

Chapter I

INTRODUCTION

1.1 Background of the study

Nepal sandwiched between the two giant countries, India and china, is one of the land locked countries, and survives with her own natural beauty in Asia. Its half-century of experiments and efforts to raise the quality of life of its populace is defeated. Almost half of its population lies under absolute poverty line, especially living in the rural areas are deprived of even basic needs and facilitates like enough calories pure drinking water sanitation facilities, electricity, road facility etc. Some of the basic human indicators like life expectancy, literacy, nutrition level etc. also show that Nepal occupies among the nation to eliminate the massive poverty persisting in the country through gradual development of the total nation and by providing and availing basic needs to poor people. Actually slow pace of developing of Nepal is due to nothing but landlocked position, poor resources mobilization and its utilization, weak infrastructure development and more over unstable eco-political environment.

Banking Sectors are the backbone of a country's economy. Motto of the commercial banks is to mobilize the resources by investing the same in a profitable manner. The resources may include capital funds consisting of shareholders equity, money deposited by the people, borrowings and profit capitalization. The competency of any commercial banks is referred as to the utilization of resources on most profitable manner. The profit should be adequate to meet its costs of funds as well as there should be some margin left over as the reward for risk bearing. The financial institutions are supposed to have contribution for over all economic reforms in the country. Though their activities are guided by some social obligations but some profits are always been desirable for maintaining existence.

The concept of the banking has been developed from the ancient history with the effort of ancient goldsmiths who developed the practice of storing people's gold and valuables under such arrangement the depositors would leave their gold for safekeeping would get

back their gold and valuable after paying a small amount as fee for safekeeping and serving.

The role of money in an economy is very important. Proper and well-planned management of money directs, determines and enhances the health and productivity of total financial sector and the performance of financial sector affect the growth of economy. Hence, money is the topic to manage and banks are the manger. The existence of a bank is for the change in every aspect of human being and its presence is for the up - liftment of people. Banks are the back bone of the economy. They act as intermediaries to channel funds to productive business companies and projects.

Banks grants loan and advances to industries, people and companies that result in the increase in the productivity of nation. For example: The loan against to agricultural sector enhances the agricultural product on. The loan amount can be used by the farmers as per their need to produce their product that will promote the agriculture product on. Similarly the loan and advances to different people and corporate bodies help to increase their income and profits. They can use the amount as per their need at right place at the right time. Bank is a business organization where monetary transaction occurs. It creates fund from its clients saving and lends the same to needy person or business companies in term loans, advances and investment. So proper financial decision making is more important in banking transactions for its efficiency and profitability.

Most of the financial decision making loan management, it plays the vital role in the business succession, so efficient management of lending policy is needed.

The source of finance is the most essential element for the establishment and operation of any profit and non-profit institutions. Profit oriented institutions usually obtain these sources through ownership capital, public capital through the issues of shares and through financial institutions such as banks, in the form of credits, overdrafts etc Commercial banks, others banking institutions (OBIs), Non Bank Financial Institutions occupy important role in mobilizing financial resources. There are 25 commercial banks, 72 finance companies about 21 insurance companies including deposit insurance and Credit Guarantee Corporation, one Employee Provident Fund and one Citizen Investment Trust

belong to this type of financial institutions. Apart from this, securities such as corporate shares debentures and bonds are being traded in one stock exchange.

Banking plays significant role in the economic development of a country. Nepal Bank Limited (NBL) is the first commercial bank of the country. Commercial banks are the heart of the financial institutions. They hold the deposits of many persons, government establishments and business units. They made funds available through their lending and investing activities to borrowers, individuals, business firms and government establishments. They assist both the flow of goods and services from the procedures to consumers and financial activities of the government, they provide a large proportion of the medium of exchange they are the media through which monetary policy is affected. These facts show that the commercial banking system of the nation is important to the functioning of the economy. Bank is a resource for the economic development, which maintains the self-confidence of various segments of society and extends credit to the people.

The more developed financial systems of the world characteristically fall into three parts: The Central Bank, The Commercial Banks and other financial institutions. They are known as financial intermediaries. The banking business has its genesis from its function of lending.

Lending is the most fundamental function of a bank. The importance of Lending in banking business is undoubtedly unchanged and remains vital as it was early days of this business. Lending has its different forms. It can be dividend into fund based and non-fund based Lending. The fund based Lending can be further divided into cash credit, Overdrafts, demand and term credits, bills purchased and discounted and export packing credit, project loan, etc. Similarly, non-fund based credit can be classified into documentary credit, guarantees and bill co-acceptance facility.

Non Performing loan refers to those loans and advances which are not able to serve the interest and the installment within the given period of time. The term of non-performing loan is popularly known as NPA as well as NPA. There are little differences in the basis of measuring NPA in different countries, though the concept is same. Everywhere it is

considered as one of the key economic indicator for financial stability and sustainable economic development.

The less opportunity for getting avenues for loan floatation has compelled the banks to finance without being choosy. Quality of the loans and advances could not be maintained to the desirable level if there is no choice whether to finance or not. Once the loan is given it is supposed that the re-payment of interest or principal shall have to be served without any hindrance. The resources could not be regular and if there is cumulative overdue outstanding. There may be various reason may be economic situation of the country which has global and far-reaching impact. The smooth operation of the commercial banks is possible only when the economy of the country functions well. Satisfactory level of return on investment is the pre-requisite for the financial sector to be groomed. The other contributing factors that turn the good loan into bad are the attitude of the borrower, types and quality of security taken and legal hurdles created by the borrower when the recovery action is started. Once they distributes, loan is not returned timely by clients and becomes overdue than it's known as Non Performing Assets (NPA) for the banks. Reduction of NPA has always been a significant problem for every commercial Banks and proper attention for the management of the NPA now under top priority. Due to various hurdles on way of management of NPA, commercial banks are now losing their profitability and struggling for their existence.

Lesser the NPAs, corporate sector enjoys with robust balance sheet so that public confidence could be restored in the system. Nepal has been facing severe financial distress for a couple of years.

1.2 Focus of the study

NPA may be defined broadly as the Bad Debt. However NPA in terms of banking sector consists of those loans and advances which are not performing well and likely to be turn as bad loan. NPA as per current directives of Nepal Rastra Bank (NRB) has been categorized as classified loans and Advances. NPA has severe impacts on the financial

institution. On the one hand the investment becomes worthless as expected return cannot be realizable and on the other, due to the provisioning required for the risk mitigation the profitability is directly affected. NPA as categorized by NRB are classified loans and advances. For the probable loss on lending that can not be recovered even after liquidation of security held with banks NRB has directed to maintain loan loss provisioning according to aging basis for risk mitigation. The loan loss provision is to be maintained by debiting profit account. Thus as the quality of loan degrades the ratio of loan loss provision is increased affecting the profitability of the banks. This study will have effort to find out the relationship of NPA on Profitability of the commercial banks.

Management of NPA has led the banks towards the rigorous recovery action which ultimately may cause auctioning of the security held with bank's custody. Due to adverse economic situation of the country and perception build up among people that the properties under auction are always over evaluated there is less participation of the bidder during auction. Such situation compels the banks to accept the security on its own name. Continuous acceptance of the ownership has now created another problem by piling up the volume of Non Banking Assets (NBA). As the major chunk of NBA are fixed in nature the fund supposed to be rolled over are being tied on fixed asset which is heating the liquidity of the Banks. Present study is confined to evaluate the relationship of NPA and NBA.

Level of NPA in Nepalese Commercial Banks

It is confined to analyze the implication of NPA on the profitability of banks. Further it will be an effort to assess the relationship of NPA and NBA. Credit concentration risk and its implication on NPA increment shall also be considered. Affecting internal and external factors for the conversion of NPA shall be another area to be intended to focus under this study. For the analyzing of the cause and consequences the NPA level of three privately owned banks shall be taken into consideration.

1.3 Statement of the Problem

Nepal remained fortunate enough not to facing any major financial crisis, especially, from the influence of the Asian crisis. However, at the beginning of the Asian crisis in 1907, Nepalese currency depreciated by 11.2 percent against US dollar within a short span of time. Manandhar K.B. (2055) opines that the prime reasons behind this are (i) not opening up capital account and portfolio investment; and (ii) enough foreign currency reserve in the economy. Nepalese financial system have two major drawbacks that large intermediation cost and inefficiencies. The weak legal and regularity framework are the responsible factors for weakening the Nepalese financial system. Obviously, a distress financial system adversely hits the quality of the assets in the system. as such, the non-performing loans in the banking sector remained at high level for the last few years. The non-performing loans in the banking sector remained at high level for the last few years. The non-performing loans as a percentage of total loans in the banking sector was 14.3 percent in 2000 while it increased by over cent percentage point to 29.3 percent in 2001 and to 30.10 percent 2002. However, in the mid of Jan 2003, it was 28.68 percent. Marginally it declined to 14.22 percent in 2005/06 and on Mid April 2007, 14.18 percent. However the public banks significantly cover 30.69 percent NPA while the private banks covered average 6.58 % of NPA.

In this background, it felt to make a research on NPA of Nepalese Banking and financial sector. Maintaining NPA as per international standard is prominent for the growth, stability, competitive power of banking sector, which help to make them competitive for the exposure to present context of globalization. The main problem is that the Nepalese banking sector is affected by the NPA problem. In this background it is necessary to assess NPA situation on Nepalese financial sector.

In this background, the researcher has the following questions for the study.

- What the trend and actual level of NPA on Nepalese financial sector?
- Is the NPA affecting the financial performance of this sector?
- Is the regulation and policy framework of NRB sufficient to control the NPA level?

- Is the NPA in Nepalese banking sector as per the international standard?
- Is the present level NPA satisfactory in Nepalese financial sector?

1.4 Objectives of the study

The gradually increasing NPA has now become a major issue for every commercial bank. Every bank has now put the NPA management under top priority. Thus in present context analyzing the cause and implication of NPA obviously shall be useful for banking sector. The basic objective of this study is to analyze and identify the impact, cause and consequences of NPA. The specific objectives of this research are as follows.

- To evaluate the impact of NPA on the profitability of the sample banks.
- To analyze the NPA of the banks under study
- To assess the relationship between NPA and Total lending
- To examine loan loss provision in sample commercial bank in accordance with NRB directives.

1.5 Significance of the Study

The proper mobilization and utilization of domestic resources become indispensable for suitable economic development and there is no doubt that commercial banks have pivotal role for the collection of dispersed small savings of Nepalese people and transferring them into meaningful investment. The success and prosperity of the bank relies heavily upon the important sectors of economy as well as to generate more profit by investing in consumer's demand. The main aim of the present study is to find out what sorts of tools and techniques have been used to overcome the problem of conversion of performing assets into the non-performing assets, by the commercial banks in the country and to analyze what other kinds are being used in the present world that corresponding banks can adopt, if found, under the study.

Loans and advances are the most profitable of all the assets of a bank. These assets constitute primary sources of income to the bank. It means interest earned from such loan

and advances occupy major space in income statement of the bank. As a business institute, a bank aims at making huge profit. Since loan and advances are more profitable than any of other assets, the bank is willing to lend as much as its fund as possible. But it has to be careful about the safety of such loans and advances. So it is very important to be careful about the safety of such loans, and advances. So it is very important to be reminded that most of the banks failures in the world are due to shrinkage on the value of loans and advances. Hence loan is known as risky assets. Risk of non-repayment of loan is known as credit risk or default risk. Performing loan/assets has multiple benefits while non-performing loan/assets erode even existing capital. Therefore success of any bank doesn't depend upon how much money a bank is able to lend, but it depends upon the quality of the loan. So success of a bank depends upon the amount of performing assets/loan. Performing assets are those loans that repay principal and interests to the bank from the cash flow it generates.

It is well known fact that bank and financial institutes in Nepal has been facing the problem of swelling non-performing assets and issues is becoming more and more unmanageable. Unfortunately, nowadays banks have been becoming the victims of high level of NPA, which has been the subject of headache to the banking sector and Nepalese banking industry is not also exception from this truth.

The total NPA of Nepalese banking sector is about 35 billion rupees, and it is worse case of the two largest banks of Nepal, Nepal Bank Limited and Rastriya Banijya Bank Limited. The NPA level in these two banks is above 50% of the total deposits of the bank.

This present study mainly concern with the analysis of level of NPAs in total assets, total deposits and total lending of different commercial banks of Nepal. Therefore, it is significant to find out the level of NPA and to find out whether the banks maintained loan loss provision in accordance to NRB's directives or not. It also examines the effects of NPA in ROE and ROA of the bank. And point out the defects inherent in it and provide package of suggestion for its improvement if found any.

Apart from above this study will be a matter of interest of or the students, academicians and other professionals.

1.6 Limitations of the study

This study has been made for the partial fulfillment of the requirement for the Master Degree in Business Studies (MBS) but not a comprehensive study. Its limitations are:

- The accuracy of the research solely depends upon the exactness and reliability of data used.
- The study is fully based on the student's limited financial resources within a limited period.
- The study is not a final study on the subject.

1.7 Organization of the study

This research has been organized in five chapters as below:

Chapter I: Introduction:

The first chapter deals with introduction. This includes background, statement of problem, objectives of the study, significance of the study, limitation of the study.

Chapter II: Review of Literature:

Second chapter presents review of available literature. It includes review from book, reports, article journal, previous thesis etc.

Chapter III: Research Methodology:

Third chapter incorporates the research methodology used in the study, which includes research design, sources of data population and samples, methods of data collection and analysis etc.

Chapter IV: Presentation and Analysis of Data:

The fourth chapter deals with data collected from different sources. Based on the data analysis of analysis of investors' preferences will be made using statistical and non-statistical tools. This chapter also includes major findings.

Chapter V: Summary, Conclusion and Recommendation:

The fifth chapter includes summary, conclusion and offers suggestions for further improvement.

Chapter Two

LITERATURE REVIEW

2.1 Background

This chapter includes the brief presentation of the origin and concept of Bank, concept of commercial bank, evolution of the banking sector in Nepal with detail profile about the sample banks under study. This also covers the review of the theoretical background being implemented as for the management of NPA Nepalese commercial bank have now started to give proper attention on NPA .Some banks have recently introduced the NPA management policy for the recovery and regularization of the dues. But relating to the cause of NPA growth and its total impact on financial position of the banks has been studied so far in detail. There are some articles in this perspective that comes occasionally however those are also not specific for tracing out the cause and effect of NPA.

2.2 Conceptual Framework

2.2.1 Origin and Concept of the Bank

As early as 2000 BC, the Babylonians had developed a banking system using their temples as banks. From those foundations Greek banking institutions had been emerged. When the Romans conquered the Greeks, the temple priests no longer acted as financial agents. But future growth in the industry was seen thereafter and it was only in the 12th century that some banks were established in Venice and Geneva. During this period there was boom in banking business in Florence (Khusbuchandani, 2000:23). The traces of rudimentary banking are found in the Chaidenan Egyptian and Phoenician history (Vaidya, 1999:273).

In England, banking had its origin with the London goldsmiths who in the 17th Century, began to accept deposits from merchants and other for safe keeping of money and other valuables, crude money lending and money changing were present during the reign of Elizabeth (1533 AD - 1603 AD), and the practice developed whereby merchants would

deposit money (coins) in the Tower of London, which served as the British mint. The next stage in the banking arises when the goldsmith becomes a money-lender (Paul, 1996). Fractional reserve banking must have developed shortly after the goldsmiths entered the banking business, because periodically, they computed balance sheet, or as they called it "casting up ye shop (Makinen, 1981:65).

The concept of modern commercial bank came into existence by the emergence of the Bank of England in 1694 with a capital of 1.2 Million Pound by a group of wealthy London merchants and financiers. Since, at that time, there was no concept of Joint Stock Company, it was necessary to obtain a special charter from the crown to pool their money in common venture. King William III was too pleased to grant a Royal charter to Bank of England, because in return a capital subscribed of 1.2 Pound was lent to him to finance his war against France. The charter also gave the new bank the right to issue notes, payable on demand, up to the amount of the loan to the kin (Joshi, 2001:56).

2.2.2 Concept of Commercial Bank and Historical Review in Nepalese Perspective

Commercial Bank Act, 2031 BS of Nepal has defined commercial bank as an organization which exchanges money, accepts, grants loans and performs commercial banking functions and which is not a bank meant for co-operative, agriculture, industries or for such specific purpose.

As per Banking and Financial Institution Act (BAFIA) commercial bank is defined as any financial institution that is operate under section 47(1) of BAFIA-2063.

It is fact that financial sector plays a vital role for the economic development of a country. Even before the establishment of a banking system in Nepal financial transaction was in practice as undertaken by some moneylenders like sahu-mahajans, zamindars, relatives, friends, and few informal organization limited to ethnic group such as Guthi. The borrowing from the other people and the informal organization was limited and based on personal understanding. At that time people deposit their gold, silver, and valuable goods for the sake of security. Thus, the private moneylender can be taken as forerunner of the concept of financial institution.

Nepal has been ruled over by many rulers like Kirati, Lichchhavi, Mall, Ranas and Shahs. Mostly Kirati, Lichhavi, and Mall regimes were concerned with the construction of temples, pati, pouwa, chautari etc. At that period neither the people nor the government were interested to think about the economic development of the country. According to ancient "Vanshawali" in fourteenth century, the ruler of the then Kathmandu Jaysthiti Malla segregated the local domiciles into 64 different classes according to profession they had undertaken. Tankadhari was one of those classes who used to deal in coins and precious metals such as gold. These Tankadharis were said to have carried out the borrowings and lending on money (coins). Hence, Tankadharis can be regarded as the traditional bankers of Nepal (Singh & Khadka, 2056:125)

After long time, during the Ran regime only handfuls prime minister thought about the economic development of the country. They established some offices in 1993 B.S. (1887 AD). "Tejarath Adda" was established during the tenure of Prime Minister Ranodip Singh Rana as a first institutionalized credit house. Tejarath adda provided loan under the security of gold and silver to the government employees and public. The government established its various branches and sub-branches at different places of the country for the sake of benefits of people. In the overall development of the banking system in Nepal, the Tejarath Adda may be regarded as the Father of modern banking institutions and for a quit long time it tendered a good service to government employee as well as to the general public (Shrestha, 1995:52). The government also implemented the rules against the vast interest rate taken by moneylenders. Thus, the government financial institution occupies an important role in the banking history of Nepal.

No financial institutions were established over a long period due to political reasons. To fulfill the growing need of economy on Nepal, banking activities were performed only after the establishment of Nepal Bank Ltd in 1994 B.S. as the first commercial bank of Nepal. This bank was establishment under Nepal Bank Act 1994 B.S. (1983 A.D.)

Nepal Rastra Bank was established in Baisakh 14, 2013 B.S. (1956 A.D.) under Nepal Rastra Bank Act 2012 B.S. (1955 A.D.) as the central bank of Nepal. It is totally owned by government, NRB is heavily assisting for the development of whole economy. It is

giving timely directives to all financial institutions operated and conducted in all over the country.

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

Along vacuum in the banking sector got some rays of hope only when the government forwarded the economic liberalization policy in 2039 B.S. and decided to allow foreign banks to operate their activities in Nepal in "joint-venture model". "Joint venture banks can be defined as an association of two or more parties having common objectives and goals so as to get maximum satisfaction. Basically at that time, it was envisioned that joint-venture banks (JVBS) would support the country in various ways" (Singh and Khadka, 1999:58)

The Nabil Bank Ltd is the first joint-venture bank established in 2041 B.S. and started its operation with modern banking services. In the same way, Nepal Indosuez Bank (at present Nepal Investment Bank), the second joint-venture bank established in 2042 B.S. with an objective to encourage efficient banking services and facilities. Likewise Standard Chartered Bank is operated under the direction of Indian management.

With the satisfactory result of joint-venture banks, Nepalese promoters are highly encouraged and as a result, commercial banks are introduced with cent percent domestic investment. At present Nepal Industrial & commercial bank (NIC), Lumbini Bank Ltd, Machhapurchhre Bank Ltd, Kumari Bank Ltd, Laxmi Bank Ltd, and Siddhartha Bank Ltd came into operation with cent percent domestic investment by Nepalese promoters which is the plus point of development of banking history of Nepal. Now, there is a strong competition between commercial banks for their existence so that the growing needs of the customers can easily be achieved.

2.2.3 Definition of Loan and Advances

Loans and advances are the most profitable source of income of all the assets of a bank. Banks universally seek after the asset. This asset constitute primary source of income to banks. According to Dr. Walter Leaf - "*In the item of 'advances to customers', we have reached the central portion of the activity of bank.*" The banker is brought into direct relation with public. His capacity and Judgment and his usefulness to the community is judged by the way he lends the money left with him by the depositors. As, the business institution, a bank aims at making a huge profit. Since loan and advances are more profitable than any other assets, he is willing to lend as much as of his fund as possible. But he has to be careful about the safety of such loan and advances. In the words of Dr. Leaf, the bankers, has to timber liberality with caution. If he is too liberal, he may easily impair his profits by bad debts, if he is too timid, he may fails to obtain n adequate return on the fund which are confided to him for use. It is by his capacity in lending that a bank manager Judged (Radhaswamy & Vasudevan, 1979:550)

Loan and advances dominate the asset side of balance sheet of any bank. Similarly earnings from such loans and advances occupy major space in the income statement of the bank. Lending can be said to be the raison d etre of a bank. However, it is very important to be reminded that most of the bank failures in the world due to shrinkage in the value of loan and advances. Hence loan is known as risky assets. Risk on non-repayment of loan known as risky asset. Risk of non-repayment of loan is known as credit risk or default risk." (Dahal & Dahal, 2002: 114)

Likewise the term Loan is defined as a lending. Delivery by one party to and receipt by another party of sum of money upon agreement expressed or implied, to repay it with or without interest (Boerner Vs. Colwell Co. 21 Cal. 3d.37 145 Cal Rptr. 380, 384, 577p.2d.200). Any thing furnished for temporary use to a person at his request, on condition that it shall be returned, or its equivalent in kind, with or without compensation for its use (Liberty Nat Bank & Trust Co. V travelers Indem. Co.58 Misc.2d 443, 295N.Y S.2d.983, 986). Loan included (i) the creation of debt by the lender's payment of or agreement to pay money to the debtor or to a third party for the account of the debtor; (ii)

the creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately; (iii) the creation of debt pursuant to a lender credit card or similar arrangement; (iv) the forbearance of debt arising from a loan: Uniform Consumer Credit Code: 30-106.

Further Debt means 'Principal and Interest provided to debtor by banks or financial institutions, with the pledge of immovable or movable property or other securities or guarantee or without guarantee, and the word also means over dues of the transaction beyond balance or fees, commission and interest incurred in that relation (Debt Recovery Act for Bank and Financial Institution, 2058:3)

2.2.4 Definition of NPA

To define NPA first of all meaning of Assets should be understood. Asset means the property of a person or a company. This indicates that assets are the property of a company accumulated with the help of sources.

An asset is classified as non-performing assets (NPAs) if the borrower does not pay dues in the form of principal and interest for a period of 180 days. However with effect t from March 2004, default status would be given to a borrower if dues are not paid for 90 days. if any advances or credit facilities granted by bank to a borrower becomes non performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status.

Non-performing assets (NPAs) could wreck bank's profitability both through a loss of interest income and write of the principal loan amount. It tackles the subject of in entire starting from the stage of their identification till the recovery of dues in such account (Bidani, 2003:1).

Non Performing Loan means an outstanding loan that is not repaid i.e. neither payments on interest or principal are made. In case of the banks the loans and advances are the assets as the banks flow loans from the funds generated through shareholders equity,

money deposited by the people and fund having through the borrowings. Hence the term NPA means the loans and advances that are not performing well. Thus all the irregular loans and advances can be termed as 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 transaction or a future obligation.

2.2.5 Global Development of NPA's (Causes & Measures of NPA's)

(Country- Wise Analysis)

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 do not give much confidence to banks. In case after case, these giant corporate became bankrupt and 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 bank upon in a situation of default.

China

Causes

- I. Moral Hazard: The SOE's believe that there the government will bail them out in case of trouble and so they contribute to take high risks and have not really strived to achieve profitability and to improve operational efficiency.
- II. Bankruptcy laws favors borrowers and law courts are not reliable enforcement vehicles.
- III. Political and social implications of restructuring by SOE's force the government to keep them afloat.
- IV. Banks are reluctant to lend to the private enterprises due to
 - a. Non-standard accounting practices.
 - b. While NPA of an SOE is financially undesirable, and NPA of a private enterprise is both financially and politically undesirable.

Measures

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

Thailand

Causes

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

Measures:

- I. Amendments were made to the Bankruptcy Act.
- II. Corporate Debt Restructuring Plan (1998) focused on capital support facilities for bank recapitalization and setting up of AMC's.
- III. New rules governing NPA exit procedures based on international standards were introduced.
- IV. Privatization of government entities was mooted, but faced strong political oppositions for fear of a social backlash.
- V. Adoption international standards for loan classification and provisioning.
- VI. Caps and Foreign equity ownership in financial institutions were removed.

Korea

Causes

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

Measures

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

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

Japan

Causes

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

Measures:

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

2.2.6 Nepalese Banking System and NPA

We all know that collection of deposits and making of loan and advances are the core functions of the banks and financial institutions. While collecting the deposits the bank has to provide interest to the depositors, it is cost to the bank. The money collected in the form of deposits is again translated into loans and advances and banks get interest income. On this transformation process the banks have a small interest spread from which they have to meet the operating expenses, cost of bad debts and a small profit margin. In order to pay the interest to the depositors and meet the withdrawals of depositors, there should be regular repayments of the principle and interest of loans from borrowers as per agreed schedule. In order to make this system interrupted banks should have to make, the loans as performing assets, i.e. good loans. Good loans and advances are called performing assets. Banks and financial institutions always try to have almost all the financial assets as performing assets to make them sound, sustainable, profitable and healthy within the system. Sometimes, unfavorable internal economic shocks and other discrepancies affect the quality of such assets. Deterioration in the quality of loans and other assets, give birth to non performing loans and ultimately invites the financial crises. In Nepalese case, the quality of loans has been deteriorated mostly not because of the

unfavorable economic condition of the nation but because of their bad intention of the borrowers. This is because, if we study the defaulted loan files of the banks we can find that most of the loans can be defaulted from the economic situation was favorable to the borrowers and also the economy was achieving a higher level of economic growth. Their track record is not good and even in that time they have not paid the bank as per agreement. It is a business principle that an entrepreneur has full right over profit and responsibilities over losses of the business if any. If there will be a continuous loss in the business, or symptoms of losses are envisaged, then the borrower should either change the business or stop the operations to control further losses. This is because; the borrower has to meet the obligation of loss from its own resources. In such cases, borrowers need to liquidate their assets for debt servicing. If we see the scenario of defaulted borrowers, they were serious to repay the loans, they would have been using available options such as liquidation of their personal assets and cut down the cost for the luxurious life in order to repay the bank's debt.

2.2.7 Level of NPA in the Nepalese Financial System

The government of Nepal has been endeavoring a lot of efforts to make the Nepalese financial healthy and prudent through various reform programs, the level of NPA in the Nepalese Banking System has not come down to an acceptable level. The efforts to date succeeded only to reduce the NPA to some extent but it is still not sufficient to maintain the sound health of the system to the desired level. The level of NPA was around 30 percent in 2003 and is continuously decreasing thereafter with the implementation of FSRP. It has decreased to 18.04 percent in July 2005 and 14.22 percent in July 2006.

On the other hand the level of NPA is still increasing in the Development Banks and finance companies. Therefore, we can see that the financial discipline and level of NPAs is improving in banks, whereas the problems in Development Banks and finance companies are deteriorating. The table provided below highlights the facts.

In the healthy financial system the level of NPA should be contained within 5 percent. The financial sector reform program has focused its efforts at reducing the level of NPA. Therefore, it has still been challenging task for Nepalese authorities to date.

Level of NPA in Nepalese Commercial Banks

S.No	Name of the Bank	Percentage of NPA at 2008/12/31
1	Nepal Bank Limited	11.0%
2	Rastriya Banijya Bank	19.0%
3	NABIL Bank Limited	0.8%
4	Nepal Investment Bank	1.0%
5	Standard Chartered Bank	0.8%
6	Himalayan Bank	1.8%
7	Nepal SBI Bank	2.7%
8	Nepal Bangladesh Bank	29.3%
9	Everest Bank Limited	0.5%
10	Bank of Kathmandu Ltd.	1.8%
11	Nepal Credit & Commerce Bank	10.3%
12	NIC Bank Ltd.	0.9%
13	LUMBINI Bank	12.3%
14	Machhapuchhre Bank	4.8%
15	KUMARI Bank	1.1%
16	LAXMI Bank	0.1%
17	Siddhartha Bank Limited	0.6%
18	ADB/N	11.7%
19	GLOBAL Bank	0.1%
20	CITIZENS Bank	0.0%
21	PRIME Bank	0.0%
22	SUNRISE Bank	0.0%
23	Bank of Asia	0.0%
24	DCBL Bank	1.8%
25	NMB Bank	1.5%

Source: Banking and Financial Statistics; Mid January 2009

2.2.8 Classification of NPA

As per the NRB directives NPA are said as classified loans. And this includes sub-standard, doubtful and loss categories as defined by new NRB Directives (NRB Circular, 2057).

As per the circular no.BP.BC.79/21-043-92 dated April 27, 1992 and Circular No.B.B.BC.59/22.04.943-92 dated December 17, 1992 the NRB has identified the NPA as an account of loan where on the Balance sheet date in respect of:

- Term Loan interest remains "past due" for more than 180 days, overdraft and cash credit account remain out of order
- Bills purchased or discounted remain overdue or unpaid for more than 180 days,
- Other accounts receivables remain past due for 180 days.

The Circular further says a NPA is credit facility in respect of which interest has remained unpaid for two quarters. According to the Circulars the loans are classified based on weakness and dependence on collateral securities into four categories and prescribed the provisioning rate as follows (Tannan, 1997:26)

Categories of Loan

Categories of loan	Criteria of Classification	provisioning required
Standard	not disclose any problem and not carry risk (actually a performing asset)	1% of outstanding loans
sub-standard	overdue for not exceeding 2 years	10% of the total outstanding
doubtful	overdue for exceeding 2 years	100% provision on unrealizable value of the security 20% if the asset has to remain doubtful up to 1 year 30% if the asset has remained doubtful up to 3 years 50% if the asset has remained doubtful for more than 3 years
Loss	Uncollectible/unrecoverable loans, continuance as a bankable asset is not warranted.	Entire amount should be written off. If assets are permitted to remain in the books for any reason, 100% outstanding should be provided for.

In our country the previous circular of NRB had classified the loans into six categories; however as per new circular issued and effective from F/Y 2058/059 commercial banks are required to make provision against loans and advances as follows:

Provision against Loan and Advances

Classification of loans and advances	Criteria for provisioning	Provision rate
Pass	Past due for a period up to 3 months. (performing loans)	1%
substandard	past due for a period of 3 months to 6 months	25%
doubtful	past due for a period of 6 months to 1 year	50%
Loss	past due for a period of more than 1 year or advance which have least	100%

However, for F/Y 2058/059, 2059/60 and 2060/061 there are certain relaxation on ageing of due loan. The above criteria are supposed to be effective fully onwards F/Y 2061/062 (NRB Circular, 2057).

2.2.9 Effect of NPA on Profitability of the Bank

Under the circumstances, assets that do not earn any income to the bank affect the profits in a Number of ways which are as follows:

Profitability impact:

- The resources locked up in PA are borrowed at a cost and have to earn a minimum return to service this cost.
- NPA on the one hand do not earn any income but on the other had drain the profits earned by performing assets through the claim on provisioning requirements.
- Since they do not earn interest they bring down the yield on advances and the net interest margin or the spread.
- NPA have a direct impact on return on assets and return on equity, the tow main parameters for measuring profitability of the bank.
- Return on assets will be affected because while the total assets include the NPA they do not contribute to profits which are the numerator in the ratio.
- return on equity is also affected as provisioning eats more and more into profits earned.
- The cost of maintaining these assets include administrative costs, legal costs and cost of procuring the resources locked in
- NPA bring down the profits, affect the shareholder value and thus adversely affect the investor confidence.

As a whole the impact of NPA can be assessed with the following (Athmanathan and Venkatakrisna, 2001:564)

- Lower ROE and ROA
- Lower image and rating of bank
- Disclosure reduces invertors' confidence
- Increases costs/difficulties in raising capital
- NPA do not generate income

- They require provisioning
- Borrowing cost of resources locked in
- Opportunity loss due to non recycling of funds
- 100% risk weight on net NPA for CAR
- Capital gets blocked in NPA
- Utilizes capital but does not generate income to sustain the capital that is locked.
- Recapitalization by government comes with strings
- Administration and recovery cost of NPA
- Effect on employee morale and decision making.

2.3 Review of Previous Studies

One way to conduct this research work some books, journals and publications have been studied to formulate ideas about the subject matter. Although, the specific books regarding the NPA could not be found, however, some banking related books have been consulted such as Tanna's Banking Law and Practice in India (1997). Assessing the gravity of the problem Tanna (1997) found saying that banks and financial institutions at present face considerable difficulties in recovery of dues from the clients and a significant portion of the funds of banks and financial institutions is thus blocked in unproductive assets.

In India for addressing the question of speeding up the process of recovery was examined in great detail by a committee set-up by the government under the chairmanship of the Late Shri Tiwari.

Likewise for taking reference book on management of bank credit written by Suneja, (1992) has also been consulted. Suneja (1992) pointing out the cause of NPA says that the Risk connected with lending to business depends on an enormous number of factors. For any particular type of business the risk failure is affected by.

The state of economy, trend in demand for the product or service provided competition from any other suppliers, financial resources are too limited and management skills are

lacking. Reiterating the difficulties Suneja (1992) says probably the most difficult decision facing a banker is to determine when it becomes necessary to recall a loan and to begin the process of liquidating the security. Further she suggests that if a customer fails to make repayment on the due date the bank has to consider what steps need be taken to recover the debt.

Ram Chandra Ghimire (2056) in his article, "*Efficiency Indicators of commercial Bank: A comparative analysis*", found saying that efficiency indicator of the bank may be viewed on the basis of amount allocated for loan loss provisioning against loan and investment.

Sagar Basyal (2057) discussing the financial performance of government owned banks in his article "*Placing RBB and NBL under Management Contracts: Rational and Opposition*" agreed that the disappointing performance of these two banks has become serious concern to all the stockholders. Further he mentions that they are having with huge level of NPA which could be termed as the darkest sides of their operational inefficiency and undisciplined financial behavior.

Suresh Pradhan (2058) in his article "*NPA: Some suggestions to tackle them*" found saying that unless the growth in NPA is kept in control, it has the potential to cause systematic crisis. He has mentioned that a dream of globalization led to huge investment which unfortunately could not be utilized properly due to hesitant liberalization policies. Large corporate misused the credits and delayed payments and contributed indirectly for enhancing NPA ratio.; He further argues the lack of vision in appraisal of proposal while loan sanctioning, reviewing or enhancing credit limits, absence of risk management policy of financing, concentration of credit in few group of parties and sector, lack of coordination among a various financiers, lack of initiatives to take timely action against willful defaulters, indecision on existing out of bad loans for fear of investigating agencies like special police, CIAA, Public Accounts Committee of the parliament have also contributed in whatsoever measures to the worsening situation of NPA front. He further pointed out that most crucial reason for the increase in the NPA is the shabby and defaulter friendly legal system. Suggesting the remedy of NPA he adds that

Administrative system should be strengthened, Legal reforms should be made and Assets Reconstruction Company should be formed. Henderson (2003), CEO of RBB turnaround is restructuring and collection of NPA.

Though these studies are found to be quite useful in their own side but the question of NPA and its cause as well as effect on various aspects in commercial bank is yet to be reviewed. In view of these, this study has been based on the various contributing factors that increase NPA level in commercial banks in Nepalese perspective and its effect on profitability position of the banks.

2.4 Review of Dissertations

On the way to conduct this research work, some previous thesis has been studied to formulate ideas about the subject matter. Thesis on this subject matter is scarce hence only two theses have been reviewed.

Dinesh Kumar Khadka (2004) has conducted research on “*Non Performing Assets of Nepalese Commercial Bank*”. He observed various aspects on NPA’s. The objectives of his thesis is

- i. To study and examine the level of NPA’s in total assets, total deposit and total lending of Nepalese commercial banks.
- ii. To identify the effect of non performing assets on ROA and ROE of Nepalese commercial banks.

The major findings of his study were as follows:

- i. NPA of the bank seems at remarkable level at the end of FY 2059/60.
- ii. NPA in total assets, total deposit and total lending has been decreasing of NIB Ltd. and of NABIL where as increasing in NB Bank Ltd. and BOK td.
- iii. None of the bank has follows NRB’s directive regarding loan loss provision.

- iv. ROA and ROE of the bank somehow depends on NPA.

The study by Narayan Shrestha (2004) on “*Non performing Loans and Loan Loss Provisioning of Commercial Bank*”. To achieve her objectives she has analyze different aspect of SCBNL, NBL and NABIL. He has set the following objectives:

- i. To evaluate the impact of NPA on profitability.
- ii. To assess the adequacy of Loan Loss provisioning.
- iii. To measure the level of NPA and its relationship with total loans.
- iv. To analyze the external and internal factor that influence NPA.

And the major findings of her study were as follows:

- i. Management of SCBNL has risk adverse attitude or they have policy of investing low in risky assets as compared to NABIL and NBL.
- ii. Loan and advance to total deposit ratio of SCBNL is more consistent in comparison to other two banks.
- iii. SCBNL has low non performing loans in comparison to other two banks.
- iv. Loan loss provisioning of NBI is significantly higher than othe two banks.

The study done by Govinda Gimire (2005) on “*Non performing Assets of Commercial Bank*” has set the following objectives for analysis.

- i. To evaluate the impact of NPA on profitability
- ii. To assess the relation ship of NBA and NPA.
- iii. To analyse the external and internal factor that influence NPA.

And the major findings of his study were as follows:

- i. Operating profit of sample banks are increasing but the growth on net profit is negative because of loan loss provision.
- ii. There is a positive relation between credit expansion and incremental on NPA.
- iii. NBA is created due to having NPA but cannot say whether there is NPA that always creates NBA.

Subash Koirala, (2006) has conduct research on “*Non Performing Assets and Profitability of Commercial Banks*”. He analyzed the data of six commercial banks and has set the following objectives:

- i. To evaluate the impact of NPA on the profitability of the commercial banks.
- ii. To evaluate internal and external factor those influence the performing assets to non performing assets.

And the major findings of his study were as:

- i. The NPA of NIB and NB Bank was increasing during the study period.
- ii. The NPA of EBL and NABIL was decreasing during the study period.
- iii. The NPA of HBL and SBI Bank was fluctuating during the study period.
- iv. In overall performance Nabil Bank was found to be satisfactory where as NB Bank performance was the worst.

2.5 Research Gap

With compare to the previous thesis on this subject, data of this study has been updated till 2063/64. None of the previous researcher has done hypothesis testing on NPA. To find out the relationship between NPA and Total lending T-test has been conducted. In this research more emphasis has been given on relationship between NPA and other

relevant variable. Previous researches carried on the same topic has shown only the level of Non Performing Loan in the Nepalese Financial Institutions but this study has tried to reflect the trend of NPA/NPA in Nepalese financial institutions and the interrelationship of NPA/NPA with other relevant variables like level of deposit, MPS, DPS and Net Profit. In this connection, this study contributes something new toward the loan and advances of commercial banks that is not sought yet by surveying the psychology and awareness of investors investing in various types of securities. This sort of study identifying the level, trend and impact of NPA is a new and challenging in itself but is also an opportunity to learn and identify the banking market. More specific studies as to the NPA/NPA for example in the field of policies and operational issues, is necessary opening up the new and challenging research avenues for researchers.

Chapter III

RESEARCH METHODOLOGY

3.1 Introduction

The research methodology is the process of arriving to the solution of the problem through planned and systematic dealing with collection, analysis and interpretation of fact and figure. The research methodology adopted for the present study is mentioned in this chapter which deals with research design, population and sample, sources of data, presentation and analysis of data, methods for analyzing collected data.

3.2 Research Design

Research design is necessary for each research work. It is a plan for the collection and analysis of data. It presents a series of guideposts to enable the researcher to progress in the right direction in order to achieve the goal. So, selecting a suitable methodology is a good part of the research study. Then a suitable research design has been employed in order to analyze the privatization and capital markets growth in Nepal.

As the principal objective of study is to analyze the relationship between the NPAs and other different variable of financial institutions, this study follows the descriptive as well as analytical approach so that logical conclusion could be drawn. Most importantly, the study is based on historical data.

3.3 Population and Sample:

All the commercial banks listed in the stock exchange were considered as the total population. Out of them, four commercial banks (LBL, EBL, NSBI, NBB, HBL and NABIL) that were in existence and doing share transactions in NEPSE Limited were considered as the sample for the study.

Table -3

Total population, sample and Sample Percentage

Types of the listed companies	Total Population	Sample considered	%
Commercial Banks	25	6	24

[Source: Nepal Stock Exchange limited, 2008]

3.4 Sources of Data:

Data are considered as an integral part of research. Required data for this study is equally based on secondary sources of information. Some information has been gathered from the personal interview with the bank officials.

The sources of secondary data includes

- Annual Reports of corporate firms in sample
- Annual Reports, Nepal Rastra Bank
- Annual Budget Speech, Ministry of Finance
- Economic Survey, Ministry of Finance
- Economic Reports, Nepal Rastra Bank
- Quarterly Economic Bulletin, Nepal Rastra Bank
- Statistical Pocket Book, Central Bureau of Statistics.
- Various Reports and Research Studies

- Various Articles and Publications
- Various Journals and Magazines
- Daily Newspaper

3.5 Tools for Analysis

Statistical tools are the keys for the analysis of numerical data in most of the researchers. In this study analytical tools have been statistical tools.

3.5.1 Statistical Tools

Statistical tools help to measure the relationship between the variables. Mainly, the relationship between NPAs and other variables are analyzed with the help of the statistical tools as noted below. Mainly, expected return (Mean value), Standard deviation (Risk) and coefficient of variation (CV) is calculated for examining the relationship between the variables

Graph

Graph helps to show the general trend of the ratios in respect to the time periods of the analysis year. Every common way of presenting data for two variables, which have a relationship, as in a figure or chart or graph.

T-Test

When a sample size is less than 30 the student T-test is conducted. The T- distribution is similar to normal distribution but is not exactly normal. For the purpose of T-test 5% level of significance is taken.

Correlation Coefficient (r)

Correlation coefficient is calculated to find out the relationships between independent variable (x) and dependent variable (y), which is calculated as follows.

$$r = \frac{N \sum xy - \sum x \cdot \sum y}{\sqrt{[N \sum x^2 - (\sum x)^2] [N \sum y^2 - (\sum y)^2]}}$$

Where,

N= no. of observation

Y=dependent variable

X=independent variable

Chapter IV

DATA PRESENTATION AND ANALYSIS

4.1. Introduction:

In this chapter, efforts have been made to present and analyze the collected data. Data collected from various sources were classified and tabulated as requirement of the study and in accordance to the nature of the data. Different arithmetical and statistical tools are used to analyze the data collected under the study. To make easier and clearer to the understanding of the study, data are presented in the tables and Diagrams.

Simple percentage is used to analyze the data as arithmetical tools. Karl's Pearson's correlation coefficient issued to analyze the data as statistical tool.

Nowadays Non-Performing Assets (NPA) have been occupying major space in the total assts and total lending of the bank. It stands around 15% in the Nepalese banking system while it is even worse in case of two large commercial bank, Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL). The NPA of RBB is found 45.3% while that of NBL is 25.1% of the total lending. In this way it shows that commercial banks have been suffering by high level of NPA, and the efforts of the banks have been diverted to reduce it.

Keeping this fact into consideration, a provision has set up by Nepal Rastra Bank in Fiscal year 2057/58 to control the level of NPA of Nepalese commercial banks. According to that provision, every bank has to classify its total loan and advances including purchased and discounted bills) as pass loan, substandard loan, doubtful loan and bad loan, on the basis of overdue against schedule. Commercial banks are also directed to maintain loan loss provisions stated in section 11 of directives no. 2 of NRB's directives for commercial banks 2059. Main purpose was to find out the level of NPA in Nepalese commercial banks and to take necessary steps to control the level of NPA in future.

Here in the study, data of five fiscal year starting from F/Y 2059/60 to 2063/64 have been presented to study and analyze the level of NPA in total assets, total lending and total deposits of the commercial banks. Data are also presented to examine or analyze the efforts to NPA on the profitability of the banks under study.

4.2 Data Presentation and Analysis of Sample Banks:

4.2.1 Relationship between NPA and Total Lending of LUBL

In this part of the study, different indicators as like NPA to Total Lending, Total Lending to Total Deposit and Net Profit to Total Assets of Lumbini Bank Limited are analyzed. The main purpose of this analysis is to find out the impact and relationship between Non performing Assets and Total lending of a Bank. Further, the impact of Non performing assets on the profitability of a Bank is also analyzed in this segment.

Table 4.1

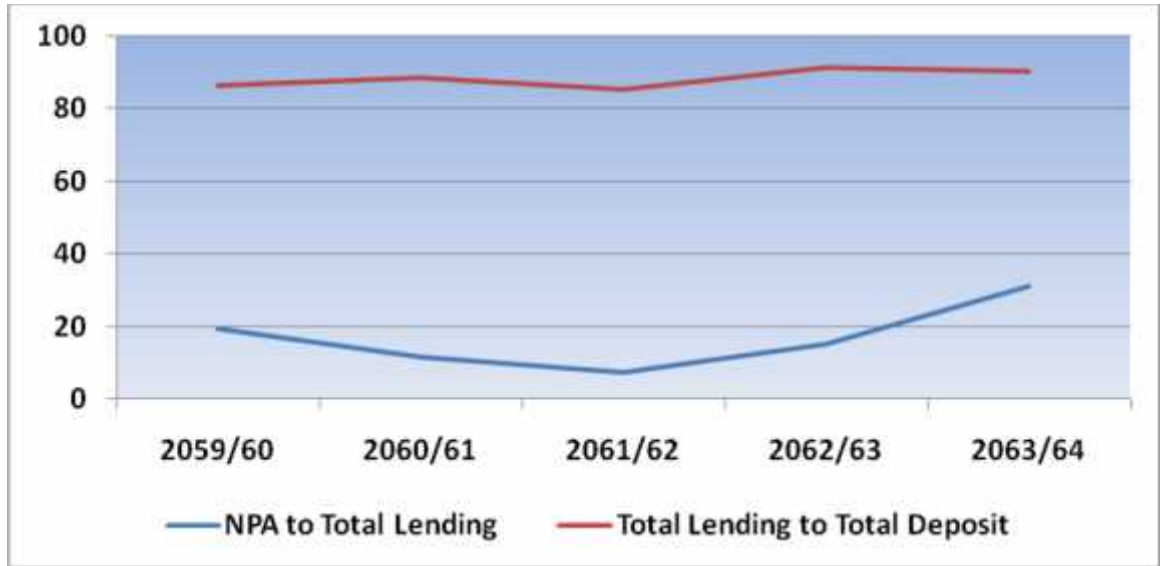
Relation between NPA, Net profit, Total lending and Total deposit

Ratio/year	2059/60	2060/61	2061/62	2062/63	2063/64	Mean
NPA to Total Lending	19.32	11.7	7.36	15.23	30.99	16.9
Total Lending to Total Deposit	86.37	88.6	85.31	91.41	90.29	88.4
Net Profit to Total Assets	-3.2	2.59	0.43	-4.38	18.92	-4.7

Source: Annual Reports of LUBL: 2059/60 to 2063/64

Diagram No. 4.1

Relation between NPA, Net profit, Total lending and Total deposit



From the Table 4.1 and Diagram No. 4.1 , it can be said that the ratio between the Non performing assets and total lending was found to increasing trend, although it had been decreased to 11.70% for the year 2060/61 and 7.36% for the fiscal year 2061/62. It was found to be 19.32% for the fiscal year 2059/60 which was found to be 30.99% at the end of fiscal year 2063/64. The average ratio between NPA and total lending of five years period was 16.92%.

Similarly the total lending to total deposit ratio was following increasing trend. It was found to be 86.37% for the fiscal year 2059/60 which has increased to 90.29% for the end of year 2063/64. Although it has been decreased for the fiscal year 2061/62. The average ratio between total lending to total deposit of five years was 88.40%.

And the net profit to total assets ratio was also found to be decreasing, it was found to be -3.2% in the fiscal year 2059/60 and it becomes to -18.92% for the fiscal year 2063/64. Although it has increasing to 2.59% for the fiscal year 2060/61 and there after the net profit to total assets ratio was decreasing to the whole study period. The average ratio between net profits to total assets of five year period was -4.7%. It shows that the profit

was decreasing in comparison to total assets of the bank shows that the bank is not able to increase its profit over the five years, indicates the poor performance of the organization.

Table 4.2

Relation between Net Profit and Total NPA

Fiscal year	Net Profit (Rs.)	Total NPA(Rs.)
2059/60	-7664786	441641381
2060/61	89139129	306776772
2061/62	18639673	237298336
2062/63	-195580188	561128272
2063/64	-806062623	1339242790

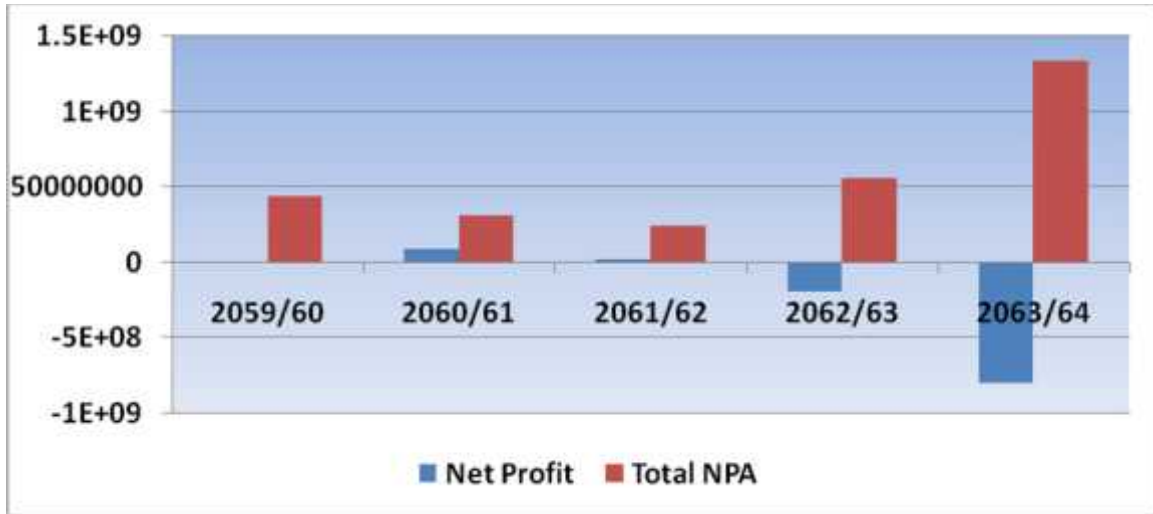
Source: Annual Reports of LUBL: 2059/60 to 2063/64

Table 4.2, shows that the status of non-performing assets (NPA) and net profit of the bank in different years, in fiscal year 2059/60, the bank had NPA amount to Rs 441641381 and bank could not earned net profit and its net loss amount to be Rs 7664786. In fiscal year 2060/61 the NPA amount to Rs. 306776772 i.e. NPA decreased by 30.5% in comparison of previous year. As the result the bank could able to increase its profit by 96803915 in comparison of previous year and net profit reached amounted to Rs. 89139129 at the end of fiscal year 2060/61. Similarly, in fiscal year 2061/62 the NPA amount to Rs. 239298336 i.e. NPA decreased in comparison of previous year. As the result the bank could not able to increased its net profit. The net profit decreased by Rs. 70499456 (i.e. 79%) in comparison to previous year and reached amounted Rs. 18639673 at the end of the fiscal year. Unfortunately, the banks NPA increased by 136% and reached to Rs. 561128272. As the result the banks the net profit of the banks decreased and reached to net loss Rs. 195580188 at the end of fiscal year 2062/63. Similarly, at the in fiscal year 2063/64, the NPA again increased by 138% reached to amount Rs. 1339242790. The net loss increased to amount Rs. 806062623 at the end of fiscal year 2063/64. The increasing level of NPA may harm to the organization, which indicates the major cause of the decreasing profit of the bank. So the bank has to control its NPA's as efficient as possible.

To make clearer the data of Table 4.2 also presented on the Diagram No. 4.2:

Diagram No. 4.2

Relation between Net profit and Total NPA



Loan Loss Provisioning of Commercial Bank Ltd:

Rise of Non performing assets increases their provisions to shore up their reserves for loan losses. Nepal Rastra Bank provisioned to be maintained certain percent of the loan of different class as per NRB’s directives for the commercial banks.

Loan Loss Provisioning of Lumbini Bank Ltd:

The loan loss provision maintained by Lumbini Bank Ltd. is presented in the table 4.3

Table 4.3

Loan loss provisioning of Lumbini Bank Ltd:

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2059/60	2060/61	2061/62	2062/63	2063/64
Pass loan	1% of pass loan	1.14	1.68	1.36	2.03	1.01
Sub-standard loan	25% of substandard loan	30.76	28.33	23.56	23.65	24.20
Doubtful loan	50% of doubtful loan	50.29	52.67	51.19	47.72	48.94
Bad loan	100% of bad loan	96.89	100.00	99.21	99.00	99.76

Source: Annual Reports of LUBL: 2059/60-2063/64

Every commercial bank has to maintain loan loss provision as per the NRB's directives for the commercial bank. Although the loan loss provision creates capital inadequacy to expand business. Up to fiscal year 2059/60, the bank made 1.14%, 30.76%, and 50.29% loan loss provision for pass loan, sub-standard loan and doubtful loan respectively which was enough more than requirement (i.e. more than 1%, 25% and 50%). The bank could not provision for loss loan which was 96.89% as per directives. Loan loss provision for bad loan must 100%.

In fiscal year 2060/61, the bank the provision requirement as per NRB's directives. The bank made 1.68% loan loss provision for pass loan, which was higher than as per directives. Similarly, the bank made 28.33% and 52.67% loan loss provision for sub standard and doubtful loan respectively which was more than as per NRB's directives. Loan loss provision for bad loan exactly met the NRB's directives, which was 100 percent of loss loan.

In fiscal year 2061/62, it was found that the bank enables to maintain loan loss provision for sub-standard loan and bad loan in accordance to NRB's directives. The bank provisioned 23.56% for substandard loan instead of 25% and only 99.21% for bad loan instead of 100 percent. Similarly bank provisioned, slightly higher for pass loan (i.e. 1.36% instead of 1%) and doubtful loan (i.e. 51.19% instead of 50%).

In fiscal year 2063/64, the bank made 1.01% for pass loan which was slightly more than the requirement i.e. more than 1%. It was found that the bank enables to maintain loan loss provision for substandard, doubtful and bad loan in accordance of NRB's directives. The bank provisioned 24.20%, 48.94% and 99.76% respectively for substandard, doubtful and bad loan.

It was found that the bank could not maintained loan loss provision, perfectly in accordance to the NRB's directives. The bank maintained higher than requirement for one class loan when lower for another class. Therefore, the bank should give priority to maintain loan lass provision as requirement as per NRB's directives.

4.2.2 Relationship between NPA and Total Lending of EBL

In the following table, different indicators as like NPA to Total Lending, Total Lending to Total Deposit and Net Profit to Total Assets of Everest Bank Limited are analyzed. The main purpose of this analysis is to find out the impact and relationship between Non performing Assets and Total lending of a Bank. Further, the impact of Non performing assets on the profitability of a Bank is also analyzed in this segment.

Table 4.4

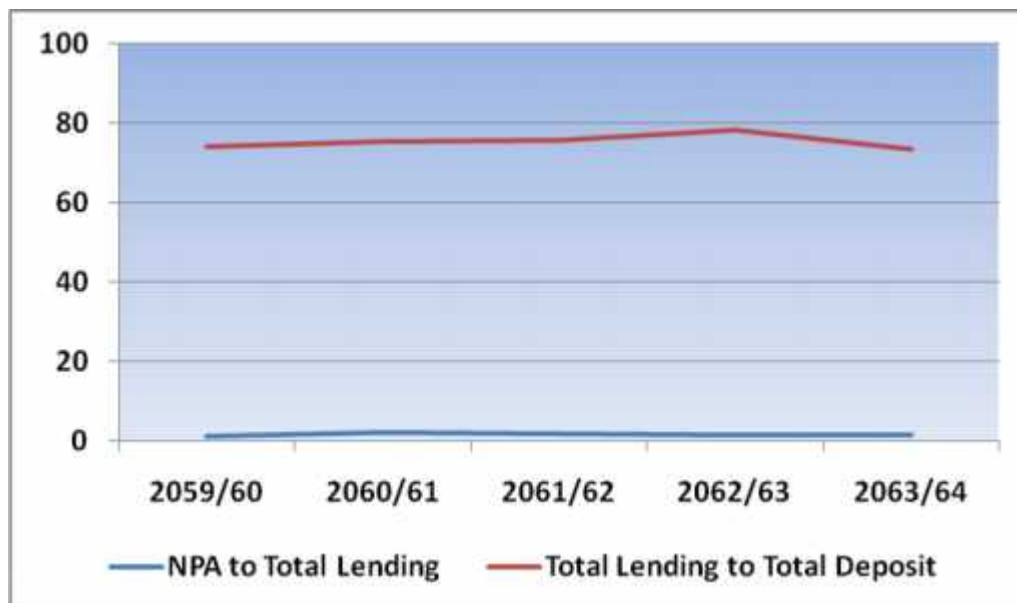
Relation between NPA, Net Profit, Total lending and Total deposit

Ratio/year	2059/60	2060/61	2061/62	2062/63	2063/64	Mean
NPA to Total Lending	1.04	2.20	1.70	1.60	1.27	1.56
Total Lending to Total Deposit	74.00	75.40	75.60	78.20	73.40	75.3
Net Profit to Total Assets	1.29	1.17	1.49	1.45	1.50	1.38

Source: Annual Reports of EBL: 2059/60 to 2063/64

Diagram No. 4.3

Relation between NPA, Net profit, Total lending and Total deposits



From Table 4.3 and Diagram No.4.3, it can be said that the ratio between the Non-performing assets and total lending was found to be in almost stagnant trend over the five years period. In the fiscal year 2059/60 it was found to be at 1.04%, which highly increased to 2.20% to the following year, and in the fiscal year 2061/62 it was found to be decreased rather than previous year. In the fiscal year 2063/64 the non performing assets to total lending ratio was found 1.27% and the average ratio between NPA and total lending of five years period was 1.56%.

The total lending to total deposit ratio was following constant trend over five years period. In fiscal year 2059/60 it was found to be 74.00% and was found to be increased in the following years and had reached to 75.40%, 75.60% and 78.20% in the fiscal year 2060/61, 2061/62 and 2063/64 respectively. And finally it was increased to 73.40% for the end of year 2063/64. The average ratio between total lending to total deposit of five years period was 75.32%.

And the net profit to total assts ratio was also found to be fluctuating over the five years period. It was found to be 1.29% in the fiscal year 2059/60 and it becomes to 1.50% for the fiscal year 2063/64. The average ratio between net profits to total assets of five years period was 1.38%.

Table 4.5

Relation between Net Profit and Total NPA

Fiscal year	Net Profit (Rs.)	Total NPA (Rs.)
2059/60	85,347,446	42,388,116
2060/61	94,180,428	111,191,103
2061/62	143,566,683	104,764,369
2062/63	170,807,797	128,807,745
2063/64	237,290,936	129,235,790

Source: Annual Reports of EBL: 2059/60 to 2063/64

In Table 4.5, shows that the status of non-performing assets (NPA) and net profit of the bank in different years, in fiscal year 2059/60. The bank had NPA amount to Rs 42388116 and bank's net profit amount to be Rs. 85347446. In fiscal year 2060/61 the NPA amount to Rs. 111191103 i.e. NPA increased by Rs. 68802987 (i.e. 162.32%) in

comparison of previous year. As the result the bank increase its profit by Rs. 8832982 in comparison of previous year and net profit reached amounted to Rs. 94180428 at the end of fiscal year 2060/61.

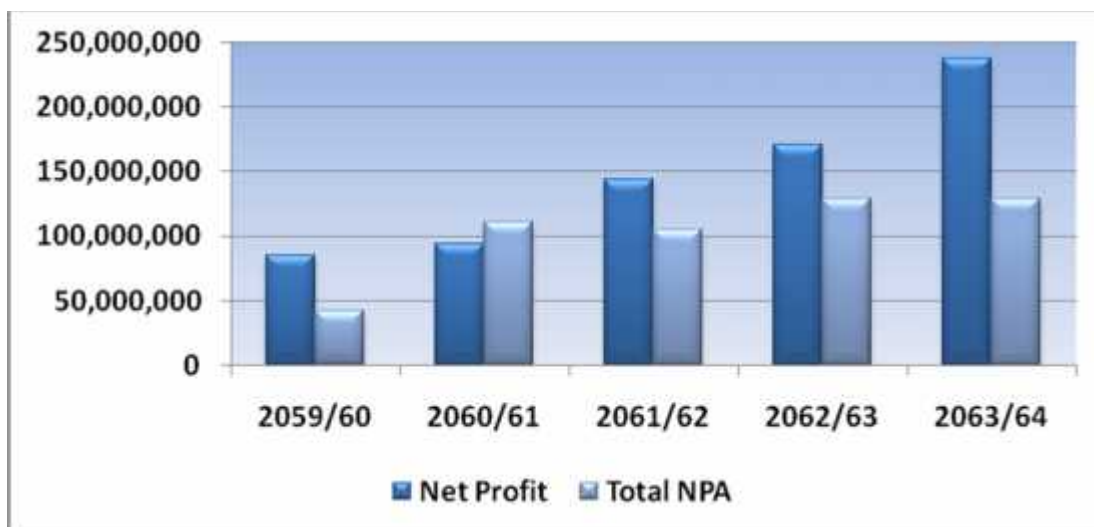
In fiscal year 2061/62, the NPA amount decreased by Rs. 6426734 (i.e. 5.78%) in comparison of previous year. The net profit increased by Rs. 49386225 (i.e. 52.44%) in comparison to previous year and reached amounted Rs. 143556683 at the end of the fiscal year.

In fiscal year 2062/63 the banks NPA increased by 22.95% i.e. Rs. 24043376 and reached to Rs. 128807745. As the result the net profit of the banks increased by 18.97% at the end of fiscal year 2062/63.

Similarly, in fiscal year 2063/64, the NPA increased by 0.33% i.e. Rs. 428045 and reached to amount Rs. 129235790. The net profit highly increased by amount Rs. 66483139 i.e. 38.92% in comparison with previous year's net profit and reached to Rs. 237290936. The bank is able to earn more profit although the level of NPA also increased. To make clearer the data of table 4.5 also presented on the Diagram No.4.6

Diagram No. 4.4

Relation between Net Profit and Total NPA



Loan Loss Provisioning of Everest Bank Ltd:

The loan loss provision maintains by Everest Bank Ltd. is presented in the Table 4.6

Table 4.6

Loan Loss Provisioning of Everest Bank Ltd

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2059/60	2060/61	2061/62	2062/63	2063/64
Pass loan	1% of pass loan	1.72	1.63	2.26	1.00	1.00
Sub-standard loan	25% of substandard loan	25.00	25.00	25.00	25.00	25.00
Doubtful loan	50% of doubtful loan	50.00	50.00	50.00	50.00	50.00
Bad loan	100% of bad loan	100.00	100.00	100.00	100.00	100.00

Source: Annual Reports of EBL: 2059/60 – 2063/64

Commercial bank has to maintain loan loss provision as per the NRB's directives for the commercial bank. In fiscal year 2059/60 Loan loss provision for substandard loan and doubtful loan exactly met the NRB's directives, which was 25% and 50% of substandard loan and doubtful loan respectively. The bank made 1.72%, and 123.78% loan loss provision for pass loan and bad loan which was higher than requirement as per NRB's directives.

In fiscal year 2060/61, the bank provisioned 1.63% for pass loan which was higher than the NRB's directives. Loan loss provision for substandard loan, doubtful loan and bad loan exactly met the NRB's directives, which was 25%, 50% and 100 percent of substandard loan, doubtful loan and bad loan respectively.

In fiscal year 2061/62, the bank provisioned 2.26% for pass loan which was higher than the NRB's directives. The bank made Loan loss provision for substandard loan, doubtful loan and bad loan exactly met the NRB's directives, which was 25%, 50% and 100% of substandard loan, doubtful loan and bad loan respectively.

In fiscal year 2062/63 and 2063/64, the bank could able to maintain the loan loss provision perfectly in accordance to the NRB’s directives.

4.2.3 Relationship between NPA and Total Lending of NBBL

In the following table, different indicators as like NPA to Total Lending, Total Lending to Total Deposit and Net Profit to Total Assets of Nepal Bangladesh Bank Limited are analyzed. The main purpose of this analysis is to find out the impact and relationship between Non performing Assets and Total lending of a Bank. Further, the impact of Non performing assets on the profitability of a Bank is also analyzed in this segment. Provisional data has been used in the fiscal year 2006/07 due to the non availability of the data in FY 2006/07 as the AGM of the bank was not held that year.

Table 4.7

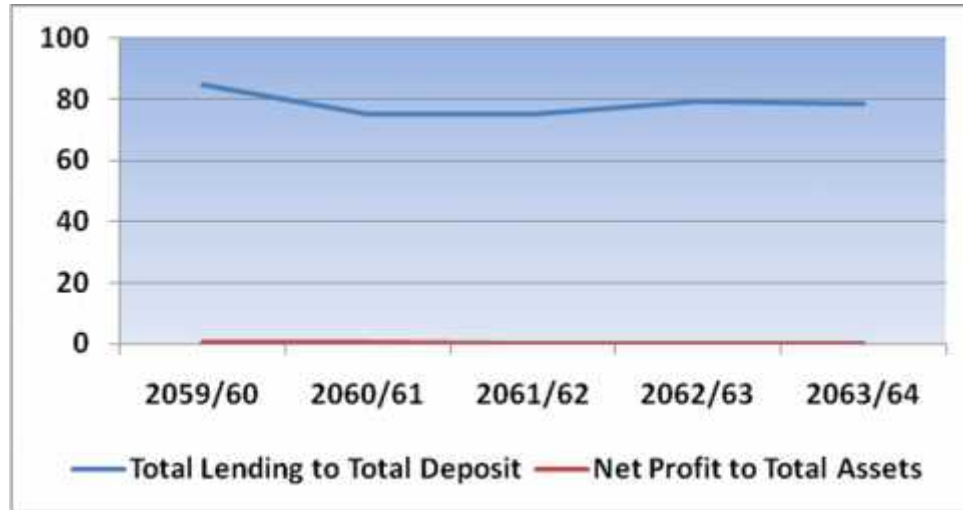
Relation between NPA, Net profit, Total lending and Total deposit

Ratio/year	2059/60	2060/61	2061/62	2062/63	2063/64	Mean
NPA to Total Lending	12.26	12.73	10.81	19.04	15.22	13.7
Total Lending to Total Deposit	84.97	75.25	75.31	79.39	75.00	78.7
Net Profit to Total Assets	0.59	0.60	0.02	0.00	0.00	0.30

Source: Annual Reports of NBBL 2059/60 to 2063/64

Diagram No. 4.5

Relation between NPA, Net profit, Total lending and Total deposits



From Table 4.7 and Diagram No. 4.5, it can be said that the ratio between the Non-performing assets and total lending was found to increasing trend. I have found 12.26% for the fiscal year 2059/60 and increased to the following year, but after that it has been found to be decreasing and remained at 10.81%, and in the fiscal year 2062/63, it again has increased and found to be at 19.04%. The average ratio between NP and total lending of five years period was 13.71%.

The total lending to total deposit ratio in the fiscal year 2059/60 is found to be 84.97%. This ratio was also following the same pattern as of the above ratio. It has been found that it used to decline all of the years during the study. And that was found to be 79.39% at the fiscal year 2062/63. The average ratio between total lending to deposit of five years period was 78.73%.

Similarly, the net profit to the total assets ratio was also found to be declining all of the years under the study. This ratio was found to be at 0.59% in the fiscal year 2059/60 which was increase to 0.6% for the fiscal year 2060/61 and in the following year it has found 0.02% in the fiscal year 2061/62. Due to not having any profit in the fiscal year 2062/63, the ratio cannot be traced out for this year.

The increasing level of NPA may harmful for the bank. So the bank has to control its non performing assets as efficiently. The net profit was going on diminishing and has reached to zero in the fiscal year 2062/63, indicates the poor performance of the bank.

Table 4.8

Relation between Net Profit and Total NPA

Fiscal year	Net Profit (Rs.)	Total NPA (Rs.)
2059/60	65,783,645	1,275,125,869
2060/61	71,495,022	1,013,274,712
2061/62	2,643,245	1,042,180,827
2062/63	-1,797,150,000	1,832,943,785
2063/64	-1,061,590,000	1,563,566,845

Source: Annual Reports of NBBL: 2059/60 to 2062/62

Table 4.8, shows that the status of non-performing assets (NPA) and net profit of the bank in different years, in fiscal year 2059/60. The bank had NPA amount to Rs. 1275125869 and bank's net profit amount to be Rs. 65783645. In fiscal year 2060/61 the NPA amount to Rs. 1013274712 i.e. NPA decreased by Rs. 261851157 (i.e. 20.54%) in comparison of previous year. As the result the bank increase its profit by Rs. 5711377 in comparison of previous year and net profit reached amounted to Rs. 71495022 all the end of fiscal year 2060/61.

In fiscal year 2061/62, NPA amount slightly increased by Rs. 28906115 (i.e. 2.85%) in comparison of previous year. The net profit highly decreased by Rs. 68851771 (i.e. 96.30%) in comparison to previous year and reached amounted Rs. 2643245 at the end of the fiscal year.

In fiscal year 2062/63, unfortunately the banks NPA increased by 75.88% i.e. Rs. 790762958 and reached to Rs. 1832943785 and the banks could not earn any profit for the year 2062/63.

The table shows that the total NPA is fluctuating over the study period and net profit goes on diminishing over the same period and has reached to zero showing, the inefficiency of the bank in making profit a profit and weak performance f the bank.

Diagram No. 4.6

Relation between Net Profit and Total NPA



Loan loss provisioning of Nepal Bangladesh Bank Ltd:

The loan loss provision maintains by Nepal Bangladesh Bank Ltd. is presented in the Table.

Loan Loss Provisioning of Nepal Bangladesh Bank Ltd:

Table 4.9

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2059/60	2060/61	2061/62	2062/63	2063/64
Pass loan	1% of pass loan	1.15	1.69	1.67	2.50	2.90
Sub-standard loan	25% of substandard loan	22.08	25.29	25.00	25.00	28.00
Doubtful loan	50% of doubtful loan	35.08	50.00	49.99	50.00	50.00
Bad loan	100% of bad loan	58.11	98.47	98.66	98.85	101.25

Source: Annual Reports of NBBL: 2059/60 to 2062/62

Commercial banks have to maintained loan loss provision as per the NRB's directives for the commercial bank. In fiscal year 2059/60, Loan loss provision for pass loan was

1.15% which was higher than the requirement as per NRB's directives. But loan loss provision for substandard loan, doubtful loan and bad loan was found lower than the NRB's directives. The bank provisioned 22.08%, 35.08% and 58.11% respectively for the substandard, doubtful and bad loan which was highly lower than that of requirement.

In fiscal year 2060/61, Loan loss provision for pass loan and substandard loan higher than the NRB's directives, which was 1 percent of pass loan and 25 percent of doubtful loan. The bank made 1.69% and 25.29% loan loss provision for pass loan and substandard loan. The loan loss provision for doubtful loan exactly met the NRB's directives which were 50%. It was found that the bank unable to maintain loan loss provision for bad loan as per the NRB's directives.

Fiscal year 2061/62, Loan loss provision for pass loan higher than the NRB's directives, which was 1 percent of pass loan. The bank made 1.67% loan loss provision for pass loan. The loan loss provision for substandard exactly met the NRB's directives which was 25%. It was found that the bank unable to maintain loan loss provision for doubtful and bad loan as per the NRB's directives. The bank made 49.99% and 98.66% provisioned for doubtful and bad loan.

Fiscal year 2062/63, Loan loss provision for pass loan higher than the NRB's directives, which was 1 percent of pass loan. The bank made 2.5% loan loss provision for pass loan. The loan loss provision for substandard loan and doubtful loan exactly met the NRB's directives which were 25% and 50% respectively. It was found that the bank unable to maintain loan loss provision for bad loan as per the NRB's directives. The bank made 98.85% provisioned for doubtful and bad loan.

It is found that the bank could not maintained loan loss provision, perfectly in accordance to the NRB's directives. The bank maintained higher than requirement for one class loan when lower for another class. Therefore, the bank should give priority to maintain loan loss provision as requirement as per NRB's directives.

4.2.4 Relation between NPA and Total Lending of NSBI

In the following table, different indicators as like NPA to Total Lending, Total Lending to Total Deposit and Net Profit to Total Assets of NSBI Bank Limited are analyzed. The main purpose of this analysis is to find out the impact and relationship between Non performing Assets and Total lending of a Bank. Further, the impact of Non performing assets on the profitability of a Bank is also analyzed in this segment.

Table 4.10

Relation between NPA, Net profit, Total lending and Total deposit

Ratio/year	2059/60	2060/61	2061/62	2062/63	2063/64	Mean
NPA to Total Lending	6.32	8.90	6.25	6.54	6.13	6.83
Total Lending to Total Deposit	82.27	73.27	76.85	77.87	69.32	75.9
Net Profit to Total Assets	0.58	0.64	0.72	0.55	0.90	0.68

Source: Annual Reports of NSBI: 2059/60 to 2063/64

Diagram No. 4.7

Relation between NPA, Net profit, Total lending and Total deposit



From Table 4.10 and Diagram No. 4.7, it can be said that the ratio between the non-performing assets and total lending was found to fluctuation trend, although it has been increase to 8.9% for the year 2060/61 and decreased to 6.25% for the fiscal year 2061/62. Again it was found to be 6.54% for the fiscal year 2062/63 and it was found to be 6.13% at the end of fiscal year 2063/64. The average ratio between NPA and total lending of five years period was 6.83%. The bank should continue to control over the non performing assets.

Similarly the total lending to total deposit ratio was following decreasing trend. It was found to be 82.27% for the fiscal year 2059/60 and it becomes to 69.32% at the end of the fiscal year 2063/64. Although it was found to be increasing for the fiscal year 2061/62 and 2062/63. The average ratio between total lending to total deposit of five years period was 75.92%.

The net profit to total assets ratio was also found to be increasing, it was found to be 0.58% in the fiscal year 2059/60 and it becomes to 0.90% for the fiscal year 2063/64. It shows that the profit was increasing in comparison to total assets of the bank, showing the improvement in the profit of the bank and the average ratio between net profit to total assets of five years period was 0.68%.

Table 4.11
Relation between Net Profit and Total NPA

Fiscal year	Net Profit (Rs.)	Total NPA (Rs.)
2059/60	40,843,769	289,766,401
2060/61	48,748,221	426,947,082
2061/62	60,851,673	345,821,458
2062/63	57,386,634	441,017,011
2063/64	117,001,973	505,336,919

Source: Annual Reports of NSBI: 2059/60 to 2063/64

Table 4.11, shows that the status of non-performing assets (NPA) and net profit of the bank in different years, in fiscal year 2059/60. The bank had NPA amount to Rs 289766401 and bank's net profit amount to be Rs 40843769. In fiscal year 2060/61, the NPA amount to Rs. 426947082 i.e. NPA increased by Rs. 137180681 (i.e., 47.34%) in comparison of previous year. As the result the bank increases its profit by Rs 79004452

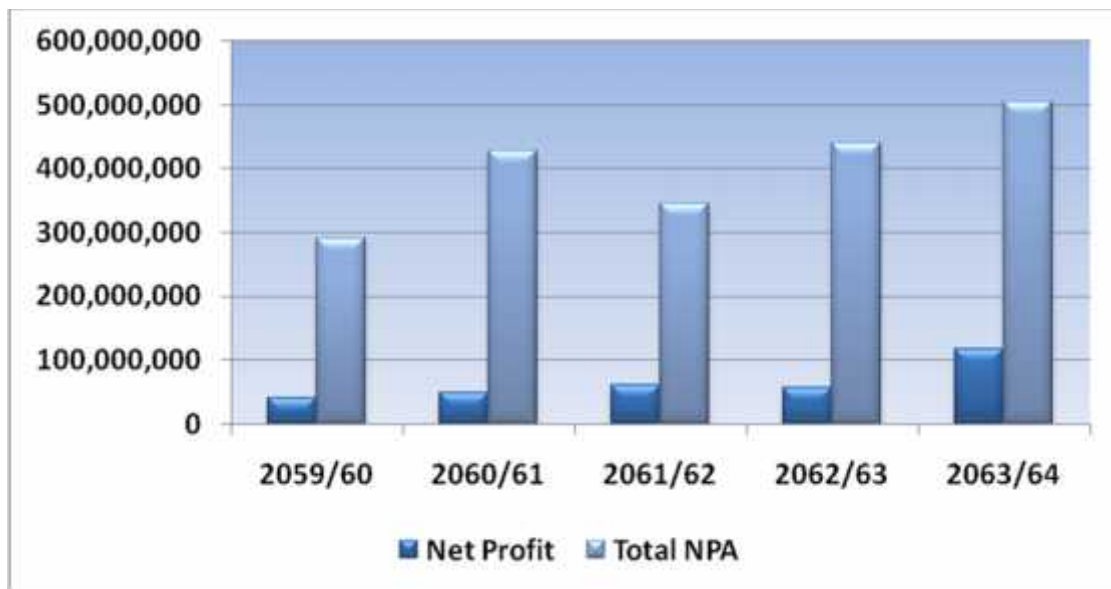
in comparison of previous year and net profit amounted to Rs 48748221 at the end of the fiscal year 2060/61. In fiscal year 2061/62, unfortunately the NPA amount decreased by Rs 81125624 (i.e. 19%) in comparison to previous year and reached to Rs. 60851673 at the end of the fiscal year. In fiscal year 2062/63, the bank's NPA increased by 27.53%, i.e. Rs 95195553 and reached to Rs 441017011. As a result, the net profit of the bank decreased by 5.69% at the end of the fiscal year 2062/63.

Similarly, in fiscal year 20-62/63, the NPA increased by 14.58%, i.e., Rs 64319908 and reached to amount Rs. 505336919. The net profit highly increased by amount Rs 59612339 i.e. 103.38% in comparison with previous year's net profit and reached to Rs. 117001973.

There is no doubt that the net profit of the bank affected by NPA. But NPA is not only a cause for increment and decrement of the net profit. There are many other causes that affect the profit of the bank. But NPA would be a major cause of decreasing profit of the bank so the bank has to control its NPA as efficiently as possible.

Diagram No. 4.8

Relation between Net Profit and Total NPA



Loan loss provisioning of Nepal SBI Bank Ltd:

The loan loss provision maintained by Nepal SBI Bank Ltd. is presented in Table 4.12

Loan loss provisioning of Nepal SBI Bank Ltd:

Table 4.12

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2059/60	2060/61	2061/62	2062/63	2063/64
Pass loan	1% of pass loan	1.19	1.19	0.94	0.95	0.96
Sub-standard loan	25% of substandard loan	26.11	22.41	13.39	20.94	17.71
Doubtful loan	50% of doubtful loan	50.00	52.17	48.39	15.67	29.18
Bad loan	100% of bad loan	100.22	89.22	95.83	98.00	99.13

Source: Annual Reports of NSBI: 2059/60 to 2063/64

Commercial bank has to maintained loan loss provision as per the NRB's directives for the commercial bank. In fiscal year 2059/60, Loan loss provision for doubtful loan exactly met the NRB's directives, which was 50 percent of doubtful loan. Similarly, the bank made 1.19%, 26.11% and 100.22% loan loss provision for pass loan, substandard and bad loan which was higher than requirement as per NRB's directives.

In fiscal year 2060/61, Loan loss provision for pass loan and doubtful loan higher than the NRB's directives, which was 1 percent of pass loan and 50 percent of doubtful loan? The similarly, the bank made 1.19% and 52.17% loan loss provision for pass loan and doubtful loan. It was found that the bank unable to maintain loan loss provision for substandard and bad loan as per the NRB's directives. Fiscal year 2062/63, it was found that the bank unable to maintain loan loss provision for all classes of loan as per the NRB's directives. The bank provisioned 0.94%, 13.39%, 48.39% and 95.83% for pass, substandard, doubtful and bad loan.

In fiscal year 2062/63, it was found that the bank unable to maintain loan loss provision for all classes of loan as per the NRB's of loan as per the NRB's directives. The bank provisioned 0.95%, 20.94%, 15.67% and 98.0% for pass loan, substandard loan, doubtful loan and bad loan. In fiscal year 2063/64 it was found that the bank unable to maintain loan loss provision for all classes of loan as per the NRB's of loan as per the NRB's directives. The bank provisioned 0.96%, 17.71%, 29.18% and 99.13% respectively for pass loan, substandard loan, doubtful loan and bad loan.

It is found that the bank could not maintained loan loss provision, perfectly in accordance to the NRB's directives. The bank maintained lower than requirement. Therefore, the bank should give priority to maintain loan loss provision as requirement as per NRB's directives.

4.2.5 Relation between NPA and Net Profit of HBL

In the following table, different indicators as like NPA to Total Lending, Total Lending to Total Deposit and Net Profit to Total Assets of HBL are analyzed. The main purpose of this analysis is to find out the impact and relationship between Non performing Assets and Total lending of a Bank. Further, the impact of Non performing assets on the profitability of a Bank is also analyzed in this segment.

Table 4.13

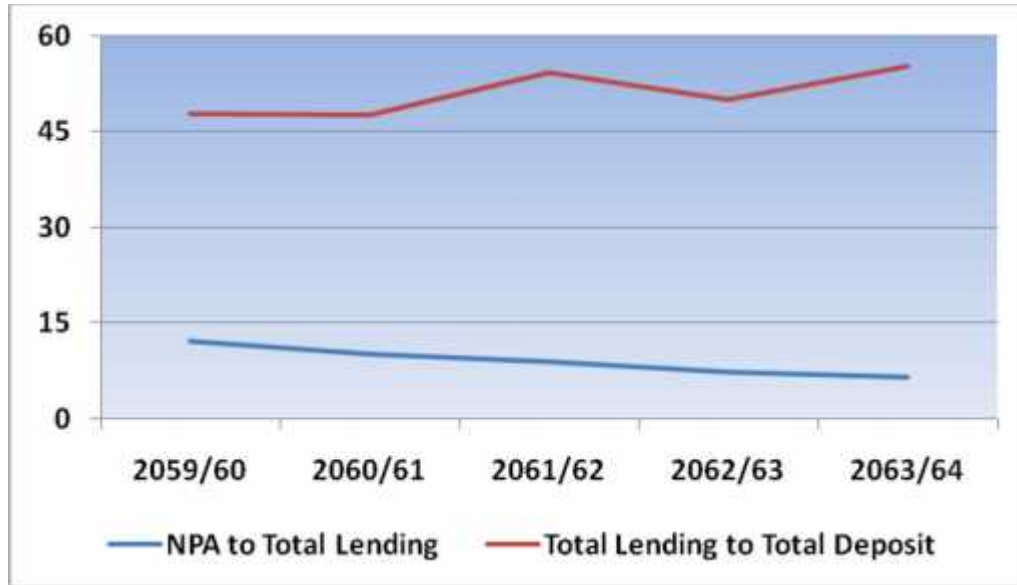
Relation between NPA, Net profit, Total lending and Total deposit

Ratio/year	2059/60	2060/61	2061/62	2062/63	2063/64	Mean
NPA to Total Lending	12.10	10.08	8.88	7.44	6.60	9.20
Total Lending to Total Deposit	47.89	47.61	54.30	50.07	55.27	51.0 3
Net Profit to Total Assets	1.14	0.91	1.06	1.11	1.55	1.15

Source: Annual Reports of HBL:: 2059/60 to 2063/64

Diagram No. 4.9

Relation between NPA, Net profit, Total lending and Total deposits



From Table 4.13 and Diagram No.4.9, it can be said that the ratio between the Non-performing assets and total lending was found to decreasing. It was found to be 12.10% for the fiscal year 2059/60 which was found to be 6.60% at the end of fiscal year 2063/64. The average ratio between NPA and total lending of five years period was 9.02%. The decreasing trend of NPA to total lending ratio indicates the effectiveness in the management of NPA.

The total lending to total deposit ratio was following increasing trend. It was found to be 47.89% for the fiscal year 2059/60 which was increased to 55.27% for the end of year 2063/64. Although it has been decreasing to 50.07% for the fiscal year 2062/63. The average ratio between total lending to total deposit of five years period was 51.03 percent.

The net profit to total assets ratio was also found to be increasing, it was found to be - 1.14% in the fiscal year 2059/60 and it becomes to 1.55% for the fiscal year 2063/64. Although it ahs increasing to 0.91% for the fiscal year 2060/61. It shows a good trend of increasing the profit in comparison to total assets of the bank shows that the bank is able

to increase its profit over the five years. The average ratio between net profits to total assets of five years period was 1.15%.

Table 4.14
Relation between Net Profit and Total NPA

Fiscal year	Net Profit (Rs.)	Total NPA (Rs.)
2059/60	235,023,510	1,156,041,462
2060/61	212,128,485	1,092,839,487
2061/62	263,053,495	1,147,462,638
2062/63	308,275,171	1,001,347,320
2063/64	457,458,000	1,040,757,823

Source: Annual Reports of HBL: 2059/60 to 2063/64

Table 4.14, shows that the status of non-performing assets (NPA) and net profit of the bank in different years in fiscal year 2059/60, the bank had NPA amount to Rs. 1156041462 and bank's net profit amount to be Rs. 235023510. In fiscal year 2060/61 the NPA amount to Rs. 1092839487 i.e. NPA decreased by Rs. 63201975 (i.e. 5.47%) in comparison of previous year and net profit reached amounted to Rs. 21212885 at the end of fiscal year 2060/61.

In fiscal year 2061/62, unfortunately the NPA amount increased by Rs. 54623151 (i.e. 5.0%) in comparison of previous year. As the result the bank could able to increase its net profit. The net profit increased by Rs. 50925010 (i.e. 24.01%) in comparison to previous year and reached amounted Rs. 263053495 at the end of the fiscal year.

In fiscal year 2062/63 the banks NPA decreased by 12.73% i.e. Rs. 146115318 and reached to Rs. 1001347320. As the result the net profit of the banks increased and reached to Rs. 308275171 at the end of fiscal year 2062/63.

There is no doubt that the net profit of the bank affected by non performing assets. But NPA is not any cause of increment and decrement of the net profit. There are many factors other than NPA's, which affect the profit of the bank. So the bank should continue to control over the non performing assets.

To make clearer the data of Table 4.14 are also presented on The Diagram No.4.10

Diagram No. 4.10

Relation between Net Profit and Total NPA



Loan loss provisioning of Himalayan Bank Ltd:

The loan loss provision maintains by Himalayan Bank Ltd. is presented in the table 4.15

Table 4.15

Loan loss provisioning of Himalayan Bank Ltd:

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2059/60	2060/61	2061/62	2062/63	2063/64
Pass loan	1% of pass loan	0.99	1.00	1.00	1.00	1.01
Sub-standard loan	25% of substandard loan	24.29	27.92	26.08	60.20	57.78
Doubtful loan	50% of doubtful loan	48.22	49.13	50.71	47.23	68.16
Bad loan	100% of bad loan	94.50	96.60	97.79	99.54	100.26

Source: Annual Reports of HBL: 2059/60 to 2063/64

Commercial banks have to maintained loan loss provision as per the NRB's directives for the commercial bank. In fiscal year 2059/60, the bank unable to maintain the loan loss provision in all classes. The bank made 99% loan loss provision for pass loan which was lightly lower than the requirement i.e. 1%. Similarly the bank made 24.29%, 48.22% and 94.50% loan loss provision for substandard, doubtful and bad loan which was lower than as per the NRB's directives.

In fiscal year 2060/61, Loan loss provision for pass loan. The similarly, the bank made 27.92% loan loss provision for substandard which was more than as per NRB's directives. It was found than the bank unable to maintain loan loss provision for doubtful and bad loan as per the NRB's directives.

Fiscal year 2062/63, Loan loss provision for pass loan exactly met the NRB's directives, which was 1 percent of pass loan. The similarly, the bank made 26.08% and 50.71% loan loss provision for substandard and doubtful which was more as per NRB's directives. It was found than the bank unable to maintain loan loss provision for bad loan as per the NRB's directives. The bank provisioned 97.79% for bad loan.

In fiscal year 2062/63, Loan loss provision for pass loan exactly met the NRB's directives, which was 1 percent of pass loan. Similarly, the bank made 60.20% loan loss provision for substandard which was highly more than as per NRB's directives.

It was found than the bank unable to maintain loan loss provision for doubtful and bad loan as per the NRB's directives. The bank provisioned 47.23% and 99.54% for doubtful and bad loan. In fiscal year 2063/64, the bank made 1.01% and 100.26% for pass loan and bad loan which was slightly more than the requirement i.e. more than 1% and 100%. Similarly, the bank made 57.78% and 68.16% loan loss provision for sub-standard and doubtful loan which was highly more than as per NRB's directives.

It is found that the bank could not maintained loan loss provision, perfectly in accordance to the NRB's directives. The bank maintained higher than requirement for one class loan when lower for another class. Therefore, the bank should give priority to maintain loan loss provision as requirement as per NRB's directives.

4.2.6 Relation between NPA and Total Profit of NABIL

In the following table, different indicators as like NPA to Total Lending, Total Lending to Total Deposit and Net Profit to Total Assets of NABIL Bank Limited are analyzed. The main purpose of this analysis is to find out the impact and relationship between Non performing Assets and Total lending of a Bank. Further, the impact of Non performing assets on the profitability of a Bank is also analyzed in this segment.

Table 4.16

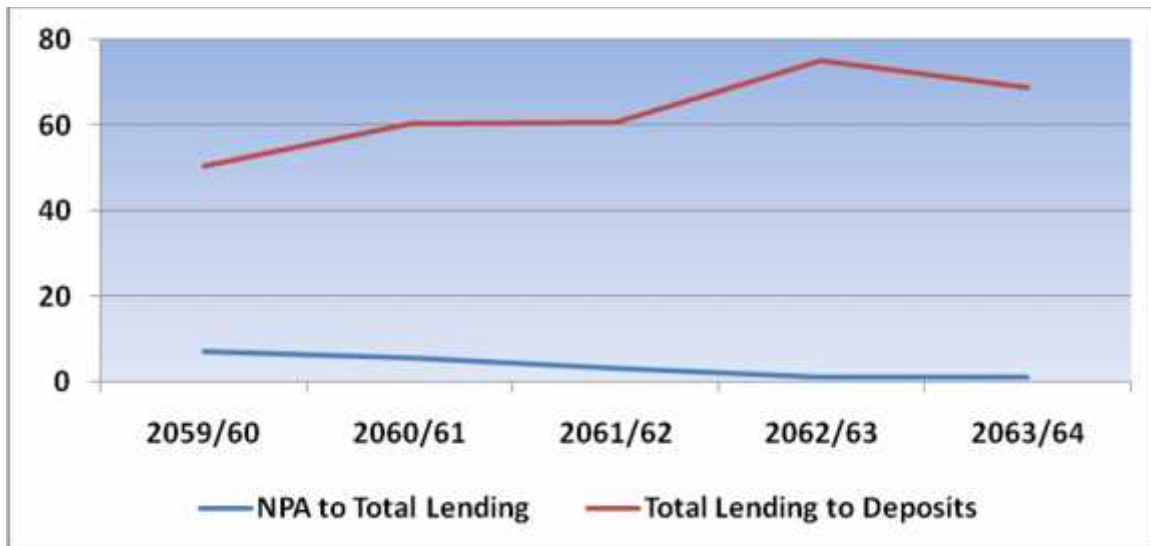
Relation between NPA, Net profit, Total lending and Total deposit

Ratio/year	2059/60	2060/61	2061/62	2062/63	2063/64	Mean
NPA to Total Lending	7.14	5.54	3.35	1.32	1.38	3.75
Total Lending to Total Deposit	50.31	60.34	60.55	75.05	68.63	62.9
Net Profit to Total Assets	1.53	2.43	2.73	3.06	3.23	2.60

Source: Annual Reports of NABIL: 2059/60 to 2063/64

Diagram No. 4.11

Relation between NPA, Net profit, Total Lending and Total deposit



From Table 4.16 and Diagram No. 4.11, it can be said that the ratio between the non-performing assets and Total lending was found to decreasing trend, although it has been slightly increased to 1.38% for the year 2063/64. The average ratio between NPA and total lending of five years period was 3.75%. The decreasing trend of NPA to total lending ratio indicates the effectiveness in the management of NPA.

The total lending to total deposit ratio was following increasing trend. It was found to be 50.31% for the fiscal year 2059/60 which has increased to 75.05% for the end of year 2062/63. It was decreased in the fiscal year 2063/64 and reached to 68.03%. The average ratio between total lending to total deposit of five years period was 62.98%. And the net profit to total assets ratio was also found to be increasing during the study period. It was 1.53% for the fiscal year 2059/60 which was increased to 3.23% for the fiscal year 2063/64 and the average ratio between net profits to total assets of five years period was 2.60%. Increasing trend of the profit in comparison to total assets of the bank is showing good management of the bank.

Table 4.17

Relation between Net Profit and Total NPA

Fiscal year	Net Profit (Ra.)	Total NPA (Rs.)
2059/60	271,638,612	556,887,682
2060/61	416,235,811	449,630,763
2061/62	455,311,222	286,678,920
2062/63	518,635,749	144,506,893
2063/64	635,262,439	182,624,480

Source: Annual Reports of NABIL: 2059/60 to 2063/64

Table 4.17 shows that the status of non-performing assets (NPA) and net profit of the bank in different years in fiscal year 2059/60. The bank had NPA amount to Rs. 556877682 and bank's net profit amount to be Rs. 271638612. In fiscal year 2060/61 the NPA amount to Rs. 449630763 i.e. NPA decreased by Rs. 107246919 (i.e. 19.26%) in comparison of previous year. As the result the bank increase its profit by Rs. 144597199 in comparison of pervious year and net profit reached amounted to Rs. 416235811 at the

end of fiscal year 2060/61. The profit was increased for the following years and the non performing assets were decreasing during the study period except 2063/64.

Similarly, in fiscal year 2063/64, the NPA increased by 26.38% i.e. Rs. 38117587 and reached to amount Rs. 182624480. The net profit increased by amount Rs. 116626690 i.e. 22.49% in comparison with previous year's net profit and reached to Rs. 635262439. This trend of non performing assets indicates that the bank could not able concentration towards NPA in fiscal year 2063/64. Above analysis clearly states that the bank could able to increase its net profit due to decrement in non performing assets. So the bank should be continued to control over NPA.

To make clearer the data of Table 4.17 also presented on the Diagram No. 4.12

Diagram No. 4.12

Net Profit and Total NPA



Loan loss provisioning of Nabil Bank Ltd:

The loan loss provision maintains by Nabil Bank Ltd. is presented in the Table 4.18

Table 4.18**Loan loss provisioning of Nabil Bank Ltd:**

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2059/60	2060/61	2061/62	2062/63	2063/64
Pass loan	1% of pass loan	1.95	1.60	1.55	2.18	1.64
Sub-standard loan	25% of substandard loan	24.08	24.01	23.22	31.10	67.94
Doubtful loan	50% of doubtful loan	49.55	48.95	49.40	73.20	47.00
Bad loan	100% of bad loan	69.95	85.14	97.19	97.05	94.55

Commercial banks have to maintained loan loss provision as per the NRB's directives for the commercial bank. In fiscal year 2059/60, Loan loss provision for pass loan was 1.95% which was higher than the requirement as per NRB's directives. But loan loss provision for substandard loan, doubtful loan and bad loan was found lower than the NRB's directives. The bank provisioned 24.08%, 49.55% and 69.55% respectively for the substandard, doubtful and bad loan which was highly lower than that of requirement. The loan loss provision for bad loan was too much lower than NRB's directives.

In fiscal year 2060/61, Loan loss provision for pass loan was 1.60% which was higher than the requirement as per NRB's directives. But loan loss provision for substandard loan, doubtful loan and bad loan was found lower than the NRB's directives. The bank provision 24.01%, 48.95% and 85.14% respectively for the substandard, doubtful and bad loan which was highly lower than that of requirement. Similarly in fiscal year 2061/62, Loan loss provision for pass loan was 1.55% which was higher than the requirement as per NRB's directives. But loan loss provision for substandard loan, doubtful loan and bad loan was found lower than the NRB's directives. The bank provisioned 23.22%, 49.40% and 97.19% respectively for the substandard, doubtful and bad loan which was highly lower than that of requirement.

Fiscal year 2062/63, Loan loss provision for pass loan, substandard loan and doubtful loan as per NRB's directives, which was 1 percent of pass loan 25% of substandard loan and 50% of doubtful alone respectively. The bank 2.18% loan loss provision for pass

loan, 31.10% of substandard loan and 73.20% of doubtful loan respectively which were higher than requirement. It was found that the bank unable to maintain loan loss provision for bad loan as per the NRB's directives. The bank made 97.05% provisioned for bad loan.

Fiscal year 2063/64, Loan loss provision for pass loan and standard loan as per NRB's directives, which was 1 percent of pass loan 25% of substandard loan respectively. The bank made 1.64% loan loss provision for pass loan and 67.94% of substandard loan respectively which were higher than requirement. It was found that the bank unable to maintain loan loss provision for bad loan and doubtful loan as per the NRB's directives. The bank made 97.05% and 47.00% provisioned for bad loan and doubtful loan respectively.

It is found that the bank could not maintained loan loss provision, perfectly in accordance to the NRB's directives. The bank maintained higher than requirement for one class loan when lower for another class. Therefore, the bank should give priority to maintain loan loss provision as requirement as per NRB's directives.

4.3 Performing and Non-Performing Assets of Commercial Banks in Total Assets, Total Lending and Total Deposit

Table 4.19

Performing and Non-performing assets of commercial banks in Total Assets, Total Lending & Total Deposit

Bank	Assets		Lending		Deposit	
	% of PA to TA	% of NPA to TA	% of PA to TL	% of NPA to TL	% of PA to TD	% of NPA to TD
LBL	67.09	14.27	83.08	16.59	73.35	14.75
EBL	62.64	1.00	98.43	1.57	74.15	1.19
NBBL	59.67	10.28	85.41	14.59	67.15	11.56
NSBIBL	60.12	4.40	93.17	6.83	71.84	5.25
HBL	45.04	4.42	90.98	9.02	50.14	4.92
Nabil	51.64	1.85	96.25	3.75	60.80	2.18

Source: Annual Reports of the Respective Banks: 2007

In the above table the ratio of performing loan to total loan and restricted loan to total loan among performing assets has been analyzed in one hand and in the other hand, the ratio of substandard loan to total loan, ratio of doubtful loan to total loan and the ratio of bad loan to total loan among non performing assets has been analyzed. In performing assets category, the highest percentage of pass loan is of EBL i.e. 97.13% followed by 95%, 88%, 87%, 85% and 80% respectively of NABIL, HBL, NSBI, NBBL and LUBL.

Similarly, in the performing assets category the restricted loan to total loan ratio is highest in case of LUBL which is 5.0% and lowest in case of NBBL which is 0%.

In the non performing assets category, the ratio of substandard loan to total loan is highest in case of LUBL i.e.4.39 % and lowest in case of EBL i.e. 0.64%. Similarly the ratio of doubtful loan to total loan is highest in case of NBBL i.e. 3.97% and lowest in case of EBL i.e. 0.64%. The ratio of bad loan to total loan in NPA category is highest in case of LUBL i.e. 9.54% and lowest in case of EBL which is 0.91%. From the above analysis the performance of NBBL and LUBL regarding NPA is pretty worst and the performance of rest of the sample banks is satisfactory. Among the rest of the sample banks EBL is performing well in case of lending and recovering.

4.4 Percentage Performing and Non-performing Assets of Commercial Banks in Total loan

Table 4.20

Percentage Performing and Non-performing assets of Commercial banks in total loan

Bank	Performing Assets		Non Performing Assets		
	PL/TL	RL/TL	SL/TL	DL/TL	BL/TL
LBL	80.85	5.58	4.39	3.00	9.54
EBL	97.13	3.25	0.64	0.36	0.91
NBBL	85.41	0.00	3.49	3.97	7.13
NSBIBL	87.09	6.08	0.94	1.24	4.65
HBL	88.09	3.64	1.82	1.72	4.73
Nabil	95.88	0.93	1.04	1.48	1.22

Source: Annual Reports of the Respective Banks: 2007

In the above table the ratio of performing loan to total loan and restricted loan to total loan among performing assets has been analyzed in one hand and in the other hand, the ratio of substandard loan to total loan, ratio of doubtful loan to total loan and the ratio of bad loan to total loan among non performing assets has been analyzed.

In performing assets category, the highest percentage of pass loan is of EBL i.e. 97.13% followed by 95%, 88%, 87%, 85% and 80% respectively of NABIL, HBL, NSBI, NBBL and LUBL.

Similarly, in the performing assets category the restricted loan to total loan ratio is highest in case of LUBL which is 5.0% and lowest in case of NBBL which is 0%.

In the non performing assets category, the ratio of substandard loan to total loan is highest in case of LUBL i.e.4.39 % and lowest in case of EBL i.e. 0.64%. Similarly the ratio of doubtful loan to total loan is highest in case of NBBL i.e. 3.97% and lowest in case of EBL i.e. 0.64%. The ratio of bad loan to total loan in NPA category is highest in case of LUBL i.e. 9.54% and lowest in case of EBL which is 0.91%. From the above analysis the performance of NBBL and LUBL regarding NPA is pretty worst and the performance of rest of the sample banks is satisfactory. Among the rest of the sample banks EBL is performing well in case of lending and recovering.

4.5.1 Correlation between NPA and ROA of the commercial banks

The statistical tool, ‘correlation analysis’ is preferred in this study to identify the relationship between NPA and ROA and whether the relationship is significant or not. Here NPA denotes the percentage of NPA in total lending of the bank and ROA denotes the net profit as percentage of total assets of the banks.

Table 4.21

Correlation between NPA and ROA of the Commercial Bank

Bank	Coefficient of correlation (r)	Relationship	Coefficient of determination (r²)	Probable error (P.E.)	Significant/ Insignificant
LBL	-0.93	negative	0.87	0.04	Insignificant
EBL	-0.41	negative	0.17	0.25	Insignificant
NBBL	0.20	positive	0.04	0.29	Insignificant
NSBIBL	-0.26	negative	0.07	0.28	Insignificant
HBL	-0.57	negative	0.32	0.20	Insignificant
Nabil	-0.96	negative	0.92	0.025	Insignificant

Table 22 shows the correlation coefficient between the Non-performing Assets to Returns on Assets shows that there is negative relationship between these two variables. The established theory also states that the Profit and Non-performing Assets also flow in the opposite direction. When the amount NPA is lesser, profit would be high and whenever the amount of NPA is more then profit goes on decreasing, which is explained by the above table.

LBL and Nabil have the correlation coefficient of -0.93 and -0.96 which are categorized as having high degree of negative correlation. And 87% and 92% of the profitability is affected by the NPA to the respective banks and rest is affected by the other factor. And the test so made for these two banks is found to be insignificant as the correlation is less than Probable error (P.E) multiplied by six times.

HBL has the correlation coefficient of -0.57 which is categorized as having moderate degree of negative correlation. Only 32% of the relationship is affected by the NPA in the increment of the profitability of the bank. As coefficient of determination of the bank found to be 32% and remaining 68% for the individual bank is affected by other factor. Further more, the value of P.E. is 0.20% for the bank indicating an insignificant relationship between them.

NSBI and EBL have correlation coefficient of -0.26 and -0.41 which are categorized as having low degree of negative correlation. And 7% and 17% of the profitability is affected by NPA to the respective banks and rest is affected by the other factor. Since the

P.E. For the NSBIBL is more than the coefficient of correlation bank indicating insignificant. Similarly P.E. of EBL multiplied by is more than the coefficient of correlation EBL indicating insignificant.

Only NBBL have low degree of positive correlation coefficient i.e. higher the level of NPA would higher in the returns and vice versa. Only 4% of the profit is affected by non-performing assets and remaining 96% is affected by other factors. Further more, the value of P.E. is 0.29 for bank indicating and insignificant relationship between them.

From the above calculations, it can conclude that the profitability of the individual bank is dependent in the Non-Performing Assets of the respective banks. As the relationship between NPA and profitability is insignificant in all the sample commercial bank the level of NPA does affect the profitability of the banks.

4.5.2 Correlation between NPA and Total Lending

The statistical tool, 'correlation analysis' is preferred in this study to identify the relationship between NPA and total lending and whether the relationship is significant or not.

Table 4.22

Correlation between NPA and Total Lending of the commercial bank

Bank	Coefficient of correlation (r)	Relationship	Coefficient of determination (r²)	Probable error (P.E.)	Significant/ Insignificant
LBL	0.77	positive	0.60	0.12	Significant
EBL	0.77	positive	0.59	0.12	Significant
NBBL	0.45	positive	0.20	0.27	Insignificant
NSBIBL	0.81	positive	0.65	0.10	Significant
HBL	-0.66	negative	0.43	0.17	Insignificant
Nabil	-0.81	negative	0.66	0.10	Insignificant

Table 23 shows the correlation coefficient between Total Lending and NPA shows that there is positive relationship between these two variables. When the amount of Total Lending is increased the amount in NPA is more and vice versa.

LBL, EBL and NSBIBL have the correlation coefficient of 0.77, 0.77 and 0.81 which are categorized as having high degree of positive correlation. And 60%, 59% and 65% of the total lending is affected by the NPA to the respective banks and rest is affected by the other factor. And the test so made for these banks are found to be significant as the correlation is greater than Probable error (P.E) multiplied by six times.

NBL has the correlation coefficient of 0.45 which is categorized as having moderate degree of positive correlation. Only 20% of the relationship is affected by the NPA in the increment of the total lending of the bank. As coefficient of determination of the bank found to be 21% and remaining is affected by other factor. Further more, the value of P.E. is 0.10 for bank indicating a significant relationship between them.

HBL has the correlation coefficient of -0.66 which is categorized as having moderate degree of negative correlation. And 43% of the total lending is affected by the NPA to the respective bank and rest is affected by the other factor. Since the P.E. for the HBL is more than the coefficient of correlation bank indicating insignificant.

Nabil has high degree of negative correlation coefficient i.e. higher the level of NPA would lower in the total lending and vice versa. 66% of the total lending is affected by non performing assets and remaining 34% is affected by other factors. Further more, the value of P.E. is 0.10 for bank indicating a significant relationship between them.

As the relationship between NPA and Total lending is significant in three sample bank (EBL, LBL and SBI). This means that their NPA depends on Total Lending.

4.6 Major Findings of the Study

This study is concerned to find out the level of NPA and its effects on the returns on assets and the other factors of the Nepalese commercial banks. This study especially focuses on six commercial banks of Nepal, viz. Lumbini, Everest, Nepal Bangladesh, Nepal SBI, Himalayan and Nabil only, out of the 18 commercial banks operating in the banking industry of Nepal.

In case of Lumbini Bank Limited (LUBL), total NPA and net profit have been found to be in fluctuating trend. NPA to total lending ratio have been found increasing over the years as it was 19.32% in the fiscal year 2059/60 and increased to 20.99% in the fiscal year 2063/64. The total lending to total deposit ratio is found to be increasing over the five years period. Bu the net profit to total assets ratio is found to be decreasing over the years as it was -3.2% in the fiscal year 2059/60 and decreased to -18.92% in the fiscal year 2063/64.

In case of the Himalayan Bank Limited (HBL), total NPA have been decreased and net profit have been found to be increasing, NPA to total lending ratio have been found decreasing over the years as it was 12.10% in the fiscal year 2059/60 and increased to 6.60% in the fiscal year 2063/64. The total lending tot total deposit ratio is found to be increasing over the five years period. The net profit to total assets ratio is found to be increasing over the years as it was 1.14% in the fiscal year 2059/60 and decreased to 15.5% in the fiscal year 2063/64.

The case of Nepal SBI Bank Limited (NSBINL), total NPA and net profit have been found to be increasing, NPA to total lending ratio have been found to be slightly decreasing over the years as it was 6.32% in the fiscal year 2059/60 and increased to 6.13% in the fiscal year 2063/64. The total lending total deposit ratio is found to be decreasing over the five years period. The net profit tot total assets ratio is found to be increasing over the years as it was 0.58% in the fiscal year 2059/60 and decreased to 0.90% in the fiscal year 2063/64.

In case o Nepal Bangladesh Bank Limited (NBBL), total NPA have been found to be increasing and net profit have been found to be decreasing, NPA to total lending ratio have been found increasing over the years as it was 12.26% in the fiscal year 2059/60 and increased to 19.04% in the fiscal year 2063/64. The total lending to total deposit ratio is found to be decreasing over the five years period. But the net profit to total assets ratio is found to be decreasing over the years as it was 0.59% in the fiscal year 2059/60 and decreased to 00% in the fiscal year 2063/64.

The case of Everest Bank Limited (EBL), total NPA and net profit have been found to be increasing, NPA to total lending ratio have been found increasing over the years as it was 1.045 in the fiscal year 2059/60 and increased to 1.27% in the fiscal year 2063/64. The total lending to total deposit ratio is found to be decreasing over the five years period it was 74.0% in the fiscal year 2059/60 and decreased to 73.40% in the fiscal year 2063/64.

In case of Nabil Bank Limited (NBL), total NPA of the bank have been found to be decreasing and net profit have been found to be increasing, NPA to total lending ration have been found decreasing over the years as it was 7.14% in the fiscal year 2059/60/59 and increased to 1.38% in the fiscal year 2063/64. The total lending to total deposit ratio is found to be increasing over the five years period it was 50.315 in the fiscal year 2059/60 and slightly decreased to 68.63%. The net profit to total assets ratio is found to be increasing over the years as it was 1.53% in the fiscal year 2059/60 and decreased to 3.23% in the fiscal year 2063/64.

The percentage of performing assets to total assets of the LBL have found to be high among the sample banks, which was 67.09% and the HBL have been found to be 45.04% which was lower than other banks. Among the sample banks the percentage of non performing assets to total assets of the EBL was found low which was 1.005 and it was found to be 14.27% of the LBL which was high.

The percentage of performing assets to total lending was found higher in EBL ad lower in LBL which was 98.43% and 83.08% respectively. The percentage of non-performing assets to total lending was found lower in EBL and higher in LBL which was 1.57% and 16.59% respectively among the sample banks.

The percentage of performing assets to total deposit of EBL have been found to be 73.35% which was higher than other banks and it was 50.145 of the HBL. The percentage of non-performing assets to total deposit was 1.19% of EBL and 14.75% of LBL respectively which was lower and higher ratio.

The level of NPA is found to be highest for the NBBL in the fiscal year 2062/63, which was Rs. 1832943785 where as the lowest, was found that of EBL in the fiscal year

2059/60 which was Rs. 42388116. In overall, the performance of the Nabil bank is found to be satisfactory as the level of NPA is gradually decreasing and net profit is gradually increasing over the years covered by this study period, followed by EBL, NSBIBL and HBL respectively. But in case of LBL and NBBL the NPA is increasing and the net profit is gradually decreasing which was worse.

The average ratio of pass loan to total loan of five years have been found higher in EBL and lower in LBL which was 97.13% and 80.85% respectively. The average ratio of restricted loan to total loan of five years has been found higher in NSBIBL which was 6.08%.

The average ratio of non-performing assets to total loan of five years was found lower in Everest Bank Limited. The average ratio of substandard loan to total loan and bad loan to total loan of five years have been found lower in EBL and higher in LBL. The average ratio of doubtful loan to total loan of five years was found higher in NSBIBL and lower in EBL.

From the hypothesis testing only EBL NPL is higher than average NPL of sample bank at 5 % level of significance. All other bank average NPL is equal to average NPL of sample bank at 5 % level of significance.

The correlation coefficient between ROA and level of NPA is found to be negative for each of the bank except that the NBBL under the study period. Among them LBL and Nabil bank have high degree of negative correlation i.e. the ROA indirectly depends on the level of NPA, higher the NPA the lower will be the returns on assets and vice versa. HBL have the moderate degree of negative correlation. Only 325 nos. of returns are affected by level of NPA and remaining is affected by other factor. NSBIBL and EBL have the low degree of correlation coefficient. Only 7% and 17% of NSBIBL and EBL respectively on the profitability is affected by NPA and rest is affected by other factor. Only NBBL have low degree of positive correlation coefficient.

The correlation coefficient between total lending and non-performing assets of the commercial banks is found to be positive for each of the bank except that the HBL and

Nabil Bank Limited under the study period. Among them LBL, EBL and NSBIBL bank have high degree of positive correlation i.e. the total lending is directly dependent on the level of NPA, higher the NPA the more will be the total lending of banks and vice versa. NBBL have the moderate degree of positive correlation. Most of the lending are affected by level of NPA and remaining is affected by other factor. HBL has the moderate degree negative correlation coefficient. Nabil Bank Limited has high degree negative correlation coefficient 66% on the lending is affected by the level of NPA and remaining only 34% is affected by other factors.

Chapter V

SUMMARY CONCLUSION AND RECOMMENDATIONS

5.1 Summary

A commercial bank means the bank, which deals with exchanging currency, accepting deposits giving loans doing other various commercial transactions. Therefore, the major function of commercial bank is to accept deposits and provide loans.

There is not so long history of commercial bank in Nepal. Nepal Bank Limited established in 1994 B.S. was the first commercial bank of the Nepal. But now there are eighteen commercial banks all over the country and they have been expanding their services by establishing branches in every corner of the country.

The assets of commercial bank indicate the manner in which the funds entrusted to the bank are employed. The successful working of the bank depends on ability of the management to distribute the fund among the various kind of investment known as assets outstanding loan advance of the bank. These assets constitute primary source of income to the bank. As being a business unit a bank aims at making huge profit since loan and advances are more profitable than any other assets of the bank, it is willing to lend as much as its fund as possible. But the bank has to be careful about the repayment loan and interest giving loan. If the bank is too timid, it may fail to obtain the adequate return on the fund, which is confined to it for use. Similarly, if the bank is too liberal, it may easily impair its profits by bad debts. Therefore, bank should not forget the reality that most of the bank failures in the world are due to shrinkage in the value of the loan and advances.

Despite of being loan and advances more profitable than other assets, it creates risk of non repayment for the bank. Such risk is known as credit risk or default risk. Therefore, like other assets, the loan and advances are classified into performing and non-performing assets on the basis of overdue aging schedule. If the dues in the form of principal and the interest are not paid, by borrower within a maturity period, that amount of principal and interest is called non performing loan or assets. It means NPA could

wreak branch profitability both through loss of interest income and need to write off the principal loan amount. Performing assets have multiple benefits to the company as well as to the society while non performing assets erode even existing capital of the bank.

Escalating level of NPA's have been becoming great problem in banking business in the world. In this context, Nepal can not be run off from this situation. The level of NPA in Nepalese banking system is very alarming. It is well known fact that the bank and financial institution in Nepal have been facing the problem of swelling non performing assets and the issue of becoming more and more unmanageable day by day. It is well know from different financial reports, newspapers and news that the total NPA in Nepalese banking system is about 32 Billion while it is very worse in case of two largest commercial banks RBB and NBL. (Nepal Rastra Bank, Banking and financial statistics, 2006: 06)

Therefore, this study is concerned to find out the level of NPA and its effects on the returns on assets and the other factors of the Nepalese commercial bank. This study especially focuses on six commercial banks of Nepal, viz. Lumbini, Everest, Nepal Bangladesh, Nepal SBI, Himalayan and Nabil only, out of the 18 commercial banks operating in the banking industry of Nepal.

The level of NPA is found to be highest for the NBBL in the fiscal year 2062/63, which was Rs. 1832943785 where as the lowest, was found that of EBL in the fiscal year 2059/60 which was Rs. 42388116. In overall, the performance of the Nabil bank is found to be satisfactory as the level of NPA is gradually decreasing and net profit is gradually increasing over the years covered by this study period, followed by EBL, NSBIBL and HBL respectively. But in case of LBL and NBBL the NPA is increasing and the net profit is gradually decreasing which was worse.

Himalayan Bank Limited and Nabil Bank Limited can able to decreased the level of NPA during the study period as a result they can able to increase to net profit of the banks. In case of Everest Bank Limited and Nepal SBI Bank Limited, they able to increase net profit of the bank although they can not control the level of non performing assets. The level of NPA is also increasing during the study period. Unfortunately Lumbini Bank

Limited and Nepal Bangladesh Bank Limited can not increase their net profit because of increment in the level of non performing assets. The level of non performing assets plays vital role in increment and decrement of profit of the commercial banks.

Every commercial Bank should follow the NRB directives. Commercial bank has to maintain loan loss provision as per NRB directives for the commercial bank. According to NRB directives, loan loss provision for pass loan should be 1% of pass loan, for substandard loan it should be 25% of substandard loan, for doubtful loan it should be 50% of doubtful loan and for bad loan it should be 100% of bad loan.

Every commercial bank is trying to exactly meet the NRB's directives regarding non performing assets. But he sample banks of the study could not maintained loan loss provision perfectly accordance to the NRB directives for all classed. The bank maintained higher the loan loss provision requirement for one class loan when lower another class loan.

Everest Bank Limited could maintain loan loss provision, perfectly in accordance to NRB directives with compare to another sample bank of the study. Therefore it can conclude the EBL able to maintain the loan loss provision. The remaining sample banks should give priority to maintain the loan loss provision as requirement as per NRB's directives.

The percentage of performing assets to total assets of the LBL have found to be high among the sample banks, which was 67.09% and the HBL have been found to be 45.04% which was lower than other banks. Among the sample banks the percentage of non performing assets to total assets of the EBL was found low which was 1.00% wand it was found to be 14.27% of the LBL which was high.

The percentage of performing assets to total lending was found higher in EBL and lower in LBL which was 98.43% and 83.08% respectively. The percentage of non performing assets to total lending was found lower in EBL and higher in LBL which was 1.57% and 16.59% respectively among the sample banks.

The percentage of performing assets to total deposit of EBL have been found to be 73.35% which was higher than other banks and it was 50.14% of the HBL. The

percentage of non performing assets to total deposit was 1.19% of EBL and 14.75% of LBL respectively which was lower and higher ratio.

The average ratio of pass loan to total loan of five years have been found higher in EBL and lower in LBL which was 97.13% and 80.85% respectively. The average ratio of restricted loan to total loan of five years has been found higher in NSBIBL which was 6.085.

The average ratio of non performing assets to total loan of five years was found lower in Everest Bank Limited. The average ratio of substandard loan to total loan and bad loan to total loan of five years have been found lower in EBL and higher in LBL. The average ratio of doubtful loan to total loan of five years was found higher in NSBIBI and lower in EBL.

5.2 Conclusion

The profitability of Nepalese commercial bank is affected by non performing assets of bank. When the level of non performing assets is increasing then the profit of the bank is decreasing and vice versa. Therefore the NPA and profitably of the bank have negative correlation.

The level of NPA is found to be highest for the NBBL in the fiscal year 2062/63., which was Rs. 1832943785 where as the lowest, was found that of EBL in the fiscal year 2059/60 which was Rs. 42388116. In overall, the performance of the Nabil bank is found to be satisfactory as the level of NPA is gradually decreasing and net profit is gradually increasing over the years covered by this study periods. But in case of LBL and NBBL the NPA is increasing and the net profit is gradually decreasing which was worse.

Every commercial bank is trying to exactly meet the NRB's directives regarding non performing assets. In overall, Everest Bank Limited could maintain loan loss provision, perfectly in accordance to NRB directives with compare to another sample bank of the study. Therefore it can conclude the EBL able to maintain the loan loss provision as per

NRB's directives. The remaining sample banks should give priority to maintain the loan loss provision as requirement as per NRB's directives.

5.3 Recommendation:

High level of non performing assets not only decreased the profitability of the banks but also entire financial as well as operational health of the country. If the NPA were not controlled immediately, it would be proved as a curse for the banks in near future. Therefore, following are some of the recommendations, which will help to reduce the level of NPA of the Nepalese commercial banks:

1. Corporate structure of bank plays key role in the effective loan management. Being loan a risky asset, efforts should be made to have proper control in every steps of loan management. The banks should establish separate department for credit appraisal, documentation. Disbursement, inspection and recovery of loan which have possibility of finding mistakes of one department by the others, so that the effectiveness can be achieved.
2. Loan must be given if the banker is satisfied that the borrower can repay money from the cash flow generated from operating activities. However, the banks want to ensure that their loan is repaid even in case of failure of business. To prevent banks from such happenings, the bank take collateral is disposed for the recovery of loan. Therefore these bank should take proper valuation of collateral so that the bank at least will be able to recover its principal and interest amount in case of failure of the borrower to repay the loan.
3. Lack of proper financial analysis of the borrower by the banks, is one of the major cause behind increasing NPA of Nepalese commercial banks. Therefore, proper financial analysis should be performed before giving loan to the borrower.
4. Those banks, which have high level of NPA, should take necessary action towards recovering their bad loan as possible. In case doubtful to repay the loan by the

borrower, the bank should dispose off the collateral taken from them and recover the principal and the interest amount there of.

5. Diversification of the loan should be managed by the individual banks. In the context of Nepal it is provided to the borrower so often go to the bank not in the new sector. Default by older borrower can be found, which should be avoided.
6. Control mechanism of the bank should be managed properly. Black listed customers should not be given the new loan, as it would lead to the same situation to the bank.
7. Political influences in the loan disbursement should be avoided as it may lead to worse condition to the bank as it may increase the non performing loan of the bank.
8. Every commercial bank should maintain loan loss provision as per NRB's directives regarding non performing assets.

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