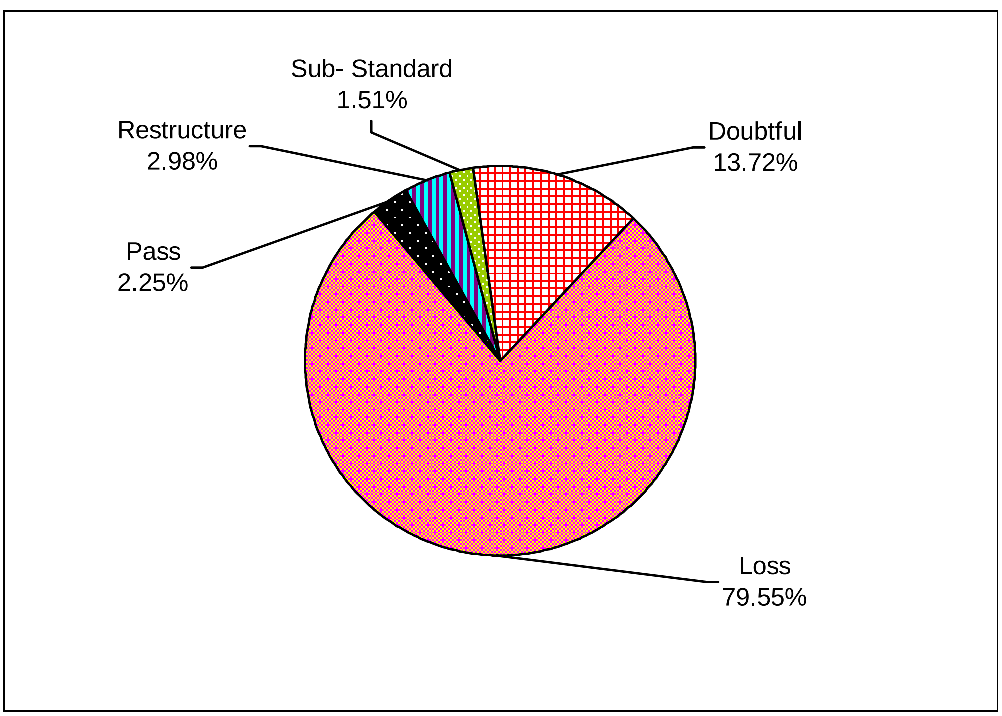


Table: 4.25

Loan Classification and LLP of NCCBL as on Mid July 2008 (In Rs '000')

Particulars	As on mid July 2007/08				
	Loan	% of Total Loan	LLP	% of Total LLP	% of LLP to Loan
Performing Loan					
Pass	42,22,918	79.96	48,275	5.59	**1**
Restructure	1,90,817	3.61	23,831	2.76	**12**
Total performing Loan	*44,13,735*	*83.57*	*72,107*	*8.35*	
Non performing Loan					
Sub standard	*24,769*	0.47	6,073	0.70	**25**
Doubtful	1,10,062	2.08	54,985	6.37	**50**
Loss	7,32,485	13.87	7,30,029	84.57	**100**
Total Non performing Loan	8,67,316	*16.42*	*7,91,087*	*91.65*	
Total	52,81,051	100.00	8,63,194		

(Source Appendix- 1)

The table no.4.25 shows different categories of Loan and Advance and the provision provided to each category of Loan and Advance of NCCBL for the fiscal year 2007/08. In 2007/08, the total loan outstanding of NCCBL has increased to Rs.5, 28,151thousand. Out of the total loan, pass, and restructure, substandard, doubtful and loss loan comprises 79.96%, 3.61%, 0.47 %, 2.08% and 13.88% respectively. Similarly out of total provision provided of Rs.8, 63,194 thousand, the respective percentage of Pass, restructure, sub-standard, default and Loss loan is 5.59%, 2.76%, 0.70%, 6.37% and 84.59%. Hence it can be understood that the General LLP comprises 8.35% and specific LLP comprises remaining 91.65%. The ratio of particular loan categories, of Pass, restructure, sub-standard, doubtful and Loss loan with their provision of 1%, 12%, 25%, 50% & 100%. Following figure no. 4.28 & 4.29 show the loan categorization & LLP of NCCBL in different loan categories for fiscal year 2007/08.

Figure: 4.28

Loan Categorization of NCCBL as on Mid July 2008

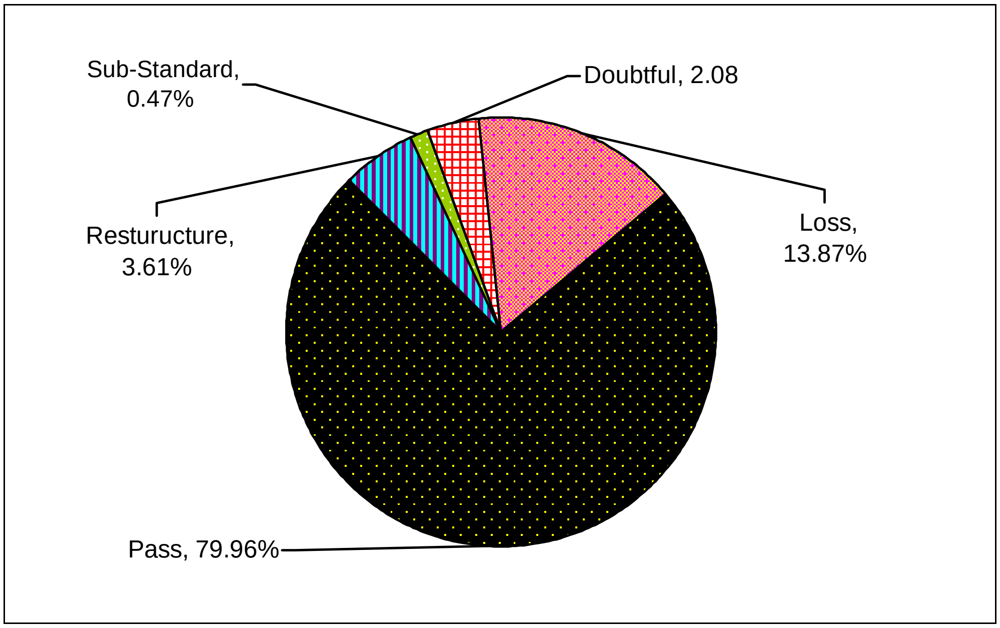


Figure: 4.29

LLP Categorization of NCCBL as on Mid July 2008

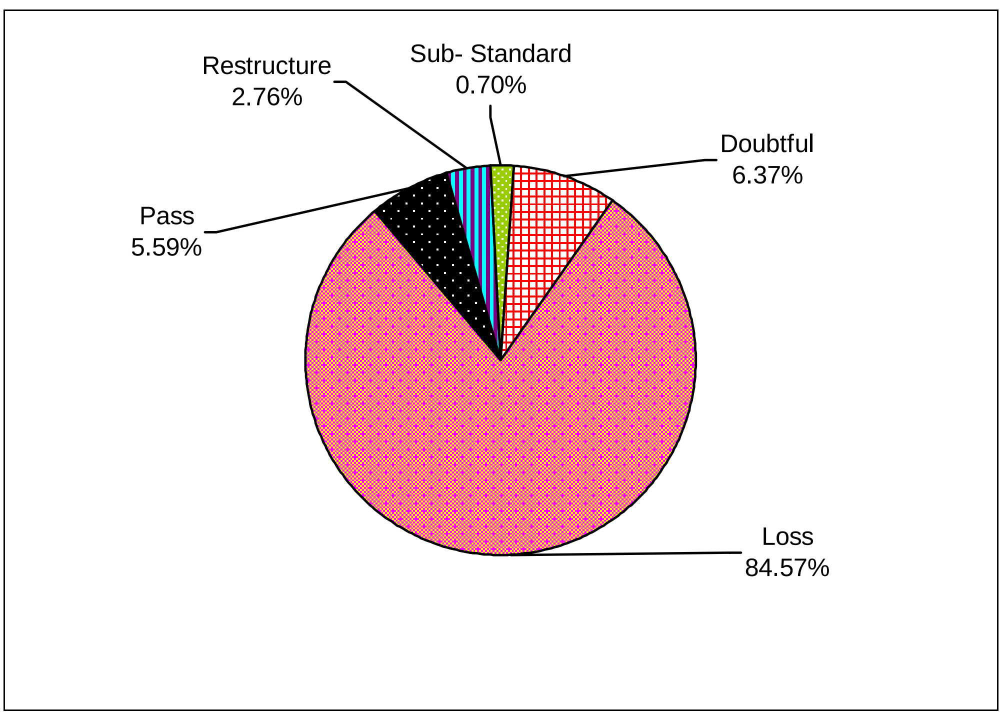


Table: 4.26

Loan Classification and LLP of NCCBL as on Mid July 2009 (In Rs '000')

Particulars	As on mid July 2008/09				
	Loan	**% of Total Loan**	**LLP**	**% of Total LLP**	**% of LLP to Loan**
Performing Loan					
Pass	68,61,324	92.52	73,503	22.58	**1**
Restructure	1,25,289	1.74	17,843	22.07	**57**
Total performing Loan	*69,86,613*	*97.26*	*1,45,346*	*44.66*	
Non performing Loan					
Sub standard	12,318	0.17	3,095	0.95	**25**
Doubtful	12,239	0.17	6119	1.88	**50**
Loss	1,72,510	2.40	1,70,926	52.51	**99**
Total Non performing Loan	*1,97,067*	*2.74*	*1,80,140*	*55.34*	
Total	71,83,680	100.00	3,25,486	100.00	

(Source Appendix- 1)

Table no. 4.26 shows different categories of Loan and Advance and the provision provided to each category of Loan and Advance of NCCBL for the fiscal year 2008/09. In 2008/09 the total loan outstanding of NCCBL was Rs.7,183,680 thousand. Out of the total loan pass, restructured, substandard, doubtful and loss loan comprises 95.52%, 1.74% 0.17%, 0.17% and 2.41% respectively. The performing loan consists of pass 95.52% and restructured loan of 1.74%. Hence it is clear that 97.26% of total loan is performing loan and remaining 2.74% is non performing loan. The loan loss provision provided for the year 2008/09 is Rs.3,25,486 thousand. Out of the total provision provided, 22.58% comprises for pass loan, 22.07% for restructured loan and the provision provided for substandard, doubtful and loss loan comprises 0.95%, 1.88% and 52.51% respectively making total provision for non performing loan 55.34% of total LLP. Hence it can be understood that the General LLP comprises 44.66% and Specific LLP comprises remaining 55% of total LLP. Following figure no. 4.30 & 4.31 show the loan categorization of NCCBL of fiscal year 2008/09.

Figure: 4.30

Loan Categorization of NCCBL as on Mid July 2009

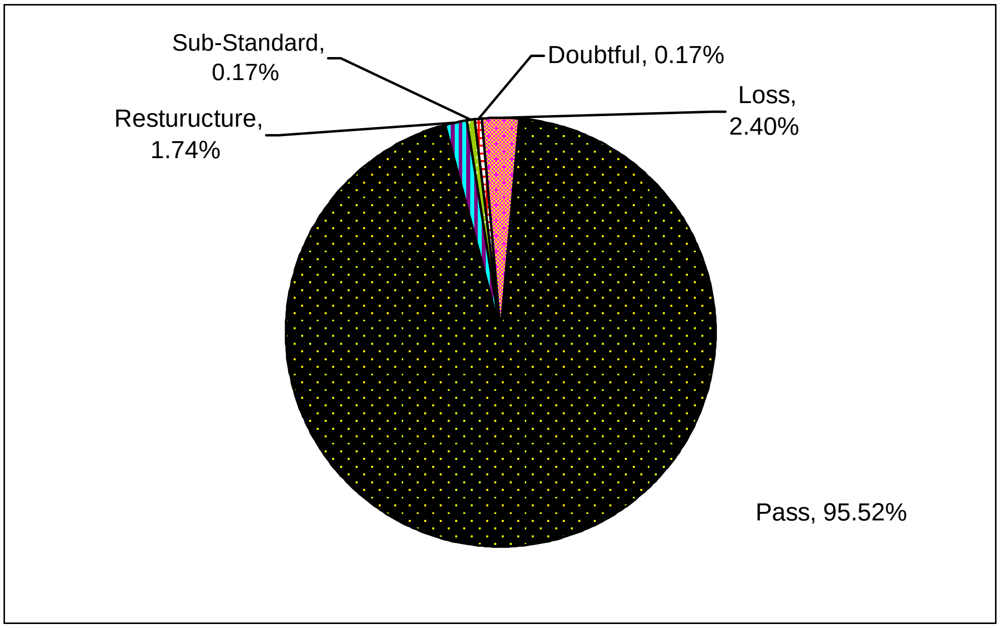


Figure: 4.31

LLP Categorization of NCCBL as on Mid July 2009

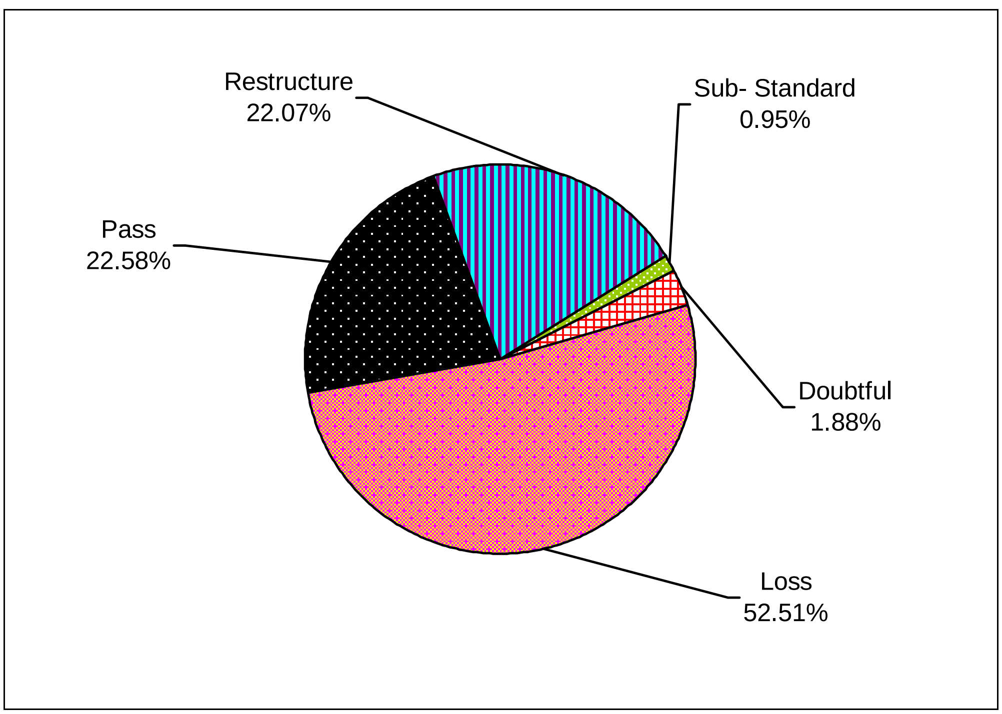


Table: 4.27

Loan Classification and LLP of NCCBL as on Mid July 2010 (In Rs '000')

Particulars	**As on mid July 2005/06**				
	Loan	**% of Total Loan**	**LLP**	**% of Total LLP**	**% of LLP to Loan**
Performing Loan					
Pass	80,30,204	95.74	86,615	22.03	**1**
Restructure	1,16,371	1.38	108525	27.60	**93**
Total performing Loan	*81,46,575*	*97.12*	*195140*	*49.63*	
Non performing Loan					
Sub standard	21,009	0.26	7,926	2.01	**38**
Doubtful	57,858	0.68	28,929	7.36	**50**
Loss	1,62,455	1.94	1,61,185	41.00	**100**
Total Non performing Loan	*2,41,322*	*2.88*	*1,98,040*	*50.37*	
Total	83,87,897	100.00	3,93,180	100.00	

(Source Appendix- 1)

Above table, table no. 4.27 shows different categories of Loan and Advance and the provision provided of different categories of Loan and Advance of NCCBL for the fiscal year 2009/10. In 2009/10, the total loan outstanding of NCCBL has increased to Rs.83, 87,897 thousand. Out of the total loan, pass, and restructure, sub-standard, doubtful and loss loan comprises 95.73%, 1.78%, 0.25%, 0.68% & 1.94 respectively. Similarly out of total provision provided of Rs.11,42,823 thousand, the respective percent of Pass, restructure, Sub-standard, doubtful and loss loan provision are 22.03%, 27.60%, 2.02% ,7.36% and 41.00%. Hence it can be understood that the General LLP comprises 49.63% and specific LLP comprises remaining 50.37%. Similarly the LLP ratio with different classes of loan, pass loan, restructure loan, sub-standard loan, default loan and loss loan are 1%, 93%, 38%, 50%, 100% Following figure no. 4.32 & 4.33show the loan categorization & LLP level on different loan categories of NCCBL of fiscal year 2009/10.

Figure: 4.32

Loan Categorization of NCCBL as on Mid July 2010

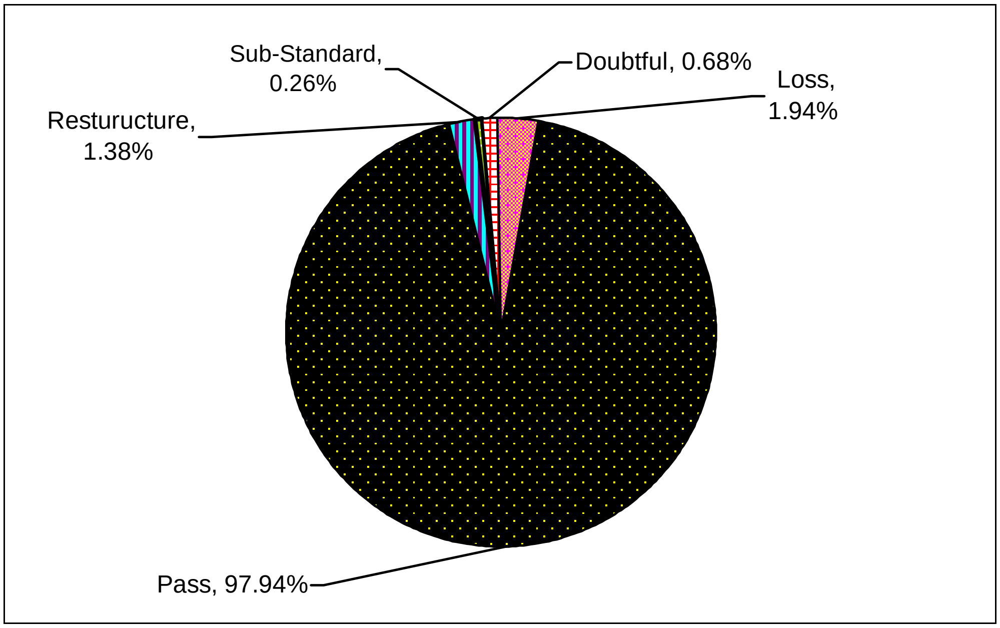
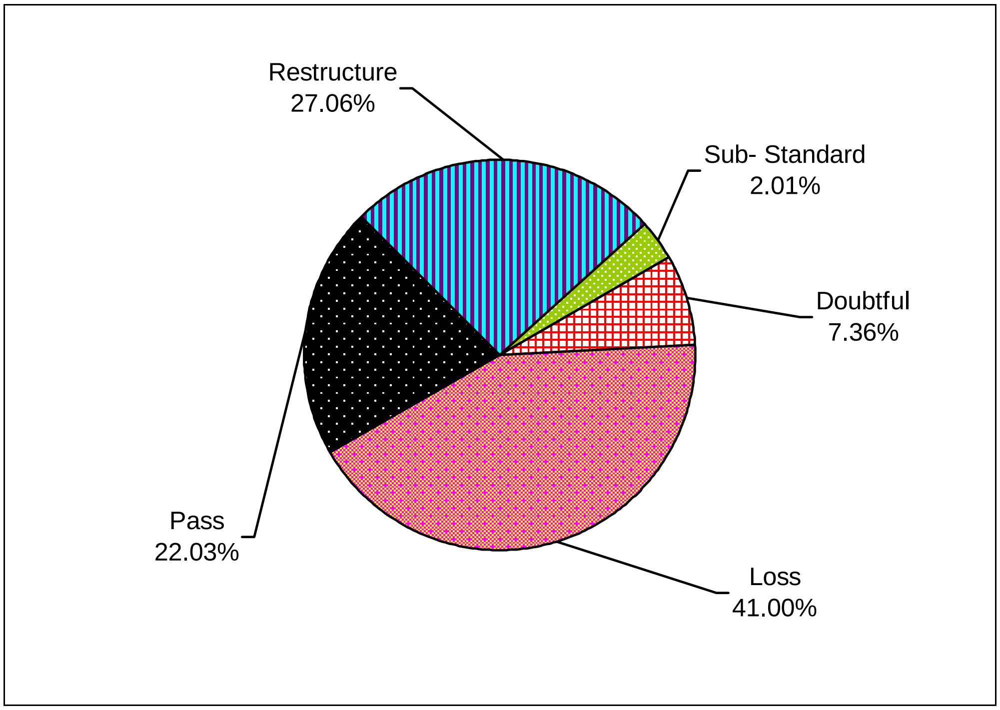


Figure: 4.33

LLP Categorization of NCCBL as on Mid July 2010



At the present context of Nepal where the banking sector has severely affected by the increasing level of Non Performing Loan, tightening the policies and provisions is essential to safeguard the banks from the banking crisis and to ensure the banks remain liquid even in the economic downturns. Taking on the subject regarding the implementation of NRB directive, both of sample banks has been found satisfactorily implemented the directives as per the table presented above.

4.7 Effects on Profitability

Latest Loan Loss Provision norm have a great impact on profitability of the banks. As earlier mentioned, Loan Loss Provision is deducted form the profit of the bank. Therefore the net profit of the bank will come down by the amount of provision. Hence increase in LLP means lesser net profit resulting to less Earning per Share (EPS), less Dividend per Share (DPS) or no dividend at all and finally lower Market Value per Share (MVPS). If any banks make profit less than the amount of provision to be made, it may have to show losses in the balance sheet. For instance the LLP of HBL& NCCBL as on mid July 2009 is Rs. 726.00 thousand and Rs 325.00 thousand respectively. Hence the net profit of HBL & NCCBL is reduced by the respective provisioned amount.

However, the impact of Loan of Loan Loss Provision on profitability of banks is of short term. After few years, when banks have enough provision for loss Loan & have sound credit management, the profitability will again pick up. Hence in long term basis banks will enjoy greater cushion against loan disbursed and improve their financial strength leading to increased profitability.

4.8 Primary Data Analysis

For the purpose of collecting data a questionnaire having a set of 6 questions were prepared and presented to 40 respondents. The respondents were selected randomly from Shareholder's, borrowers and employees. The question 1 to 6 contained objective questions. The targeted 32 respondents were composed by 9 shareholders, 12 borrowers and 11 employees of HBL and NCCBL.

a. Loan Flotation Basis

To examine the most important basis that should be considered while disbursing loan, the respondents were asked to express their view. The responses obtained from them have been presented in the table. 4.28

Table: 4.28

Loan Flotation Basis

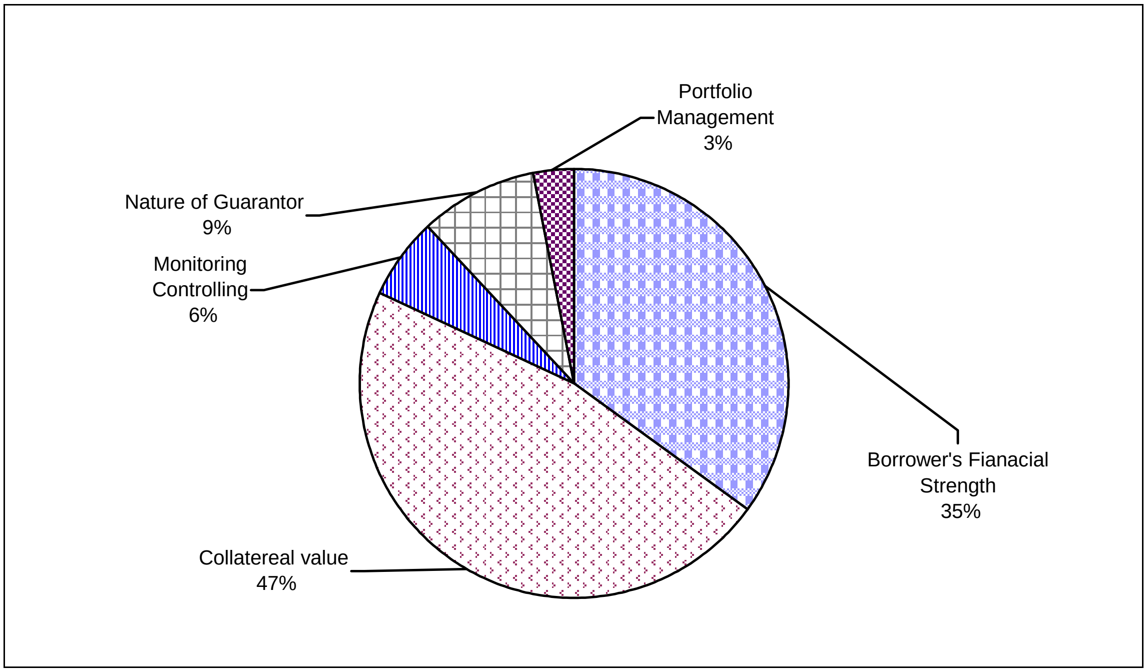
Reasons	Responses			Total	
	Shareholders	Borrowers	Employees	**Responses**	**%**
Borrower's Financial Strength	2	4	5	**11**	**35**
Collateral Value	4	6	5	**15**	**47**
Business Proposal	1	1	1	**3**	**9**
Nature of Guarantor	0	1	1	**2**	**6**
Management Team	1	0	0	**1**	**3**
Total	**8**	**12**	**12**	**32**	**100**

(Source: Opinion Survey, 2068)

The table 4.28 showed that the majority of the respondents stated that the collateral value should be given more consideration while disbursing loan. Out of the 32 respondents 15, 47%, supported this option. Besides collateral value, 35% of the respondents, 11 out of 32, opined that evaluation borrower's financial strength should be the main basis while floating loan. Similarly 9% of the respondents, 3 out of 32, 6 % of respondents, 2 out of 32 and 3% of the respondents, 1 out of 32 affirmed that business proposal, nature of guarantors and management team respectively should be the main basis for loan floatation.

Figure: 4.34

Loan Flotation Basis



b. Internal Reasons for Turning Band Loan

To know the internal reasons that turn out the good loan into bad loan, the respondents were asked on this regard. The responses obtained from the respondents have been presented in table 4.29

Table: 4.29

Internal Reasons for Turning Bad Loan.

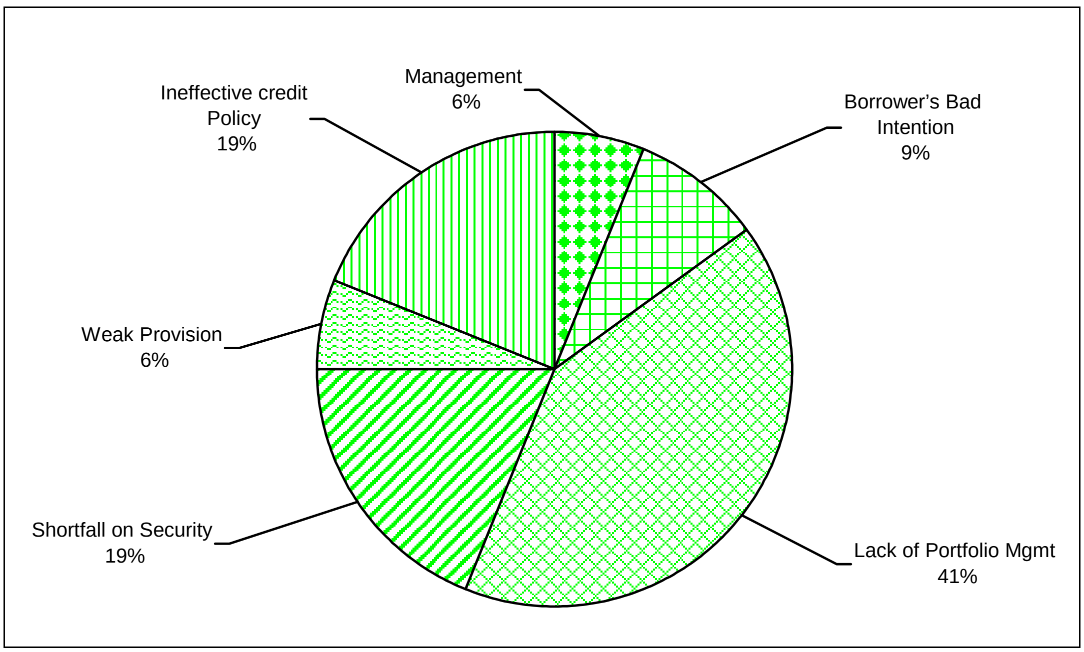
Reasons	Responses			**Total**	
	Shareholders	Borrowers	Employees	**Responses**	**%**
Mismanagement	1	0	1	**2**	**6**
Borrower's Bad Intention	0	1	2	**3**	**9**
Lack of Portfolio Mgmt.	3	7	3	**13**	**41**
Shortfall on security	3	1	2	**6**	**19**
Weak legal Provision	0	0	2	**2**	**6**
Ineffective credit policy	2	3	1	**6**	**19**
Total	**9**	**12**	**11**	**32**	**100**

(Source: Opinion Survey, 2068)

The table 4.29 showed the majority of the respondents, 13 out of 32 (14%) strongly affirmed that the bad intention of borrower turns them into bad loan. Similarly, 6 respondents 19% said that overvaluation of security and ineffective credit policy of the bank each is equally responsible for turning loan into bad loan. However 3 respondents, 9% stated that lack of good portfolio loan management is responsible for band loan, while 2 respondents each 6% opined that mismanagement and weak legal provisions are responsible for formation of bad loan. Considering the majority of each category, 3 out of 9 shareholders, 7out of borrowers, 3 out of 11 employees and the overall majority, 13 out of 32 respondents, it can be concluded that the borrower's bad intention is the major reason for turning bad loan.

Figure: 4.35

Internal Reasons for Turning Bad Loan



c. External Reasons for Turning Bad Loan.

Similarly to know the external reasons that provoke the loan to turn into bad loan, the respondents were asked to express their view. The responses obtained from them have been presented in the table 4.30.

Table: 4.30

External Reasons for Turning Bad Loan

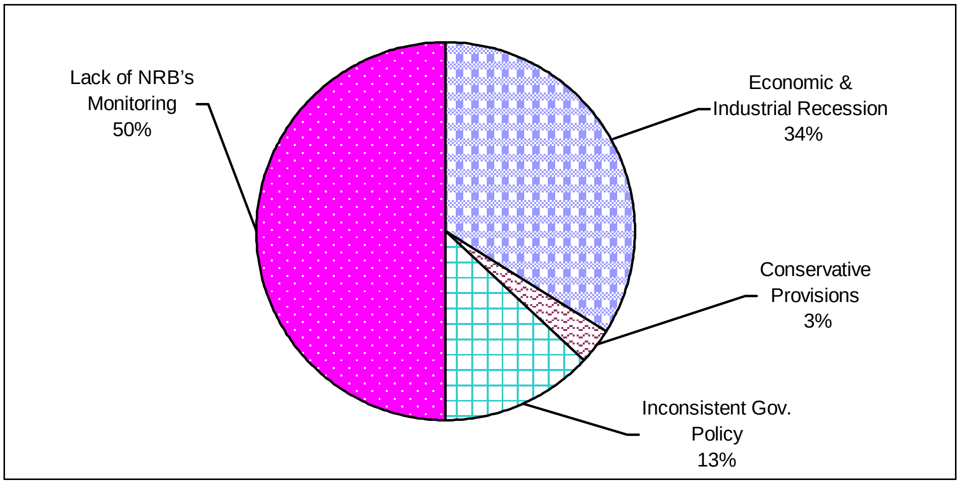
Reasons	Responses			Total	
	Shareholders	Borrowers	Employees	Responses	%
Economics and Industrial Recession	3	5	3	**11**	**34**
Conservative Provisions	0	1	0	**1**	**3**
Inconsistent Gov. Policy	1	2	1	**4**	**13**
Lack of NRB's Monitoring.	5	4	7	**16**	**50**
Total	**9**	**12**	**11**	**32**	**100**

(Source: Opinion Survey, 2068)

The table 4.30 showed that the majority of the respondents 16 out of 32 half of the total respondents opined that the lack of NRB's monitoring and supervision is the main reason behind turning loan into bad loan. Like that 11 respondents, said that recession in economy and industry causes loan to turn bad. However, 3% of the respondents, 1 out of 32 and 13% of the respondents 4 out of 32 stated that conservative provision for load and inconsistent government policy are the main reasons for having bad load. However looking each category the majority of the shareholders 5 out of 9 and the majority of employees 7 out of 11 supported lack of NRB's proper monitoring and supervision are the main reason while the majority of the borrower stated that economic and industrial recession is the main reason for bad loan. Eventually on the basis of overall majority it can be considered that lack of NRB's proper monitoring and supervision is the main external reason that causes loan to turn bad.

Figure: 4.36

External Reasons for Turning Bad Loan



d. Sector Covering More Default Loan.

To control the process of turning good loan into bad, it is essential to know the major sector defaulting loan. Hence to examine the major sector that covers more default loan the respondents were asked to express their opinions. The responses achieved from have been presented in the table below.

Table: 4.31

Sector Covering More Default Loan

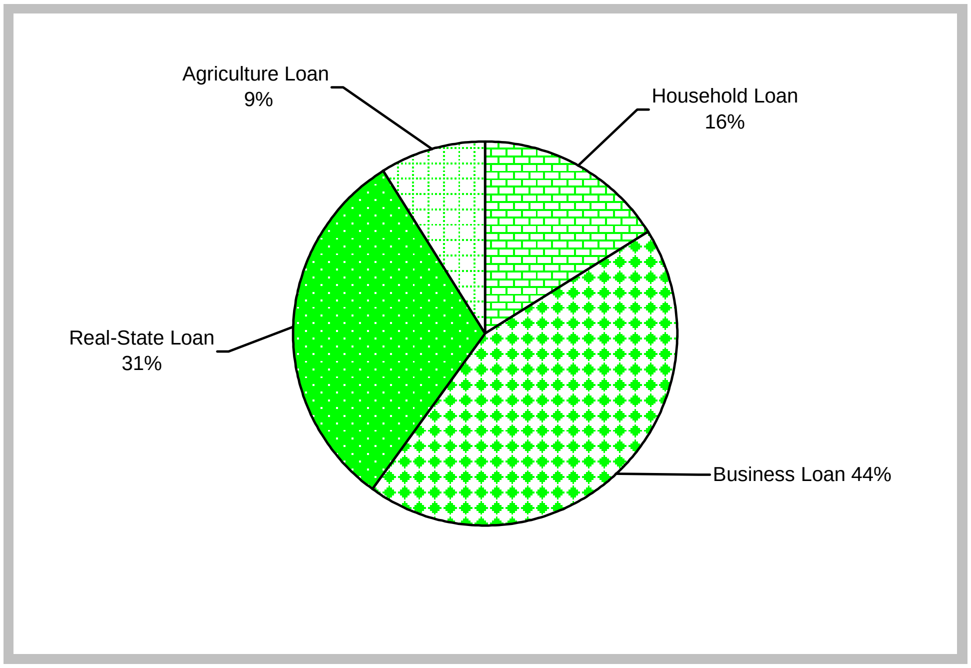
Reasons	Responses			**Total**	
	Shareholders	Borrowers	Employees	**Responses**	**%**
Household Loan	1	2	2	**5**	**16**
Business Loan	3	6	5	**14**	**44**
Real-State Loan	4	3	3	**10**	**31**
Agriculture Loan	1	1	1	**3**	**9**
Total	**9**	**12**	**11**	**32**	**100**

(Source: Opinion Survey, 2068)

The table 4.31 depicted that the majority of the respondents, 12 out of 32 pointed out business sector loan covers the more default loan. While 31% of the respondents, 10 out of 32, opined that real states loan covers default loan and 16% of the respondents, 5 out of 32 stated that household covers more default loan. It shows that most of the people think that business and real states are the major sector that makes the loan default.

Figure: 4.37

Sector Covering More Default Loan



e. Effect of NPA in Financial Health of the Bank's.

To investigate whether Non-Performing Assets actually affects the financial health of bank or not, the respondents were asked to opine their feelings. The responses obtained through questionnaire are presented in the table 4.32

Table: 4.32

Effect of NPA on Financial Health of Bank's

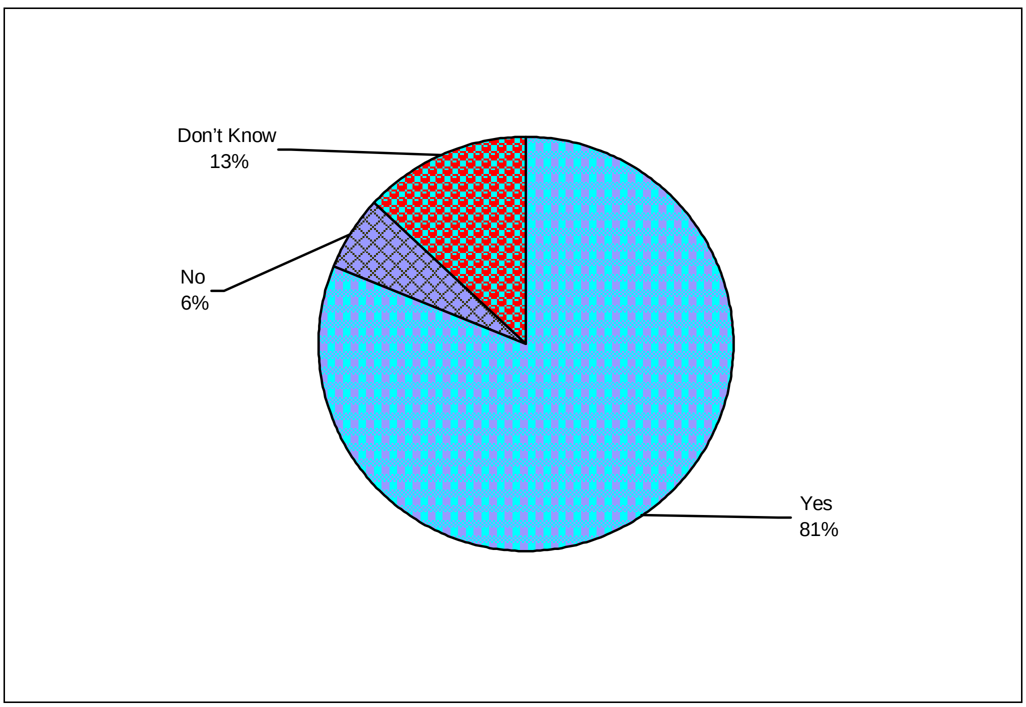
Reasons	Responses			**Total**	
	Shareholders	Borrowers	Employees	**Responses**	**%**
Yes	8	8	10	**26**	**81**
No	1	1	0	**2**	**6**
Don't Know	0	3	1	**4**	**13**
Total	**9**	**12**	**11**	**32**	**100**

(Source: Opinion Survey, 2068)

The table 4.32 delineated that the 81% of the respondents, 26 out of 32 were in the view that NPA has direct effect on the financial health of the bank, whereas only 6% of the respondents, 2 out of 32, were n the view that NPA has no effect in the financial health of the company, and 13% of the respondents, 4 out of 32 remained neutral on this query. Also, the majority of each category, 8 out of 9 shareholders, 8 out of 12 borrowers and 10 out of 11 employees were in the view that NPA has direct impact on the financial performance of the company. So, embracing the majority of each category and the whole majority, it can't be denies with the fact that NPA has direct influence on the financial health of the bank.

Figure: 4.38

Effect of NPA on Financial Health of Bank's



f. Best Measures to Resolve NPA Problems.

NPA problem has become the greatest challenge of today's banking industry to reduce the credit risk. Hence, to know what measures can be taken for resolving the NPA problem, the respondents were asked on this regard. The solution achieving from them has been presented in the table.

Table 4.33

Best Measures to Resolve NPA Problems

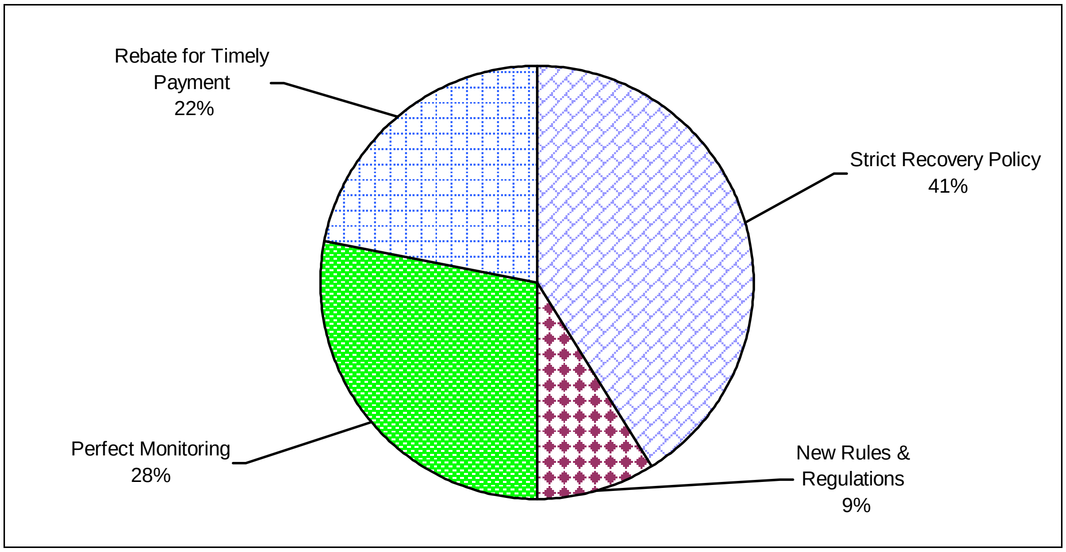
Reasons	Responses			Total	
	Shareholders	Borrowers	Employees	Responses	%
Strict Recovery Policy	4	6	3	13	41
New Rules & Regulations	0	1	2	3	9
Perfect Monitoring	2	3	4	9	28
Rebate for timely Payment	3	2	2	7	22
Total	9	12	11	32	100

(Source: Opinion Survey, 2068)

The table 4.33 depicted that 41% of the respondents, 13 out of 32 soughed that the adoption of strict recovery policy can only reduce the problem of NPA. Similarly 28% of the respondents, 9 out of 32, 22% of the respondents, 7out of 32 and 9% of the respondents, 3 out of 32 opined that monitoring of borrower's activities, providing rebate for timely payment and introduction of new rules and regulations regarding NPA respectively can reduce the problem of NPA. Looking each category, the majority of shareholders 4 out of 9 and the majority of borrowers, 6 out of 12 suggested adoption of strict recovery policy, while the majority of the employees, 4 out of 9 and the majority of borrowers, 6 out of 12 suggested adoption of strict recovery policy, while the majority of the employees, 4 out of 11, suggested monitoring of borrower's activities can reduce the NPA problem. Finally considering the majority of the respondents, 13 out of 32 it can be concluded that adoption of strict recovery policy is the best option for reducing NPA.

Figure: 4.39

Best Measure to Resolve NPA Problems



4.9 Major Findings of the Study

From the analysis of data, following major findings have been obtained.

4.9.1 Finding From Secondary Data Analysis

1. The average Loan and Advance to total asset ratio of HBL and NCCBL during the study period is found to be 57.65% and 65.82% respectively. The relatively low ratio of HBL is the indication of risk adverse attitude of the management or they have the policy of investing low in the risky assets i. e. Loan and Advance. HBL has higher proportion of its investment in risk free asset like treasury bills; National saving bonds etc. It shows that NCCBL has higher ratio but issued Loan and Advance are not generating the desired income. Although HBL shows the highest degree of deviation and variation while NCCBL has the most consistent ratio throughout the study period.

2. The core banking function is to mobilize the funds obtained from the depositors and how successfully this function have been discharged by the banks is measured by

the ratio of Loan and Advance to total deposit ratio or simply CD ratio. The average CD ratio of HBL and NCCBL during the study period is 66.62% and 76.71% respectively. This calculated show that average CD ratio of HBL is lower than NCCBL, similarly NCCBL has the most consistent and least deviated ratio (3.11%) during the study period where as HBL has higher deviation and variability in this ratio.

3. The analysis of non-performing Loan to total loan and advance ratio indicate what portion of loan disbursement couldn't perform as expectation or going failure to perform that, average NPL of HBL and NCCBL is 3.62% and 15.99% of total loan respectively. That means 96.38% and 84.01% of total loan of HBL and NCCBL is performing loan. Hence NCCBL has significantly higher proportion of the non performing loan in the total Loan portfolio in the beginning of the study period but decreasing significantly in last two years, which are the result of the banks effective credit management and its efforts of recovering bad debts through establishment of recovery cell. HBL has the least variation and NCCBL has the highest variation in this ratio throughout the study period.

4. The average non performing loan to total loan and advance ratio 3.62 % is less than 5% and 15.99 % is greater than 5%. That's why it shows that HBL has acceptable level of NPL and NCCBL has this ration higher than acceptable level. Because in general NPL up to 5% of loan and advance taking as a acceptable level.

5. The average loan loss provision to loan and advance ratio of HBL and NCCBL is 4.35% and 16.31% respectively with 1.65% and 11.70% standard deviation. Lower ratio in comparison show that banks has higher performing loan in the total Loan and Advance then others. NCCBL has relatively higher ratio which is the result of the higher proportion of NPL in the total loan. HBL data shows decreasing trend in this ratio which means HBL's asset quality is improving year by year. NCCBL has the highest deviation and variation of the ratio than that of HBL.

6. The average ratio of provision held to non performing loan of HBL and NCCBL is 123.56% and 122.12% respectively, which are almost equal. But NCCBL has higher deviation of 38.50%, instead of HBL's 14. 52%. Hence HBL has significantly higher ratio in comparison to NCCBL, which portrays that the bank has adequate provision against non performing loan. Higher portion of provision on non performing loan make this non performing loan internally secure. Even though both

of them have provided required provision on each category of NPL as per NRB directives.

7. The main objective of commercial bank is to earn profit through mobilization of fund. Provision of nonperforming loan deducts net profit and it makes the profit less. So loan loss provision and net profit are directly related. The average ratio of net profit to loan loss provision of HBL and NCCBL are 65.69% and 70.76%. It means in average if banks reduce their non performing loan then bank can increase their profit by the range of 65% & 70% approximately.

8. While analyzing correlation between Loan and Advance and deposit, it has been found that HBL and NCCBL have high degree of positive correlation between these two variables. The respective correlation coefficient of HBL and NCCBL is 0.980 and 0.992 with P.E. 0.005 & 0.012, which are significant and reliable. Hence we can conclude that the loan and advance largely depends upon the deposit of the bank.

9. The correlation coefficient between NPL and Loan and Advance of HBL and NCCBL is 0.07 and -0.88. Here correlation coefficient of both banks is less than the value of 6 times P.E. and P.E. Hence it is insignificant and there is no evidence of correlation. So increasing & decreasing trend of loan and advance can increased or decreased that total NPL lightly but it can't say that increasing and decreasing trend of Loan and advance must linearly effect in NPL.

10. The correlation between LLP and NPL revealed that there is positive correlation between LLP and NPL in both banks. As earlier mentioned higher provision needs to be provided for higher NPL, higher would be the LLP. The correlation coefficient between these two variables in HBL and NCCBL is 0.997 and 0.998. The correlation coefficient of HBL and NCCBL is higher than its P.E and 6.P, E hence the calculated correlation coefficient of both bank is significant which means LLP is largely depend upon the NPL. High correlation of NCCBL shows the high NPL in the total loan portfolio.

11. The correlation coefficient of net profit and loan loss provision of HBL is -0.714. It shows negative correlation between net profit and loan loss provision. It means decreasing LLP increased total net profit and vice versa.. This calculation shows that LLP is a serious effective factor of Net profit in HBL. And similarly correlation of Net profit and LLP in NCCBL is -0.756. It is high degree negative correlation.

r<PE, (-0.756<0.129) so it is also insignificant. It means that increasing or decreasing of LLP brought opposite effect in net profit.

12. Trend analysis of seven years has done based on the data of past five years and forecast was made for next two years. The trend of Loan and Advance showed and increasing trend in both banks HBL and NCCBL but there is dispute that of yearly increment rate amount of HBL is higher than that of NCCBL with Rs 34,44,935 thousand and Rs 8,85,900 thousand with yearly constant figure of Rs. 1,82,30,782 in HBL and 35,34,734 in NCCBL respectively while average annual increase ration of HBL (12.55%) is lower than NCCBL (10.03%) with 1.13% &1.17% S.D. So in total analysis HBL's result can take better than NCCBL.

13. From the trend analysis of NPL, it is found that NPL is decreasing in both banks in HBL and NCCBL. The NPL of HBL is decreasing at the rate of Rs. 12,216 thousand per year in average year and that of NCCBL is decreasing at the rate of Rs.-3,57,437 thousand every year. The decreasing trend of NPL in both banks is due to its efforts towards recovering bad debts. Decreasing trend of NCCBL is higher than that of HBL during the study period. But NCCBL has more variance also than HBL.

14. From the trend analysis of LLP, it is found that both banks have decreasing trend, where HBL has slow trend of decreasing of LLP. The average LLP of HBL is Rs-8,99,928 thousand which is decreasing every year at the rate of Rs.-2194.4 thousand. The average LLP of NCCBL is Rs 16,95,289 thousand which is decreasing every year at the rate of Rs -281568 Rs. thousand. NCCBL has more severe declining in LLP. It means net profits are expected to increase in coming year in two banks.

15. From the trend analysis of Net Profit, it is found that net profit is expected to increase in coming year in both two banks. The net profit of HBL will increases Rs.36,369 thousand every year while the net profit of NCCBL is increasing by Rs.2,69,616 thousand. But trend of net profit movement is highly fluctuated. The high rate of net profit earning of NCCBL is due to the recovery of NPL loan in the past years. Further in terms of reliability and consistency and nature of Net Profit of HBL much better.

16. As per NRB guidelines every bank should kept loan loss provision for probable default of loan in future. NRB has certain rate guidelines for different categories loan's provision. From this study it seems that both HBL and NCCBL have adequate provision in different categories loan or both bank have strictly followed the directive of loan loss provision of NRB directive.

4.9.2 Finding From Primary Data Analysis

17 According to primary data (Shareholder, Borrower and employees' opinion) 47 % respondents were in the view that the collateral evaluation should be the main basis that most be considered while disbursing loan. Similarly 41 % of the respondents, 13 out of 32, stated that lack of portfolio management is the main internal reason that provokes the loan to turn out into bad. Further 50% of respondents' targeted lack of NRB's monitoring and supervision is the major external reason that turns loan into bad.

18. 44% respondents said that business is the major sector that covers's more default loan. Similarly 31% and 16% of the respondents claimed real-state and agriculture loan that covers default loan.

19 About 81% of the respondents, 26 out of 32 opined that NPA has effect on the financial health of the bank. Similarly 47% of the respondents stated that the banking industry has been moderately affected by the problem of NPA.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

Finally this chapter includes the summary, conclusions and recommendations based on the result of the analysis of the data.

5.1 Summary

Bank plays an important role in the economic development of the country as the issue of development always rests upon the mobilization of resources. Banks deals in the process of chanellising the available resources to the needy sector causing overall economic development. This research is aimed at studying the non-performing loan and loan loss provisioning of Himalayan Bank Limited and Nepal Credit and Commerce Bank Limited. For this purpose, descriptive cum analytical research design was adopted. Out of the total 31 commercial banks, two banks were taken to represent the major joint venture bank, Himalayan Bank Limited and Nepal Credit and Commerce Bank Limited were selected from private sector banks. Basically secondary data has been used in the study. Primary precautions regarding data has been collected through direct interviews and annual reports and other publication forms on the basis of secondary data. The data collected from various sources are recorded systematically and presented in appropriate forms of tables and charts and appropriate mathematical, statistical, financial, graphical tools have been applied to analyze the data. The data of five consecutive years of the two banks have been analyzed to meet the objective of the study.

NCCBL has the highest proportion of the Loan and Advance in the total asset structure but HBL has relatively lower Loan and Advance in the total asset structure. Regarding NPL and Loan and advance, HBL has the least NPL and L&A ratio and then the HBL. The less orientation towards lending has made this bank successful to have low ratio of provisioning and lower ratio of non-performing Loan. NCCBL has higher proportion of NPL. However in recent years NCCBL has shown significant decrement in NPL to L&A ratio LLP. Furthermore HBL has higher proportion of investment in Loan and Advance in comparison to NCCBL and its return on Loan and Advance is also higher than NCCBL. LLP to NPL ration of HBL is higher than the same ratio of NCCBL. That means HBL applied more strong security compensation in loss loan than NCCBL There is positive correlation between loan and advance and deposit in both banks. Loan and Advance and NPL correlation in HBL is positive & negative correlation in NCCBL. Amount to be provisioned depends upon the non-performing loan and its quality. Higher provision has to be provided for NPL. Hence even though Loan and advance do not increase, if in the same loan portfolio NPL increase, LLP will increase. This has also been shown by the positive correlation between LLP and NPL in the two banks. And similarly loan loss provision and net profit has direct negative relation. Increases LLP decreased net profit and vice versa. So net profit & LLP has high degree negative correlation

The trend analysis of Loan and Advance shows increasing trend in HBL and NCCBL .The trend analysis of Non-performing loan in both banks HBL & NCCBL have shown decreasing trend in coming years. Similarly the trend of LLP in both banks is also in decreasing. But the decreasing trend of NCCBL is higher than HBL. This is due to NCC's recovery efforts towards reducing NPL through establishment of Recovery Cell.

The past trend of net profit of two banks exhibit that HBL has earned adequate profit where as NCCBL has beared loss in first three years and than after it has started generating profit..

As per the last loan classification and provisioning directives Loan and Advance have to be categorized into four types namely Pass, Substandard, Doubtful and Loss with respective provisioning of 1%, 25%, 50% and 100%. The loan falling under Pass category is regarded as performing loan and that which falls under remaining three categories is regarded as non-performing loan. NCCBL has higher proportion of loss loan in the total non-performing loan followed by Substandard and doubtful.

Today's banking industry is severely affected by the problem of NPA. Improper credit appraisal system, ineffective credit monitoring & supervision system, economic slowdown, borrower's misconduct, and overvaluation of collateral, political inconsistency and pressure to lend to uncreditworthy parties etc are the major factors leading to non-performing assets. Setting up recovery cell, hiring Asset Management Company etc are some to the measures to resolve the problem of NPA. Loan classification and loan loss provision also helps to confront the problems thus created due to non performing Loan. The latest directives regarding loan classification and loan provisioning is very important for maintaining sound financial health of the banks. the new provisioning directives leads to increment in provision amount of the banks leading to decrement in profitability of the bank but this is only for a short run.

5.2 Conclusion

Liberalization of financial sector started in 1980s with the aim to streamline it. After that the financial sector widened with more banks and financial institutions. Regarding banking sector there are 31 commercial banks. Even the financial sector developed rapidly in quantitative, but in terms of quality it is far behind from the developed countries. Bank came into existence mainly with the objectives of collecting idle funds, mobilizing them into productive sector and causing an overall economic development. The bankers have the responsibility of safeguarding the interest of the depositors, the shareholders and the society they are serving. Lending is the major function of any commercial bank and it is the most income generating asset of any commercial bank but there is risk inherent in bank's lending portfolio. In order to cover the risk inherent in the lending portfolio, banks have to make loan loss provision by categorizing the Loan into different category as per the NRB directives. Increasing non performing loan is the serious problem of the banking sector in Nepal. Non performing asset debar the income flow of the bank while claiming additional resources in the form of provisioning and hinder further gainful investments.

It has been found that NBL and RBB have very high portion of non performing loan resulting to higher loan loss provision. Hence even the bank has the highest investment in the most income generating asset i. e. Loan and Advance, it is in loss. Even the private sector bank like NCCBL has higher non performing loan and accordingly higher provision. In recent years NCCBL's non performing loan has shown significant decrement and accordingly provision has also decreased. Among the two banks HBL has the least non performing loan but the higher loan loss provision to keep the bank much safety from upcoming loan loss. From these indicators it can be said that HBL is the best among the two banks. In conclusion, it can be said that ineffective credit policy, political inconsistency with pressure to lend in uncreditworthy borrowers, overvaluation of collateral are the major causes of mounting non performing assets. Other factors leading to accumulation of NPAs are weak loan sanctioning process, ineffective credit monitoring and supervision system, economic slowdown, borrower' misconduct etc. continual review and classification of Loan enables banks to monitor quality of their loan portfolios and to take remedial action to counter deterioration in credit quality. In addition to this establishing recovery cell, hiring Asset Management Company are also measures to resolve the problem of NPL. The present loan classification and provisioning directive seems more stringent than previous one. As a result more provision has to be apportioned leading to lesser profitability but this kind of negative impact is only for short period. Adequate provisioning strengthens the financial health of the banks and makes them able to face any kind of future contingencies.

5.3 Recommendations

The following recommendations are made based on the findings and conclusion of this research work of HBL and NCCBL.

- The high portion of non-performing loan and hence high loan loss provision of NCCBL indicates that the bank's credit portfolio needs serious attention. Hence NCCBL is recommended to take immediate remedial action for recovering bad debts. Hiring Asset Management Company (AMC) is recommended for NCCBL to resolve the problem of mounting non performing loan.

- HBL has relatively low loan and Advance. Just more than half of its deposit is invested in Loan and Advance. Low level of lending means low level of investment resulting to low level of productivity, which may ultimately affect negativity on the national economy. Loan and Advance on the other hand help to upgrade the economic health of the country. Hence HBL bank is recommended to increase its investment in productive sector in the form of Loan Advance.

- The main factors which lead to non- performing loan are improper credit appraisal system, ineffective credit monitoring and supervision system etc. besides that negligence in taking information from Credit Information Bureau may also lead to bad debts. Hence two banks are recommended to be more cautious and realistic while granting Loan and Advance. After advancing Loan there should be regular supervision and follow up for proper utilization of loan.

- Even though both banks have to made provision for each category of loan as per NRB directives; but also the total provision amount is not enough in case all of pass and restructure loan may goes on default or the loan has to be written off. Hence both of them are recommended to increase this ratio by reducing non-performing loan.

- Following the directives of NRB and acting upon, it also reduce many of the credit risk. Besides there are penalty implication on non compliance of the directives. Hence the two banks are recommended to follow the directives and they are also suggested to come up with a stronger internal audit department to ensure that the directives are properly implemented.
- One of the main causes of default loan and increasing the NPAs is that the banks are not taking much collateral or doing overvaluation of collateral. Therefore banks should take enough collateral. So the bank at least can be able to recover its principle and invest amount in case of being unable to repay by the borrower.
- The regulation regarding loan classification and provisioning is stringent and tighter than the previous. Hence NRB should not only impose directives but also create supportive environment for the commercial banks. NRB is recommended to strengthen Credit Information Bureau (CIB) so that banks can get required credit information about the borrowers on time. This would help in reducing NPL.
- Lack of proper financial analysis of the borrower by the banks is one of the major causes behind increasing NPA of the banks. Therefore proper financial analysis should be performed before giving loan to the borrower.
- Bad intension, weak monitoring and mismanagement at top level are the major internal reasons turning good loan into band loan. Therefore commercial banks should take corrective action immediately.
- It is also wise for the banks to carryout special investigation audit of all financial and business transactions and books of accounts of the borrower company when there is possibility of the diversion of the funds and mismanagement.
- It is recommended for the banks to initiate training and development program for their human resources to make them efficient and professional in credit appraisal, monitoring and proper risk management.

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ANNEXES
(APPENDICES)

Appendix 1

FIGURES USED IN THE STUDY

Total Asset (In Rs '000')

Banks	2005/06	2006/07	2007/08	2008/09	2009/10
HBL	3,05,79,808	3,43,14,868	3,68,57,624	4,00,46,686	4,38,60,251
NCCBL	68,73,635	74,83,150	91,04,528	1,09,16,334	1,30,64,253

Total Deposit (In Rs '000')

Banks	2005/06	2006/07	2007/08	2008/09	2009/10
HBL	2,64,90,852	3,00,48,418	3,18,42,789	3,46,81,345	3,76,11,207
NCCBL	66,18,031	65,00,433	73,20,236	91,27,749	1,08,24,693

Loans and Advances (In Rs '000')

Banks	2005/06	2006/07	2007/08	2008/09	2009/10
HBL	1,57,61,977	1,77,93,724	2,01,79,613	2,55,19,519	2,91,23,755
NCCBL	49,88,672	51,22,221	52,81,051	71,83,680	83,87,897

Non performing Loan (In Rs '000')

Banks	2005/06	2006/07	2007/08	2008/09	2009/10
HBL	10,40,757	6,41,615	4,77,229	5,51,309	10,24,831
NCCBL	13,23,608	16,06,872	8,67,316	1,97,068	2,41,322

Loan Loss Provision (In Rs '000')

Banks	2005/06	2006/07	2007/08	2008/09	2009/10
HBL	11,19,416	7,95,727	6,82,093	7,26,363	11,43,126
NCCBL	12,56,477	14,14,579	8,63,194	3,25,486	3,93,180

Net Profit (In Rs '000')

Banks	2005/06	2006/07	2007/08	2008/09	2009/10
HBL	4,57,458	4,91,823	6,35,869	7,52,835	5,08,798
NCCBL	(6,58,614)	(1,15,928)	4,98,755	4,15,461	4,23,773

Note:

- The entire figures presented above are rounded off to the nearest thousand rupees
- The data presented herein are pertained to mid July of each year.

- The data presented herein are based on the amount mentioned in the annual reports of respective years.
- Loans and advances also include Bill purchased and discounted.

Appendix 2

Calculation of Mean, S.D. & C. V. Loans and advances to Total Asset Ratio of HBL

Years	Ratio(X)%	$\left(X-\overline{X}\right)$	$\left(X-\overline{X}\right)^2$
2005/06	51.54	-6.11	37.36
2006/07	51.85	-5.80	33.66
2007/08	54.75	-2.90	8.42
2008/09	63.72	6.07	35.82
2009/10	66.40	8.75	76.52
N=5	$\sum X = 288.26$		$\sum \left(X-\overline{X}\right)^2 = 192.79$

We have,

$$Mean\left(\overline{X}\right) = \frac{\sum X}{N} = \frac{288.26}{5} = 57.65\%$$

$$\text{standard Deviation}(\sigma) = \sqrt{\frac{\sum\left(X-\overline{X}\right)^2}{N-1}} = \sqrt{\frac{192.79}{5-1}} = 6.94$$

$$CoeffientofVariation(C.V.) = \frac{\sigma}{\overline{X}} \times 100 = \frac{6.94}{57.65} = 12.04\%$$

Similarly the Mean, S.D, and C.V. of other ratios of the HBL have been calculated.

Appendix 3

Calculation of Mean, S.D. & C. V. Loans and advances to Total Asset Ratio of NCCBL

Years	Ratio(X)%	$\left(X-\overline{X}\right)$	$\left(X-\overline{X}\right)^2$
2005/06	72.58	6.76	45.75
2006/07	68.45	2.63	6.93
2007/08	58.04	-7.78	60.47
2008/09	65.81	0.00	0.00
2009/10	61.20	-1.61	2.61
N=5	$\sum X = 329.08$		$\sum \left(X-\overline{X}\right)^2 = 115.77$

We have,

$$Mean\left(\overline{X}\right) = \frac{\sum X}{N} = \frac{329.08}{5} = 65.82\%$$

$$\text{standard Deviation}(\sigma) = \sqrt{\frac{\sum\left(X-\overline{X}\right)^2}{N-1}} = \sqrt{\frac{115.77}{5-1}} = 5.38$$

$$CoeffientofVariation(C.V.) = \frac{\sigma}{\overline{X}} \times 100 = \frac{5.38}{65.82} = 8.17\%$$

Similarly the Mean, S.D, and C.V. of other ratios of the NCCBL have been

Calculated

Appendix 4

Calculation of Correlation Coefficient®, P.E. and 6*P.E.of HBL (Rs.In '000')

Years	Deposit (X)	Loan & Advance(Y)	$x = X - \overline{X}$	$y = Y - \overline{Y}$	x^2	y^2	$x \times y$
2005/06	2,64,90,852	1,57,61,977	(56,44,070)	(59,13,800)	3,18,55,52,84,22,528	3,49,72,32,78,84,088	33,77,56,70,90,990
2006/07	3,00,48,418	1,77,93,724	(20,86,504)	(38,82,054)	43,53,49,97,76,617	1,50,69,87,43,10,441	80,99,79,59,50,773
2007/08	3,18,42,789	2,01,79,613	(2,92,133)	(14,95,864)	85,34,18,06,543	22,38,32,89,74,141	4,37,06,18,24,333
2008/09	3,46,81,345	2,55,19,519	2,56,423	38,43,741	64,84,26,91,76,356	1,47,74,80,92,02,642	97,87,94,35,23,632
2009/10	3,76,11,207	2,91,23,755	54,76,284	74,47,977	2,99,89,69,52,10,711	5,54,73,26,11,11,799	40,78,75,74,00,03,449
	$\Sigma X = 160674611$	$\Sigma Y = 108378588$	$\Sigma x = 0$	$\Sigma y = 0$	$\Sigma x^2 = 72768334292759$	$\Sigma y^2 = 122528601483111$	$\Sigma x \times y = 92489942393179$

We Know

$$\text{Mean } (\overline{X}) = \frac{\Sigma X}{N} = \frac{160674611}{5} = 32134922$$

$$\text{Mean } (\overline{Y}) = \frac{\Sigma Y}{N} = \frac{108378588}{5} = 21675718$$

We have, Karl Pearson Correlation Coefficient,

$$\text{Correlation Coeffiient (r)} = \frac{\sum xy}{N\sigma_x \sigma_y}$$

On implication of the equation of r, we obtain the following formula for computing ‘r’.

$$\text{Correlation Coefficient (r)} = \frac{\Sigma xy}{\sqrt{\Sigma x^2 \Sigma y^2}} = \frac{92489942393179}{\sqrt{72768334292759 \text{X} 122528601483111}} = 0.980$$

$$\text{Probable Error (P.E)} = \frac{0.6745(1-r^2)}{\sqrt{N}} = \frac{0.6745(1-0.9795^2)}{\sqrt{5}} = 0.012$$

$$6 \text{ P.E.} = 6 \text{ x P.E.} = 6 \text{ x } 0.0122 = 0.072$$

Similarly the Correlation Coefficients, P.E. and 6 P.E. between different variables of HBL have been calculated

Appendix 5

Calculation of Correlation Coefficient ®, P.E. and 6*P.E. of NCCBL (In Rs'000')

Years	Deposit (X)	Loan & Advance(Y)	$x = X - \bar{X}$	$y = Y - \bar{Y}$	x^2	y^2	$x \times y$
2005/06	66,18,031	49,88,672	(1460197)	(12,04,032)	21,32,17,64,46,967	14,49,69,35,38,637	17,58,12,46,87,956
2006/07	65,00,343	51,22,221	(1577795)	(10,70,483)	24,89,43,83,24,261	11,45,93,42,81,482	16,89,00,34,68,737
2007/08	73,20,236	52,81,051	(787992)	(9,11,653)	5,74,55,24,78,458	8,31,11,15,57,070	6,91,02,61,97,036
2008/09	91,27,749	71,83,680	1049520	(9,90,976)	11,01,49,34,89,824	9,82,03,30,36,186	10,40,07,95,16,201
2009/10	1,08,24,693	83,87,897	2746465	21,95,193)	75,43,06,77,99,053	48,18,87,14,29,172	60,29,01,93,15,375
	$\Sigma X = 40391142$	$\Sigma Y = 30963521$	$\Sigma x = 0$	$\Sigma y = 0$	$\Sigma x^2 = 138407285385563$	$\Sigma y^2 = 9227643842547$	$\Sigma x \times y = 11207223185306$

We Know

$$\text{Mean } (\bar{X}) = \frac{\Sigma X}{N} = \frac{40391142}{5} = 8078228$$

$$\text{Mean } (\bar{Y}) = \frac{\Sigma Y}{N} = \frac{30963521}{5} = 6192704$$

We have, Karl Pearson Correlation Coefficient,

$$\text{Correlation Coeffiient(r)} = \frac{\sum xy}{N\sigma_x\sigma_y}$$

On implication of the equation of r, we obtain the following formula for computing r.

$$\text{Correlation Coefficient (r)} = \frac{\Sigma xy}{\sqrt{\Sigma x^2 \Sigma y^2}} = \frac{11207223185306}{\sqrt{13840728538563 \text{ X } 9227643842547}} = 0.9917$$

$$\text{Probable Error (P.E)} = \frac{0.6745(1-r^2)}{\sqrt{N}} = \frac{0.6745(1-0.9917^2)}{\sqrt{5}} = 0.0050$$

$$6 \text{ P.E.} = 6 \text{ x P.E.} = 6 \text{ x } 0.0050 = 0.030$$

Similarly the Correlation Coefficients, P.E. and 6 P.E. between different variables of NCCBL have been calculated.

Appendix: 6

Trend Value Calculation

Here X is non-dependent variable (Year) and Y is the dependent variable (Loan and Advance)

Fiscal Year	Year (X)	L& A (Y)	X^2	XY
2005/06	1	1,57,61,977	1	1,57,61,977
2006/07	2	1,77,93,724	4	3,55,87,448
2007/08	3	2,01,79,613	9	6,05,38,839
2008/09	4	2,55,19,519	16	102078076
2009/10	5	2,91,23,755	25	145618775
	ΣX = 15	**ΣY= 10,83,78,588**	**ΣX^{2} = 55**	**ΣXY = 35,95,85,115**

Let the regression equation Y on X be,

Y = a + bX ………………. (i)

To find the value of a & b we have the following two normal equations

ΣY = na + bΣX ……….(ii)
ΣXY = aΣX + $b\Sigma X^{2}$…….(iii)

Substituting the values of n, ΣX, ΣY, ΣXY, ΣX^2 in equ. (ii) & (iii)
Then we get,

108378588 = 5a + 15b …………… (iv)
359585115 = 15a + 55b ………….. (v)

Now multiplying (iv) by 3 and Subtract it from (v), we get.

$$\begin{array}{rcl} 359585115 & = & 15a + 55b \\ -325135764 & = & -15a \pm 45b \\ \hline 34449351 & = & 0 + 10b \end{array}$$

$$10b = 34449351$$

$$b = 34449351/10$$

$$\text{so, } b = 344935.1 = 3444935$$

Putting the value of b in equation (iv), we get

$$108378588 = 5a + 15 \times 3444935$$

$$5a = 108378588 - 17224675$$

$$5a = 91153913$$

$$a = 91153913 / 5$$

$$a = 18230782.6 = 18230782$$

Substituting the value of a and b in equation (i) we get the regression equation of Yon X is**,**

$$Y = 18230782 + 3444935 X$$

Computation of Trend Value

Fiscal Year	Year (X)	a	b	Trend Value of Loan & Advance (Y)
2005/06	1	1,82,30,782	34,44,935	2,16,75,717
2006/07	2			2,51,20,652
2007/08	3			2,85,65,587
2008/09	4			3,20,10,522
2009/10	5			3,54,55,457
2010/11	6			3,89,00,392
2011/12	7			4,23,45,327

Similarly the 'trend values' of different variables of HBL have been calculated

Appendix: 7

Here X is non-dependent variable (Year) and Y is the dependent variable (Loan and Advance)

Fiscal Year	Year (X)	L& A (Y)	X^2	XY
2005/06	1	49,88,672	1	49,88,672
2006/07	2	51,22,221	4	1,02,44,442
2007/08	3	52,81,051	9	1,58,43,153
2008/09	4	71,83,680	16	2,87,34,720
2009/10	5	83,87,897	25	4,19,39,485
	ΣX = 15	**ΣY= 3,09,63,521**	**$\Sigma X^2 =$ 55**	**ΣXY = 10,17,50,472**

Let the regression equation Y on X be,

$Y = a + bX$ ………………. (i)

To find the value of a & b we have the following two normal equations

$\Sigma Y = na + b\Sigma X$ ………. (ii)
$\Sigma XY = a\Sigma X + b\Sigma X^2$……. (iii)

Substituting the values of n, ΣX, ΣY, ΣXY, ΣX^2 in equ. (ii) & (iii)
Then we get,

$30963521 = 5a + 15b$ …………… (iv)
$101750472 = 15a + 55b$ ………….. (v)

Now multiplying (iv) by 3 and Subtract it from (v), we get.

$$\begin{array}{rcl} 101750472 & = & 15a + 55b \\ 92890563 & = & -15a \pm 45b \\ \hline 8859909 & = & 0 + 10b \end{array}$$

$$10b = 8859909$$

$$b = 8859909/10$$

$$\text{so, } b = 885990.9 = 885990$$

Putting the value of b in equation (IV), we get

$$30963521 = 5a + 15 \times 885990$$

$$5a = 30963521 - 13289850 = 1767361$$

$$a = 17673671/5 = 3534734$$

Substituting the value of a and b in equation (i) we get the regression equation of Yon X i**s,**

$$Y = 3534734 + 885990X$$

Computation of Trend Value

Fiscal Year	Year (X)	a	b	Trend Value of Loan & Advance (Y)
2005/06	1	35,34,734	8,85,990	44,20,724
2006/07	2			53,06,714
2007/08	3			61,92,704
2008/09	4			70,78,694
2009/10	5			79,64,684
2010/11	6			88,50,674
2011/12	7			97,36,664

Similarly the 'trend values' of different variables of NCCBL have been calculated**.**

Appendix – 8

Questionnaires for primary data collection

Dear sir/Madam

This is to bring your kind information that this is an attempt to take some verdicts about *Non performing loan / assets of commercial banks for* the partial fulfillment of thesis of MBS degree, T.U. You are kindly requested to fill up the following questionnaire with the best answer in your view. I would be grateful to you for the contribution of your valuable time and effort.

Name: ______________________________ Sex: M [ ] F [ ]

Occupation (Tick One):

[ ] Shareholders [ ] Borrower [ ] Bank Employee

1) What are the things that should be considered by bank while disbursing loan?
   - [ ] Borrower's Financial Strength
   - [ ] Collateral Value
   - [ ] Nature of guarantor
   - [ ] Business Proposal
   - [ ] Management Team

2) What are the main internal reasons for loan turning bad loan?
   - [ ] Weak Management (Mismanagement)
   - [ ] Borrower's bad intention
   - [ ] Lack of portfolio management
   - [ ] Shortfall on security
   - [ ] Weak legal provision
   - [ ] Ineffective credit policy

3) What are the main external reasons for loan turning ban loan?

[ ] Economics and Industrial recession

[ ] Conservative provision

[ ] Inconsistent government policy

[ ] Lack of NRB's monitoring.

4) Which sector of investment covering more default loan?

[ ] House hold loan

[ ] Business / Industrial loan

[ ] Real State loan

[ ] Agriculture loan

5) Does NPL effect in the financial health of the bank?

[ ] Yes

[ ] No

[ ] No Idea

6) What is the best way or measure of resolving NPL problem in banking sector?

[ ] Strict recovery policy.

[ ] New rules & regulation

[ ] Perfect monitoring

[ ] Rebate for on time payment.

***Thank you for your time, consideration and support*.**

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