

## 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. (Vaidya; 2008:3)

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. (Vaidya; 2008:9)

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 32 commercial banks, 78

finance companies about 24 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 producers 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. (Vaidya; 2008:7)

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 divided 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.

### **1.1.1 Brief Profile of the banks under study:**

For the study purpose of this research two commercial banks i.e. Laxmi Bank Ltd. & Everest Bank Ltd. were selected. The brief introduction of both the sample banks are as follows:

#### **Laxmi Bank Ltd.**

Laxmi Bank was incorporated in April 2002 as the 16th commercial bank in Nepal. In 2004 Laxmi Bank merged with HISEF Finance Limited, a first generation financial company which was the first and ever merger in the Nepali corporate history.

Laxmi Bank is a Category 'A' Financial Institution and re-registered in 2006 under the "Banks and Financial Institutions Act" of Nepal. The Bank's shares are listed and actively traded in the Nepal Stock Exchange (NEPSE).

Laxmi a technologically driven progressive Bank with strong risk and corporate governance foundations. We are known for our innovation and claim to many "firsts" in the Nepalese financial market. We have the best asset quality among all financial institutions in the country and our technology has been rated "Highly Secure" by an independent internationally accredited information system auditors. Laxmi Bank's award winning Annual Reports has set the standards for quality, presentation and disclosure for the Nepalese corporate sector to follow since 2005.

Laxmi Bank promotes a separate life insurance company – Prime Life Insurance Limited which came into operation in 2009. ([www.laxmibank.com](http://www.laxmibank.com))

#### **Everest Bank Ltd.**

Everest Bank Limited (EBL) is a professionalized and efficient banking services provider in Nepal. Founded in 1994, the bank has been one of the leading banks of the country and has been catering its services to various segments of the society since then. With clients from all walks of life, the bank has helped develop the nation corporately, agriculturally

and industrially. So one can say with all earnestly that Everest Bank Limited is truly a Nepalese bank

Punjab National Bank (PNB), is the joint venture partner (holding 20% equity in the bank) of Everest Bank Ltd. which is the largest nationalized bank in India. With its presence virtually in all the important centers at India and over 5600 ATM counters, Punjab National Bank offers a wide variety of banking services which include corporate and personal banking, industrial finance, agricultural finance, financing of trade and international banking. For its excellence in banking services, it was recently awarded the "Best Bank Award 2011" amongst all banks in India by the leading corporate magazine, Business India.

Everest Bank Limited (EBL) provides customer-friendly services through its Branch Network and all its branches are connected through Anywhere Branch Banking System (ABBS), which enables customers for operational transactions from any branches. The bank has 45 Branches, 55 ATM Counters and 21 Revenue Collection Counters across the country making it a very efficient and accessible bank for its customers, anytime, anywhere. ([www.everestbank.com.np](http://www.everestbank.com.np))

## **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 1997, Nepalese currency depreciated by 11.2 percent against US dollar within a short span of time. Manandhar K.B. (1998) 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. 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 is the trend and actual level of NPA on Nepalese commercial banks?
- Is the NPA affecting the financial performance of the Nepalese commercial banks?
- 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?
- What are causes for the increment of NPA?
- 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 of sample commercial bank in accordance with NRB directives.

### **1.5 Significance of 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. 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 at a bank is able to lend, but it depends upon the quality of the loan. 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. 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 limited to FY 2007/08 to 2011/12 only from last five fiscal years.
- Data of FY 2011/12 for both the banks is unaudited.
- The study is based on both primary and secondary data.

## **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.

Bibliography and annexure are included in the last of the chapter.

## CHAPTER – II

# REVIEW OF LITERATURE

### 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

Having exercised the powers conferred by Section 79 of the Nepal Rastra Bank Act, 2002, the following Directives have been issued with regard to classification of credit/advances and provisions to be made for its possible loss by the institutions obtaining licenses from this Bank to carry out financial transactions.

#### 1. Classification of loans/advances:

Entire loans and advances extended by a licensed institution have to be classified as follows based on expiry of the deadline of repayment of the principal and interest of such loans/advances:-

- (a) Pass: Loans/advances which have not overdue and which are overdue by a period up to three months.
- (b) Sub-standard: Loans/advances which are overdue by a period from three months to a maximum period of six months.
- (c) Doubtful: Loans/advances which are overdue by a period from six-months to a

maximum period of one year.

(d) Loss: Loans/advances which are overdue by a period of more than one year.

The loans which are in pass class and which have been rescheduled/restructured are called as "the performing loan, and the sub-standard, doubtful and loss categories are called non-performing loans.

Note: Loans/advances also include bills purchased and discounted.

## **2. Additional provisions relating to pass loans**

- (1) The following loans may be included in the pass loan:-
  - (a) Loans/advances extended against the collateral of gold and silver;
  - (b) Loans/advances of fixed receipts
  - (c) Loans/advances of Government of Nepal securities and loans/advances made against the collateral of Nepal Rastra Bank bonds

Provided that the cases of the loans/advances against the fixed receipts or Government of Nepal securities or Nepal Rastra Bank bond as the additional collateral, such loans and advances shall also have to be classified in accordance with the directive referred to into Point No. 1 above.

(2) The working capital loan having the deadline of up to one year for repayment may be included in the pass loan class. In case the interest to be received from the loans of working capital nature is not regular, such loans have to be classified on the basis of the duration of interest to be due.

## **3. Additional Provisions Relating to Loss Loans**

In case there seem any of the following discrepancies in any of the following loans, whether or not the deadline for repayment of which is expired, such loans and advances has to be categorized as the loss loan:

- (a) The market price of the collateral cannot secure the loans;
- (b) The debtor is bankrupt or has been declared to be bankrupt;
- (c) The debtor disappears or is not identified;
- (d) In case non-fund based facilities such as purchased or discounted bills and L/C

and guarantee which have been converted into fund-based loan, are not recovered within ninety days from the date of their conversion into loan;

- (e) Loan is misused;
- (f) Expiry of six months of the date of auction process after the loan could not be recovered or a case is pending at a court under the recovery process;
- (g) Providing loan to a debtor who has been enlisted in the black-list of Credit Information Bureau Ltd;
- (h) The Project/business is not in a condition to be operated or project or business is not in operation
- (i) The credit card loan is not written off within 90 days from the date of expiry of the deadline;
- (j) While converting the L/C, guarantee and other possible liabilities into a fund-based loan under the regular process, if the said loan is not recovered within 90 days; and
- (k) In case of expiry of the deadline of a trust-receipt loan.

Note: For the purpose of clause No. 3(e) of these Directives, "misuse" means non-use of the amount of the loan for the purpose for which it has been taken; the project is not in operation; the amount accrued from the concerned project or business is not used in repayment of the loan but in other activities; and the word also includes the loan which is proved to have been misused by a supervisor in the course of inspection or supervision or by an auditor in the course of auditing.

#### **4. Additional Provisions Relating to Term-Loan**

In cases of the term loans extended in installments, if the deadline of installment of the principal amount expires, remaining entire loan amount has to be classified based on expiry of the deadline of the installment amount.

Provided that in cases of the installment of the term loan given by licensed institution not having the facility of engaging in overdraft transaction, entire loan amount has to be categorized as loss loan only if the installment amount has crossed the deadline by a period of more than one year. In case the installment amount has crossed the deadline by

a period of less than one year, only such installment amount has to be classified in the loss loan with a provision of loan loss. However, this clause shall not be deemed to have hindered if the licensed institution wants to classify the entire loan amount as the loss loan.

Note: For the purpose of this clause "term loan" means a credit/advances made available having fixed the repayment period of more than one year.

### **5. Additional Provisions Relating to Gold/Silver Loan**

The licensed Banks and financial institution of classes "A", "B" and "C" may provide loan having mortgages gold/silver subject to the following conditions:-

- (a) The provisions of providing loan by mortgaging gold and silver has to be stated in the credit policy/byelaws of the institution;
- (b) Prior to carry out transaction of gold/silver loan, provisions relating to necessary security, evaluation of the collateral, vault insurance and checkers have to be made;
- (c) Annual studies have to be conducted whether or not the gold/silver loan is useful and profitable to the financial institution and annual monitoring has to be conducted from the Board of Directors.

### **6. Principal and Interest not allowed to be recovered crossing the overdraft limit:**

Principal and interests of a loan shall not be allowed to be recovered having overdrawn the current account of a customer so that the overdraft limit is crossed. Provided that this provision shall not be deemed to prohibit to recover the principal and interest having debited the balance in an account of the customer. In case the account is not settled by a period of one month after overdrawn of the account while recovering principal and interest by debiting the account of the customer, the amount overdrawn shall also be included in the loans not recovered and such loans have to be classified in one class lower than the class to which such loans belongs. While debiting the account, overdraft shall not be allowed by crossing the limit provided to the customer.

## **7. Provisions Relating to Grace Period**

Licensed institution shall not normally be allowed to make available term loans with grace period of more than one year. In case longer grace period has to be provided, the reasons for and bases on which such longer period has to be granted, such details shall have to be disclosed and it shall have to be approved by the Board of Directors at the time of approval of the loan.

## **8. Provisions Relating to Rescheduling and Restructuring of Loans**

- (1) In case a licensed institution is convinced on the following bases stated in the written action plan submitted by the debtor, it may reschedule or retract the loan:-
  - (a) Evidence showing that documents relating to loans and security are adequate;
  - (b) Bases on which the licensed institution is convinced of the possibility that the rescheduled or restructured loans would be recovered;
  - (c) In addition to submission of written plan of actions for rescheduling and restructuring loans at least 25 percent of the interest due to be paid until the date of rescheduling or restructuring of such a loan has been paid;
  
- (2) While rescheduling or restructuring the loans to the industries which have been recommended by the Sick Industries Preliminary Inquiry and Recommendation Committee formed under Government of Nepal, a minimum of 12 percent of interest has to be paid, other procedures need to be fulfilled and rescheduling and restructuring shall have to be carried out making a provision for twenty-five percent loan loss. Provided that in the event where the loan has been rescheduled and restructured based on payment of less than 12 percent of interests, provision for loan loss has to be made based on the duration upon expiry of the deadline according to the prevailing provisions.
  
- (3) Description of the loans classified pursuant to classes (1) and (2) has to be separately prepared.

Note: For this purpose, "Rescheduling" means the process of extending the time-limit of repayment of the loan availed by the customer.

"Restructuring" means the process of changing the nature or terms and conditions of altering the restrictions on or changing the time limit of the credit facilities.

### **9. Provision to be maintained for loan loss**

(1) For the loans and bills purchase classified according to these Directives, the following loan loss provision shall be maintained based on the remaining amount of principal:

<u>Loan classification</u>	<u>Minimum Provision for loan loss</u>
(a) Pass	1 percent
(b) Sub-standard	25 percent
(c) Doubtful	50 percent
(d) Loss loan/the loan extended to blacklisted	100 percent

(a) The loans classified in the pass class at the time of rescheduling and restructuring shall, while rescheduling and restructuring, provision of at least 12.5 percent has to be made as loan loss, while rescheduling and restructuring the loans classified as substandard, doubtful and loss, no adjustment shall be allowed in the then loan loss provision except in the cases referred to in clause 10(c). In cases of the loans made available on an equal monthly installment, no loan loss provision shall have to be made in case of rescheduling and restructuring of the following of such loans if the principal and interest is regular:

(i) In case amount of installment and number of installment is decreased because of prepayment of installment.

(ii) Due to change in the rate of interest having regard to the market situation, the duration of the loan and installment amount has been changed. In this context, if the rate of interest is increased and thereby by the duration and installment amount is increased, the installment amount determined at the time of sanctioning the loan is not allowed to be decreased. Similarly, if the rate of interest is decreased and thereby the duration and number of installment are decreased, the installment amount determined at the time of sanctioning the loan is not allowed to be decreased.

(b) In case the installment of principal of the rescheduled and restructured loan and interest of two years, such loans may be converted into pass loans.

(c) No loans extended having pledged shares shall be rescheduled and restructured.

(3) In the event of deprived sector lending made by licensed institution Bank and financial institution to deprived communities according to Directives of this Bank; if such loans have been secured through Deposit Insurance and Credit Guarantee Corporation or if other loans have also been insured an exemption of 75 percent has been made and provision for remaining 25 percent shall be required.

(4) Banks and financial institution shall not provide any type of loan on the security of the memo (ardhakatti) of an application to be submitted for share purchase at the time of initial public offering. In case of providing loan in such a way, the concerned bank or financial institution shall have to make cent percent loan loss provision.

(5) While providing loan on personal/institutional guarantee, description of property equal in value to the amount of the personal guarantee and in sole ownership of the debtor and free of any claim of any one else shall compulsorily be obtained. Even the loans given only on the basis of personal/institutional guarantee shall also be classified as stated above in pass, substandard and doubtful as may be required and loan loss provision shall be made 20 percent more in addition to the percentage prescribed for that class. Even in the cases where personal guarantee has been taken for the collateral of physical property alone could not secure the loan, the provision for additional loan and stated above has to be made. Classifications of such loan has to be made separately. Provided that in cases of loans and advances made to the institutions referred to in sub-clause (b) of clause 4 of the Directives No. 3, Nepal Oil Limited and Nepal Food Corporation, no additional loan loss provision of 20 percent shall be required to be made.

(6) No additional loan loss provision of 20 percent shall be required to be made in the loan loss provision referred to in sub-clause (3) above in cases of education loan and

loans extended to micro-credit financial institutions and cooperative financial institution under the deprived sector lending by banks and financial institution on personal guarantee.

(7) There is no restriction to classify loans and advances of higher class to lower class in case licensed institution so wishes. For an example, substandard loan may be classified as doubtful or loss loan and doubtful loan may be classified as loss loan.

(8) Loans/advances also include bills purchase and discounts.

Note: Loan loss provision made for performing loan shall be treated as general loan loss provision and that for non-performing loans shall be treated as specific loan loss provision.

#### **10. Conditions for Adjustment in loan loss provision**

No loan loss provision shall be allowed for adjustment except in the following conditions:-

- (a) In case the loan is written off;
- (b) In the event where repayment of loan is in installment or in partial basis, the loan loss provision made to the extent of the loan so repaid may be written back and adjusted while maintaining loan loss provision according to loan classification; and
- (c) In the event of the loan is reclassified after loan rescheduling and restructuring, if the repayment of the principal and interest of the loan so rescheduled and restructured is regular for a consecutive period of two years. Details of such loans shall be separately prepared.

#### **11. Loss Provisions and Auction of Non-banking assets**

- (1) In case of the non-banking assets accepted by the licensed institution, cent percent loss provisions shall be made from the date of the acceptance.
- (2) In case of sale of the non-banking assets, necessary adjustment in the accounts of loss provision maintained for such property shall immediately be made.
- (3) While accepting collateral security as non-banking assets by licensed institution, the following provisions shall be applicable while selling the non-banking assets so accepted:

- (a) While accepting the collateral property of a customer as non-banking assets whose outstanding loan amount is more than 2.5 million, the concerned party shall compulsorily be black-listed.
- (b) Prior to auctioning the non-banking assets in the name of the institution, it shall have to be evaluated by an independent evaluator. No excessive/less evaluation shall be allowed.
- (c) Transparent and clear provisions shall be made with regard to auction sale of collateral security/non-banking assets in Financial Administration Byelaws and sales shall have to be carried out in such a manner to serve interest of the bank or financial institution.
- (d) While accepting the non-banking assets in such a manner, entire property mortgaged as collateral that could not be sold by auction shall have to be accepted and it may not be accepted in part.
- (e) The property so accepted shall have to be sold at the earliest to the extent possible. In case it is necessary for own purpose of the licensed institution, the same shall have to be approved by the Board of Directors and information thereof shall be made available to this Bank as well.

### **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 12<sup>th</sup> 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 17<sup>th</sup> 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, 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-2006.

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 1983 as the first commercial bank of Nepal. This bank was establishment under Nepal Bank Act 1983 A.D.

Nepal Rastra Bank was established in 1956 A.D. under Nepal Rastra Bank Act 1955 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 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 1979 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 1984 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 1985 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 Mega Bank, Janata Bank, Commerz & Trust Bank came into operation with cent percent domestic investment by Nepalese promoters which are 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 an adequate return on the fund which are confided to him for use. It is by his capacity in lending that a bank manager is 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'être* 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. 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. 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, 2001:3)

#### **2.2.4 Definition of NPA**

A Non-performing loan is a loan that is in default or close to being in default. Many loans become non-performing after being in default for 3 months, but this can depend on the contract terms.

“A loan is nonperforming when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full” (IMF) 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)**

A question that arises is how much risk can a bank afford to take? Recent financial crisis in USA and Europe 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.

### **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 loan can be defaulted from the economic situation was favorable to the borrowers and also economy was achieving a higher level of economic growth. Their track record is not good and even in that time they have not paid the bank as per agreement. It is business principal that 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 borrower should either change the business or stop the operations to control further losses. This is because; 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 on Nepal has been endeavoring a lot of efforts to make the Nepalese financial healthy and prudent through various reform program, 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. The non-performing loan of commercial banks increased to 3.2 percent in Mid – July 2011 from 2.39 percent in the Mid - July 2010. The total amount of NPA in Mid –July 2011 reached to Rs. 16,872 million from Rs. 11,223 million in the Mid - July 2010.

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, where as 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.

**Table 1****Level of NPA in Nepalese Commercial Banks**

1	Nepal Bank Limited	5.28%
2	Rastriya Banijya Bank	10.92%
3	NABIL Bank Limited	1.77%
4	Nepal Investment Bank	0.59%
5	Standard Chartered Bank	0.62%
6	Himalayan Bank	3.92%
7	Nepal SBI Bank	1.13%
8	Nepal Bangladesh Bank	19.18%
9	Everest Bank Limited	0.34%
10	Bank of Kathmandu Ltd.	1.82%
11	Nepal Credit & Commerce Bank	3.94%
12	NIC Bank Ltd.	0.60%
13	LUMBINI Bank	0.96%
14	Machhapuchhre Bank	4.48%
15	KUMARI Bank	1.12%
16	LAXMI Bank	0.90%
17	Siddhartha Bank Limited	0.59%
18	ADB/N	8.64%
19	GLOBAL Bank	2.59%
20	CITIZENS Bank	1.17%
21	PRIME Bank	0.48%
22	Bank of Asia	0.65%
23	Sunrise Bank	3.44%
24	DCBL Bank	1.64%
25	NMB Bank	0.27%
26	Kist Bank	0.99%
27	Janata Bank	0.00%
28	Mega Bank	0.00%
29	Commerz & Trust Bank	0.00%
30	Civil Bank	0.00%
31	Century Bank	0.00%
32	Sanima Bank	0.80%

Source: *Banking and Financial Statistics; Mid July 2012; www.nrb.org.np*

### 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, 2000).

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)

**Table 2**  
**Categories of Loan**

<b>Categories of Loan</b>	<b>Criteria of Classification</b>	<b>provisioning required</b>
<b>Pass</b>	not disclose any problem and not carry risk (actually a performing asset)	1% of outstanding loans
<b>Sub-standard</b>	overdue for not exceeding 2 years	10% of the total outstanding
<b>Doubtful</b>	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
<b>Bad</b>	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 2001/02 commercial banks are required to make provision against loans and advances as follows:

**Table 3**  
**Provision against Loan and Advances**

<b>Classification of loans and advances</b>	<b>Criteria for provisioning</b>	<b>Provision rate</b>
<b>Pass</b>	Past due for a period up to 3 months. (performing loans)	1%
<b>Substandard</b>	past due for a period of 3 months to 6 months	25%
<b>Doubtful</b>	past due for a period of 6 months to 1 year	50%
<b>Bad</b>	past due for a period of more than 1 year or advance which have least	100%

(NRB Circular, 2000)

However, for F/Y 2001/02, 2002/03 & 2003/04 there are certain relaxation on ageing of due loan. The above criteria are supposed to be effective fully onwards F/Y 2003/04.

### **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 Venkatakrishna, 2001:564)

- Lower ROE and ROA
- Lower image and rating of bank
- Disclosure reduces investors' 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 string
- Administration and recovery cost of NPA
- Effect on employee morale and decision making.

### **2.3 Review of Related Studies**

On 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 book have been consulted such as Tannan's Banking Law and Practice in India (1997). Assessing the gravity of the problem Tannan (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.

### **2.3.1 Review of articles, journals & magazines**

Ghimire (2007) 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.

Sharma (2009) 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.

Rayamajhi (2009) 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.

Sharma D.(2012) in his article in Republica National dailyThe net profit of commercial banks dipped 16.01 percent and at least two banks posted net loss in the first nine months of the current financial year, as the process of recovering debt absorbed by the now stagnant real estate sector moved ahead at a tardy pace.

The unaudited financial reports published by 32 commercial banks till Friday showed category 'A' financial institutions generated a net profit of Rs 9.14 billion in the nine-

month period till April with Rs 10.88 billion in the same period last fiscal year. The reports of top five private banks in terms of assets show mixed results. For instance, Nabil posted a profit of Rs 1.12 billion, up 19 percent, while Standard Chartered and Nepal SBI scooped up Rs 850 million and Rs 319 million in profit, a hike of 1.62 percent and 0.65 percent, respectively. Profits of two other top five banks - Himalayan and Nepal Investment - however, dropped 14.34 percent and 16.53 percent to Rs 570.22 million and Rs 801 million respectively.

The worst performers in the nine-month period were Kist Bank, which reported a net loss of Rs 153.73 million, and Century Bank, which was Rs 36.20 million in red. “Profits of most of the banks shrunk in the review period and some even posted losses as they had to allocate bigger amount on loan loss provisioning as borrowers, especially those exposed to the real estate sector, failed to repay debts on time,” .

#### **2.4 Review of Unpublished 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.

Khadka (2007) has conducted research on “*Non Performing Assets of Nepalese Commercial Bank*”. He observed various aspects on NPA’s. The objectives of his thesis is

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

The major findings of his study by applying financial and statistical research tools were as follows:

- ) NPA of the bank seems at remarkable level at the end of FY 2059/60.
- ) 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.

- ) None of the bank has follows NRB's directive regarding loan loss provision.
- ) ROA and ROE of the bank somehow depends on NPA.

Shrestha (2008) 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:

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

The major findings of his study by applying financial and statistical research tools were as follows:

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

Gimire (2009) on "*Non performing Assets of Commercial Bank*" has set the following objectives for analysis.

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

The major findings of his study by applying financial and statistical research tools were as follows:

- ) Operating profit of sample banks are increasing but the growth on net profit is negative because of loan loss provision.
- ) There is a positive relation between credit expansion and incremental on NPA.

- ) NBA is created due to having NPA but cannot say whether there is NPA that always creates NBA.

Koirala, (2010) 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:

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

The major findings of his study by applying financial and statistical research tools were as follows:

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

Amatya, (2011) has conduct research on “*Non Performing Assets and its Impact on Profitability of Commercial Banks*”. She analyzed the data of six commercial banks and has set the following objectives:

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

The major findings of his study by applying financial and statistical research tools were as follows:

- ) The NPA of KIST and NB Bank was increasing during the study period.
- ) The NPA of SCBNL and NABIL was decreasing during the study period.
- ) The NPA of NIB and HBL was fluctuating during the study period.
- ) In overall performance SCBNL was found to be satisfactory where as NB Bank’s performance was the worst.

Giri, (2011) has conducted research on “*Non Performing Assets; A Major Obstacle on Profitability of Commercial Banks*”. She analyzed the data of two commercial banks and has set the following objectives:

- ) To evaluate the impact of NPA on the profitability of both the private and government sector commercial banks.
- ) To evaluate internal and external factors that influence the performing assets to non performing assets.

The major findings of his study by applying financial and statistical research tools were as follows:

- ) The NPA of RBB and NB Bank was increasing during the study period.
- ) The major source of NPA was internal factors rather than external.
- ) The NPA of RBB was found to be somewhat in correction phase
- ) Operating profit of sample banks are increasing but the growth on net profit is negative because of loan loss provision.

Rimal (2011) on “*Interrelationship between Real Estate Lending & NPL of Nepalese Banks*”. To achieve her objectives she has analyzed different aspects of NBBL, KIST and DCBL. He has set the following objectives:

- ) To evaluate the level of real estate loan of sample banks.
- ) To assess the adequacy of Loan Loss provisioning of sample banks.
- ) To measure the level of NPL and its relationship with real estate loans.
- ) To analyze the correlation between NPL & Total Lending.

The major findings of her study by applying financial and statistical research tools were as follows:

- ) Real Estate Loan of the sample banks under study is in increasing trend.
- ) NPL level of NBBL is decreasing whereas the same of KIST & DCBL is in increasing trend.
- ) There is a positive correlation between NPL & Total Loan of the sample banks under study.
- ) Loan loss provisioning of NBBL is significantly higher than other two banks.

## **2.5 Research Gap**

With compare to the previous thesis on this subject, data of this study has been updated till 2011/12. 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 in Nepalese financial institutions and the interrelationship of 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 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 operating in Nepal were considered as the total population. Out of them, two commercial banks i.e. Laxmi Bank Ltd. & Everest Bank Ltd. were in existence and doing their daily transactions were considered as the sample for the study.

**Table -3**

**Total population, sample and Sample Percentage**

<b>Types of the listed companies</b>	<b>Total Population</b>	<b>Sample considered</b>	<b>%</b>
Commercial Banks	32	2	6.25

[Source: Bank and Financial Statistics, NRB Mid July 2012]

### **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 Newspapers

### **3.5 Tools for Analysis**

#### **3.5.1 Financial Tools**

To evaluate the financial position and performance of any firm ratio is used as a key tool of financial analysis. "Financial Analysis is the process of identifying the financial strength and weakness of the firm by properly establishing relationship between the items of the balance sheet and profit and loss account". Financial Analysis is the use of

financial statements to analyze a company's financial position and performance and to assess future financial performance.

### **3.5.1.1 Ratio Analysis**

Ratio Analysis is a tool of scanning the financial statement of the firm. It is simply one number expressed in terms of another and as such it expresses the numerical and quantitative relationship between two variables. Through this, one comes to know that in which areas operation the organization is strong and in which areas it is weak. Ratio Analysis is the widely used tool of financial analysis in financial analysis; a ratio is used as a benchmark for evaluating the financial position of the firm. Ratio Analysis reflects the relative strengths and weakness of any organization and also indicates the operation and financial growth of the organization. "Ratio helps to summarize large quantities of financial data and to make quantitative judgment about the firm's financial performance. The relationship between two accounting figures expressed mathematically is known as financial ratio". Even though there are many ratios, only those ratios have been calculated which are related to the subject matter. Following ratios have been computed and analyzed in this study.

#### **Loans and Advances to Total Assets Ratio**

Total assets side of a bank is composition of different assets among them some generated income and some do not generate income. Among income generating assets loan and advances are the high income generating assets therefore management always tries to increase the portion of loan and advances in total assets and decrease non income generating portion of assets from total portfolio. The ratio of loans and advances to total assets measures the volume of loans and advances in the structure of total assets.

Loans and Advances of commercial banks represent the major portion in total assets. The high degree of ratio indicates the good performance of the banks mobilizing its fund by way of lending functions. However in its reverse side, the high degree indicates low liquidity with the bank. Loans and Advances always carry certain degree of risk. Thus this asset of banking business is regarded as risky assets. The low ratio indicates low

productivity and high degree of safety in liquidity and vice versa. This ratio is calculated as follows.

$$\text{Loan and Advances to Total Assets} = \frac{\text{Loan and Advances}}{\text{Total Assets}}$$

### **Credit Deposit Ratio (CD Ratio)**

CD Ratio is the most important tool to analysis the profitability of a bank. Since, all depositors has to pay interest and if any deposit is not utilized in profit earning way it will decrease net interest income of that bank. CD ratio is the parameters, which ascertain fund deployment efficiency of commercial bank. In other words, this ratio is calculated to find out how successfully the banks are utilizing their total deposits on credit or loans and advances for profit generation purpose as loans and advances yield high rate of return. Greater CD ratio implies the better utilization of total deposits and better earning, however, liquidity requirements also needs due consideration. Hence, management should always try to make better combination of risk and return. This ratio is calculated by dividing total credit by total deposit of the bank.

$$\text{Credit Deposit Ratio} = \frac{\text{Loan and Advances}}{\text{Total Deposit}}$$

### **Loan Loss Provision to Loan and Advances ratio**

Loan loss provision to Loan and Advances shows percentage of loan is covered against the possible future loss due to non-payment of loan. This ratio describes the quality of assets in the form of loan and advances that a bank is holding. Since, there is risk inherent in loan and advances, NRB has directed commercial banks to classify its loan and advances into different category and accordingly to make provision for possible loss. Loan Loss provision signifies the cushion against the future contingencies created by the default of the borrower in payment of loan and ensures the continuous solvency of the bank. Since high provision has to be made for non-performing loan, higher provision for loan loss reflects increasing non performing loan in volume of total loan.

The total ratio signifies the good quality of assets in the volume of total loan. It indicates how efficiently it manages loan and advances and make effort to cope with probable loan loss. Higher ratio implies higher portion of NPL in the total loan portfolio. The ratio is calculates as follows.

$$\text{Loan Loss Provision Ratio} = \frac{\text{Loan Loss Provision}}{\text{Total Loan Advances}}$$

### **Non-Performing Loans to Total Loan**

Total loan is divided into two category performing loan and non-performing loan. Non-performing loan to total loan ratio determines the proportion of non-performing loan in the total loan portfolio. Higher ratio implies the bad quality of assets of banks in the form of loan and advances. Hence, lower NPL to total credit ratio is preferred. The ratio is calculated as follows.

$$\text{NPL to Total Loan and Advances} = \frac{\text{Non - Performing Loan}}{\text{Total Loan and}}$$

### **Total Provision to Non Performing Loan**

NRB had directed all commercial bank to provide provision for all types of loan and advances. Even performing loan needs to provide loan loss provision at the rate of 1% and 12.5%. This ratio determines the proportion of provision held to non-performing loan. This ratio measures up to what extend of risk inherent in NPL is covered by the total loan loss provision. More than 100% ratio signifies that the bank is safeguard against the future contingencies that may create due to bad loans, where as lower than 100% may create huge provision in coming future due to requirement of high provision to substandard loan advancers

This ratio is calculated as follows.

$$\text{Loan Loss Provision to NPL} = \frac{\text{Loan Loss Provision}}{\text{Non Performing Loan}}$$

### **Return to Loan and Advances**

Net profit is the amount recovered after deducting all kinds of liabilities therefore various ratios are calculated in relation with the net profit. Return on loan and advances ratio indicates how efficiently the bank has employed its resources in the forms of loan and advances. Net profit of a bank largely depends upon interest earn from loan and advances and net profit. This ratio measures the bank's profitability with respect to loan and advances. Higher the ratios better the performance of the bank and vice versa. This ratio is calculated as follows.

$$\text{Return to Loan and Advances} = \frac{\text{Net Profit}}{\text{Loan and Advances}}$$

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.

### **3.5.2 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.

### 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.

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

Where,

N= no. of observation

Y=dependent variable

X=independent variable

## CHAPTER IV

### DATA PRESENTATION AND ANALYSIS

This chapter is devoted to the presentation, analysis, interpretation and scoring the empirical finding out of the study through definite course of research methodology. To achieve the stated of the study and also to make the reader easier to understand the findings qualitative data and information has been analyze. Different types of ratios have been calculated to reach in the conclusion of this study.

#### 4.1 Financial Analysis

##### 4.1.1 Loan and advances to Total Assets Ratio

Loan and advances is the major portion of the assets of any balance sheet of commercial banks. Loan and advances directly generates incomes to the bank therefore it is essential to analysis the ratio of the loan and advances to total assets. The more the portion of loan and advances in the assets the more the effective utilization of assets of the bank.

Granting loan is the risky decision because each loan carries certain level of risk therefore loan and advances are also known as risky assets. Therefore if loan and advances to total assets ratio is low it indicated low risk to management and low profitability and vice versa. Total Loan and Advances of listed commercial banks can be seen in the Table 4.1 below.

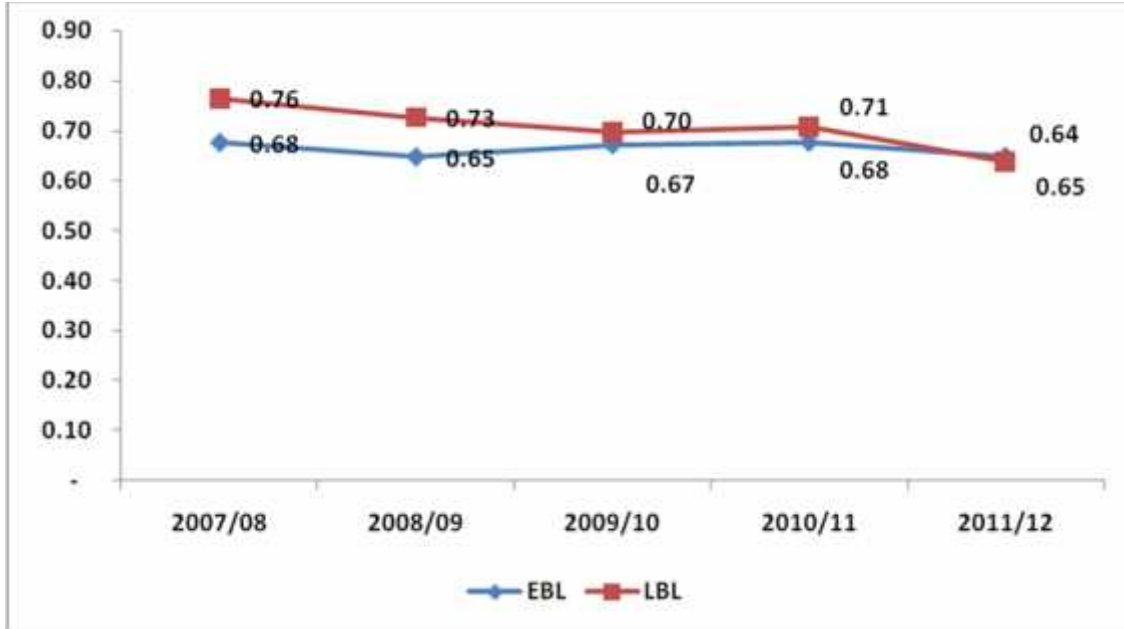
**Table 4.1**  
**Loan and Advances to Total Assets Ratio**

<b>Year</b>	<b>EBL</b>	<b>LBL</b>
<b>2007/08</b>	<b>0.68</b>	<b>0.76</b>
<b>2008/09</b>	<b>0.65</b>	<b>0.73</b>
<b>2009/10</b>	<b>0.67</b>	<b>0.70</b>
<b>2010/11</b>	<b>0.68</b>	<b>0.71</b>
<b>2011/12</b>	<b>0.65</b>	<b>0.64</b>

*Source: Annual Reports of the respective Banks and Annex-1*

**Figure 4.1**

**Loan and Advances to Total Assets Ratio**



(Source: Table 4.1)

Table 4.1 and figure shows the total loan and advances to total assets ratio. The ratio of both the sample banks under study was found to be in fluctuating trend. The ratio has been decreased substantially in the last FY of the study period than in the first FY of the study period. The ratio of both the bank is in the range of 64% to 76%. This clearly shows that both the banks are facing low risk towards managing the loan and advances.

**4.1.2 Loan and Advances to Total Deposit Ratio**

Loan and advances to total deposit ratio indicates the proportion of deposit utilized as lending. This ratio is also called CD ratio. CD ratio is the most important to analyze the banks utilization of their deposits and to know the liquidity position of the bank. The core banking function is to take deposit and channel the funds in the form of loan. For every deposits bank has to pay interest and failing to utilize the deposit may hamper the profitability of the bank. Therefore, Higher CD ratio implies higher utilization of the deposit and low fund available to service the depositors when they come for withdrawal and vice versa. 75 percentage of CD ratio is assumed to be optimal in banking sector but exception can be witnessed in case of some poorly operating banks.

**Table 4.2**

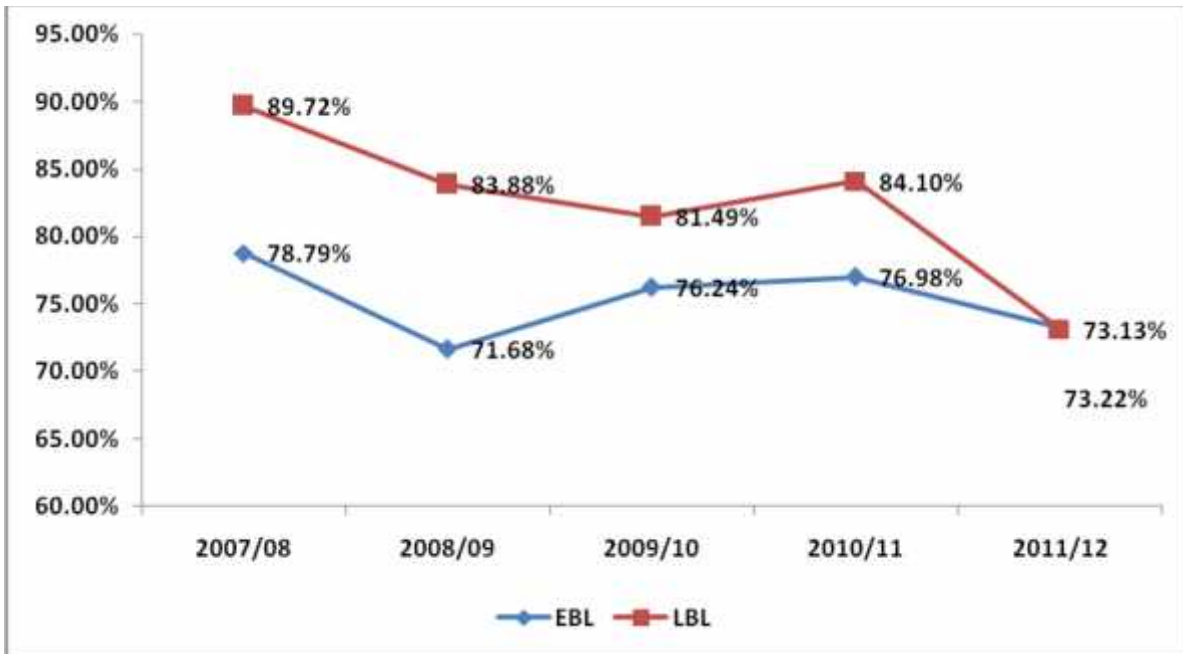
**Loan & Advances to Total Deposit Ratio**

Year	EBL	LBL
2007/08	78.79%	89.72%
2008/09	71.68%	83.88%
2009/10	76.24%	81.49%
2010/11	76.98%	84.10%
2011/12	73.22%	73.13%

*Source: Annual Reports of the respective Banks and Annex-1*

**Figure 4.2**

**Loan & Advances to Total Deposit Ratio**



*(Source: Table 4.2)*

Table 4.2 and figure shows the CD ratio of both the sample banks under study. The CD ratio of both the sample bank is found to be in fluctuating trend during the study period but at the last of the study period the ratio is in decreasing trend. NRB has prescribed all the Banks & FI's to maintain the CD ratio within 75%. Both EBL and LBL CD ratio was found higher in the first four FY but both of the banks have reduced the ratio within 75% in the FY 2011/12.

### 4.1.3 Loan Loss Provision to Total NPL

Loan loss provision to loan and advances shows percentage of loan is covered against the possible future loss due to non payment of loan. Since there is risk inherent in the loan and advances, NRB has directed commercial banks to classify its loan and advances into different category and accordingly to make provision for possible losses.

Loan loss provision signifies the cushion against the future contingencies crease by the default of borrower in the payment of loan and ensures the continuous solvency of the bank. Since high provision has to be made for non performing loan, higher provision for loan loss reflects increasing non performing loan in the volume of total loan.

The low ratio signifies the good quality of assets in the volume of total loan. It indicates how efficiently it manages loan and advances and makes efforts to cope with portable loan losses.

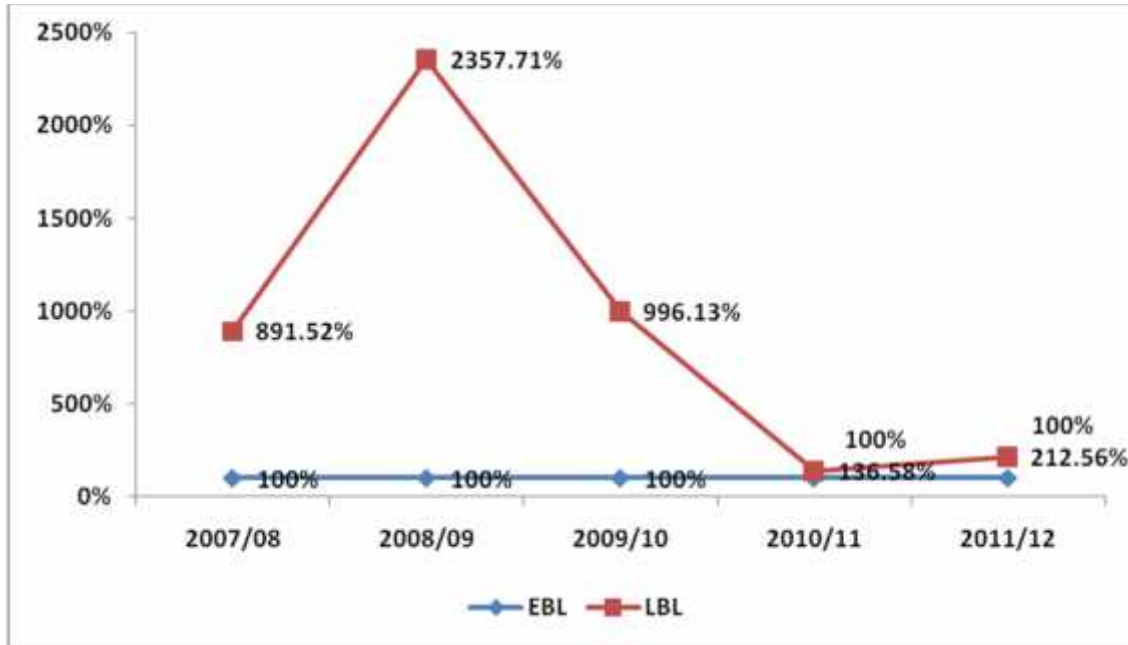
Higher ratio implies higher portion of NPL in the total loan Portfolio. The ratio is calculated as follows.

**Table 4.3**  
**Loan Loss Provision to Total NPL**

<b>Year</b>	<b>EBL</b>	<b>LBL</b>
<b>2007/08</b>	<b>100%</b>	<b>891.52%</b>
<b>2008/09</b>	<b>100%</b>	<b>2357.71%</b>
<b>2009/10</b>	<b>100%</b>	<b>996.13%</b>
<b>2010/11</b>	<b>100%</b>	<b>136.58%</b>
<b>2011/12</b>	<b>100%</b>	<b>212.56%</b>

*Source: Annual Reports of the respective Banks and Annex-1*

**Figure 4.3**  
**Loan Loss Provision to Total NPL**



(Source: Table 4.3)

Table 4.3 and figure shows the loan loss provision to total NPL of the sample banks under study throughout the study period. From the analysis it can be depicted that the ratio of LLP to NPL of EBL is constant throughout the study period i.e. 100% whereas the ratio of LBL is in fluctuating trend. The cushion to cover the NPL is extremely high in case of LBL in FY 2008/09 i.e. 2357.71%. LBL has maintained more than 100% of provision each year which shows that the loan and advances and NPL of LBL is more risk inherent than that of EBL.

#### **4.1.4 Non Performing Loan to Total Loan and Advances**

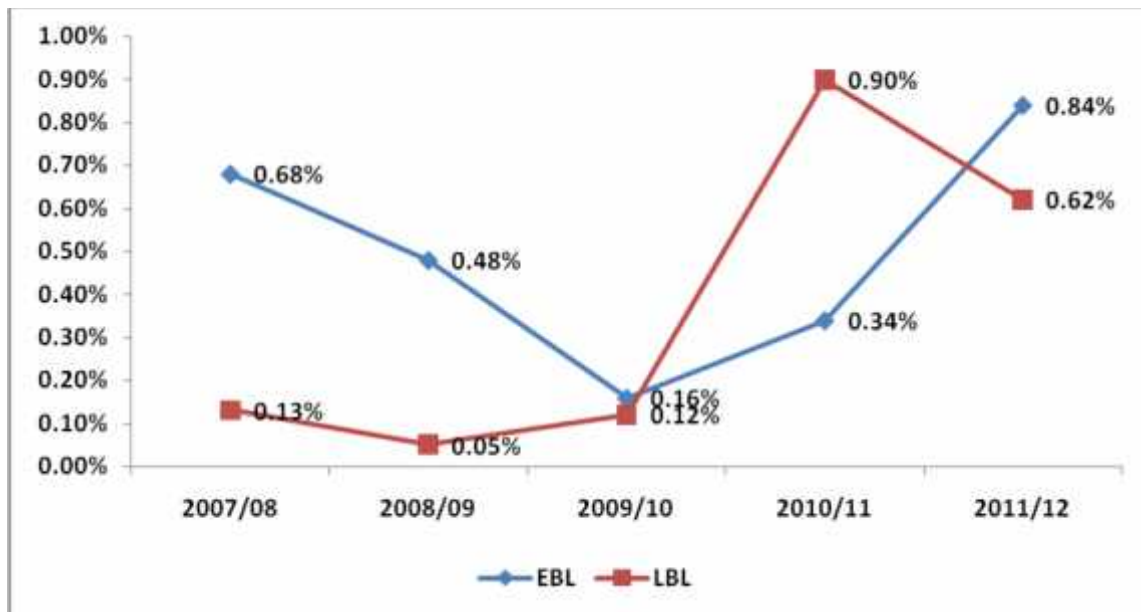
NRB has directed the commercial banks to classify their loan into two categories i.e. performing loan and non performing loan. Non performing loan to total loan and advances ratio determines the proportion of nonperforming loan in the total loan portfolio. Higher ratio implies the bad quality of the assets of the bank in the form of loan and lower return from the loan portfolio and lower ratio implies good quality of loan. Hence lower NPL to total credit ratio is preferred. The ratio is calculated as follows:

**Table 4.4**  
**NPL to Total Loan & Advances**

Year	EBL	LBL
2007/08	0.68%	0.13%
2008/09	0.48%	0.05%
2009/10	0.16%	0.12%
2010/11	0.34%	0.90%
2011/12	0.84%	0.62%

*Source: Annual Reports of the respective Banks and Annex-1*

**Figure 4.4**  
**NPL to Total Loan & Advances**



*(Source: Table 4.4)*

Table 4.4 exhibits the ratio of non-performing loan to total loan and advances of the selected commercial banks for the period of five year from 2008 to 2012. From the above table it is clear that NPL of the sample bank is found to be in fluctuating trend. The NPL percentage of EBL was found to be decreasing for the first three FY of the study period and then it started to increase. Similarly in case of LBL the portion of NPL decreased in the first FY then started to increase and finally decreased in the last FY of the study period. From the above calculation it can be depicted that Nepalese commercial banks are

not being able to maintain their NPL level in a uniform standard but the level of NPL of both the bank is found within 1% which is a very good sign and plus point for both the sample banks under study.

#### **4.1.5 Return on Loan and Advances**

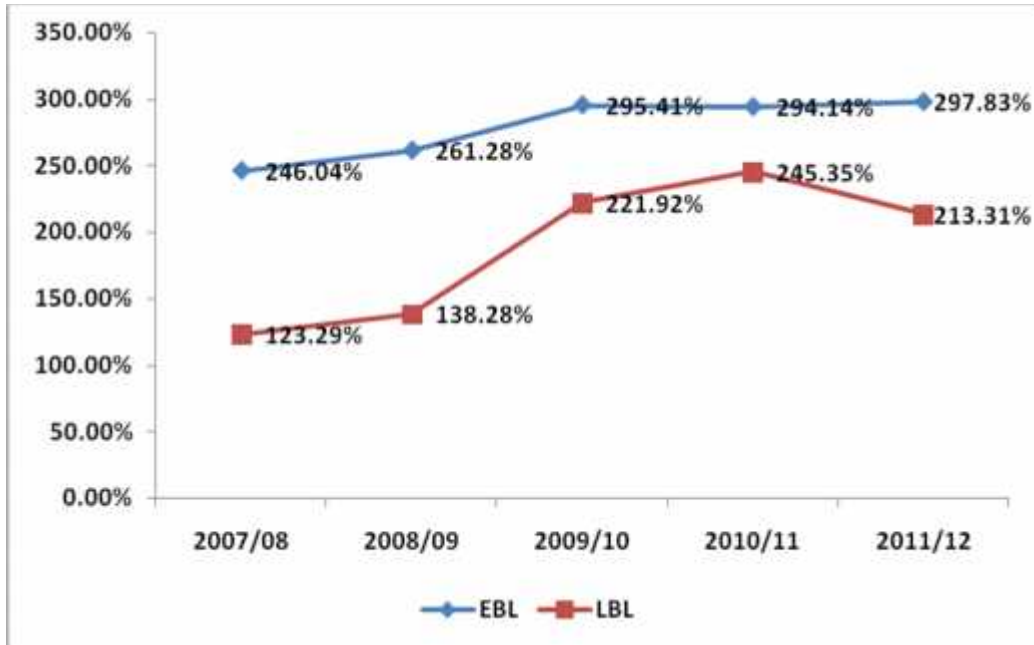
Return on loan and advances ratio indicates how efficiently the bank has employed its resources in the form of loan and advances. Net profit of a bank largely depends upon interest earned from loan and advances and there is positive correlation between effective utilization of loan and advances and net profit. This ratio measures the bank's profitability with respect to loan and advances. Higher the ratios better the performance of the bank.

**Table 4.5**  
**Return on Loan & Advances**

<b>Year</b>	<b>EBL</b>	<b>LBL</b>
<b>2007/08</b>	<b>246.04%</b>	<b>123.29%</b>
<b>2008/09</b>	<b>261.28%</b>	<b>138.28%</b>
<b>2009/10</b>	<b>295.41%</b>	<b>221.92%</b>
<b>2010/11</b>	<b>294.14%</b>	<b>245.35%</b>
<b>2011/12</b>	<b>297.83%</b>	<b>213.31%</b>

*Source: Annual Reports of the respective Banks and Annex-1*

**Figure 4.5**  
**Return on Loan & Advances**



(Source: Table 5)

Table 4.5 and figure shows the level of return on loan and advances of both the sample banks under study. The ratio of both the bank is found to be in an increasing trend. It shows that both the banks are effectively utilizing the loan and advances to generate a profit therefrom. It also shows that there is a positive correlation between the net profit and loan and advances of both the banks. The ratio is continuously increasing in case of EBL and is higher in FY 2011/12 i.e. 297.83% but whereas in case of LBL the ratio in FY 2011/12 i.e. 213.31 % has been decreased than the ratio of 2010/11 i.e. 245.35%.

#### **4.1.6 Total Loan & Advances**

Loan and advances is the major portion of the assets of any balance sheet of commercial banks. Loan and advances directly generates incomes to the bank therefore it is essential to analysis the ratio of the loan and advances to total assets. The more the portion of loan and advances in the assets the more the effective utilization of assets of the bank.

Granting loan is the risky decision because each loan carries certain level of risk therefore loan and advances are also known as risky assets. Total lending or gross loan and

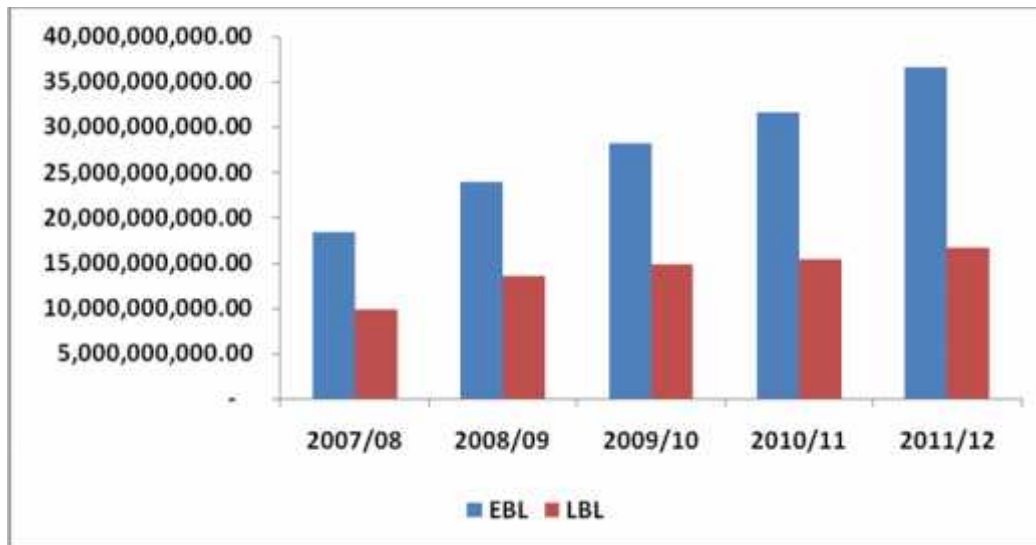
advances of a commercial bank is composed of different type of loan products as like personal loan, real estate loan, housing loan, margin lending, hire purchase loan, deprived sector loan etc. The total loan and advances of the sample banks under study is as follows:

**Table 4.6**  
**Total Loan & Advances (Amount in Rs.)**

Year	EBL	LBL
2007/08	18,339,085,562.00	9,794,438,000.00
2008/09	23,884,673,616.00	13,463,349,000.00
2009/10	28,156,400,000.00	14,736,405,000.00
2010/11	31,661,843,000.00	15,389,472,000.00
2011/12	36,616,832,000.00	16,697,063,000.00

*Source: Annual Reports of the respective Banks and Annex-1*

**Figure 4.6**  
**Total Loan & Advances**



*(Source: Table 4.6)*

Table 4.6 and figure it can be concluded that the total loan and advances of both the sample banks under study is increasing continuously throughout the study period. The total portfolio of EBL is higher than the total portfolio of LBL throughout the study period. Therefore it can be concluded that Nepalese commercial banks are being able to

increase their lending portfolio annually. The growth ratio of loan and advances of EBL is higher than that of LBL. The total loan and advance amount of both the sample banks under study are found to be higher in FY 2011/12 and lower in 2007/08. It also shows that there is a positive correlation between the total deposit and loan and advances.

#### **4.1.7 Provision for Possible Losses**

Provision for possible losses shows amount of loan is covered against the possible future loss due to non-payment of loan. This amount describes the quality of assets in the form of loan and advances that a bank is holding. Since, there is risk inherent in loan and advances, NRB has directed commercial banks to classify its loan and advances into different category and accordingly to make provision for possible loss. Loan Loss provision signifies the cushion against the future contingencies created by the default of the borrower in payment of loan and ensures the continuous solvency of the bank. Since high provision has to be made for non-performing loan, higher provision for loan loss reflects increasing non performing loan in volume of total loan.

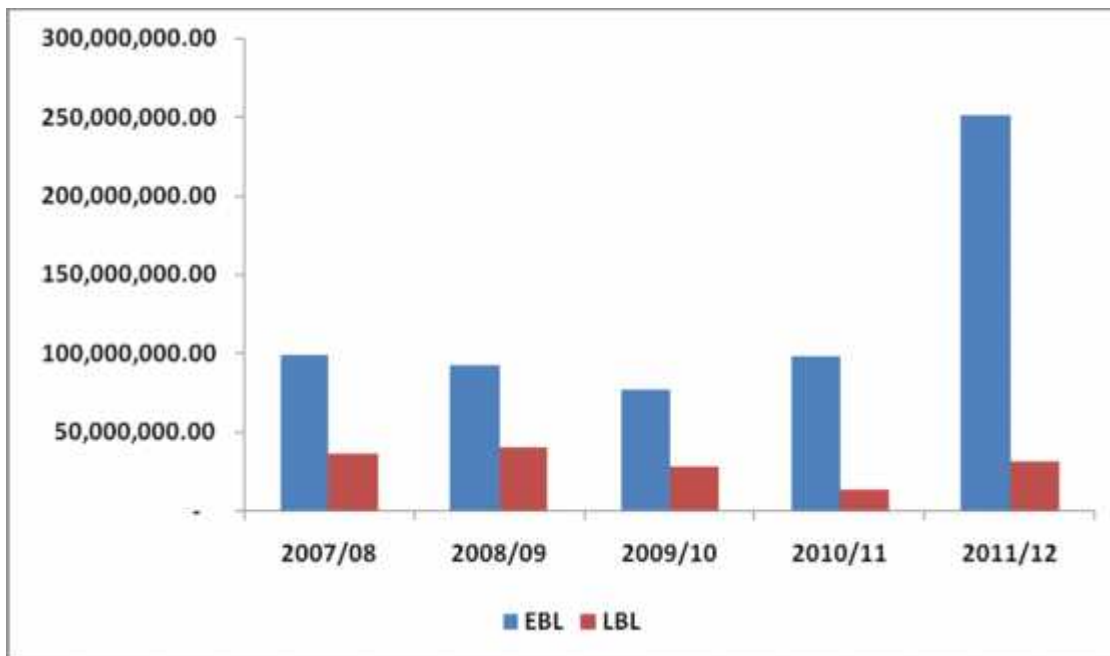
The total amount signifies the good quality of assets in the volume of total loan. It indicates how efficiently it manages loan and advances and make effort to cope with probable loan loss. Higher amount implies higher portion of NPL in the total loan portfolio.

**Table 4.7**  
**Provision for Possible Losses (Amount in Rs.)**

Year	EBL	LBL
2007/08	99,340,505.00	36,465,000.00
2008/09	93,084,080.00	40,437,000.00
2009/10	77,011,000.00	28,767,000.00
2010/11	98,299,000.00	13,622,000.00
2011/12	251,188,000.00	31,353,000.00

*Source: Annual Reports of the respective Banks and Annex-1*

**Figure 4.7**  
**Provision for Possible Losses**



(Source: Table 4.7)

Table 4.7 and figure shows the amount set by both the sample banks under study as a provision for possible losses which may occur in future. The amount is in fluctuating trend throughout the study period. The level of provision amount is higher in case of EBL than LBL comparatively. EBL has highest amount of provisioning in FY 2011/12 whereas LBL has highest amount of provisioning in FY 2008/09.

#### **4.1.8 Write back of Provision for Possible Losses**

Banks and FI's set aside certain amount of fund to cushion their bad and non performing loan which is known as provision for possible losses. At the end of the FY quarter some of the non performing loan which was thought to be converted into bad may recover and the amount of provision set up for that purpose (possible loss) is written back in the balance sheet of the bank.

**Table 4.8**

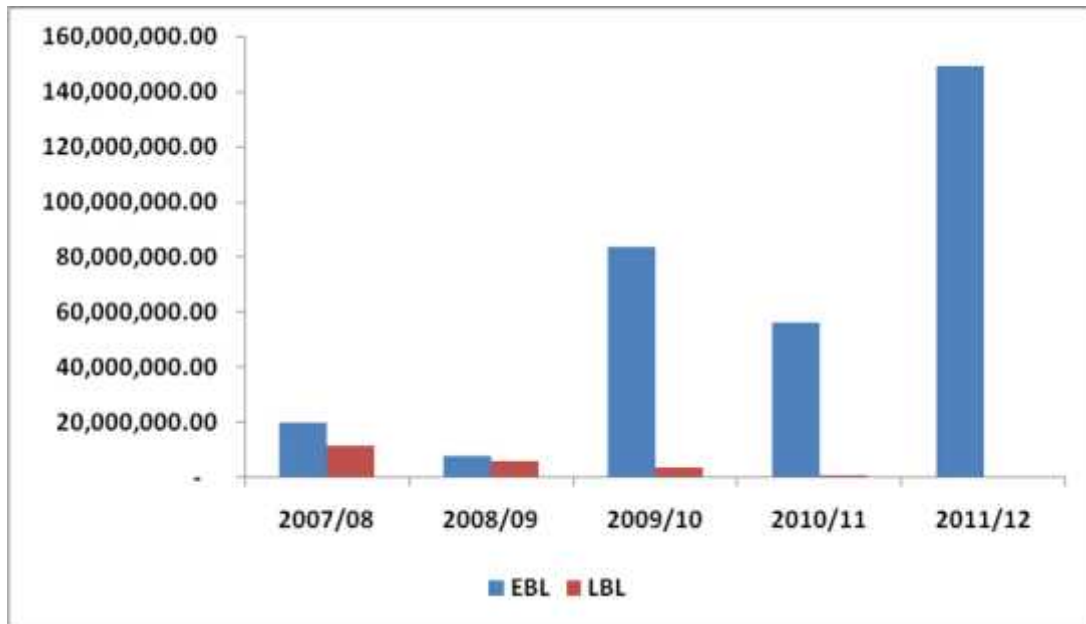
**Write back of Provision for Possible Losses (Amount in Rs.)**

Year	EBL	LBL
2007/08	20,201,067.00	11,438,000.00
2008/09	8,044,170.00	6,182,000.00
2009/10	83,553,000.00	3,645,000.00
2010/11	56,337,000.00	786,000.00
2011/12	149,482,000.00	544,000.00

*Source: Annual Reports of the respective Banks and Annex-1*

**Figure 4.8**

**Write back of Provision for Possible Losses**



*(Source: Table 4.8)*

Table 4.8 and figure depicts the amount set for provision for possible losses for the sample banks under study. The result shows that EBL has provisioned much fund for possible loss in future in comparison with EBL. The amount of provision set aside by LBL is in decreasing trend where the same is in increasing trend in case of EBL. The amount of provision for possible loss of LBL in the last two FY is negligible in comparison with EBL. The amount set for provision by EBL in FY 2011/12 is excessively high in comparison than the rest of the FY.

#### 4.1.9 Non Performing Loan Amount

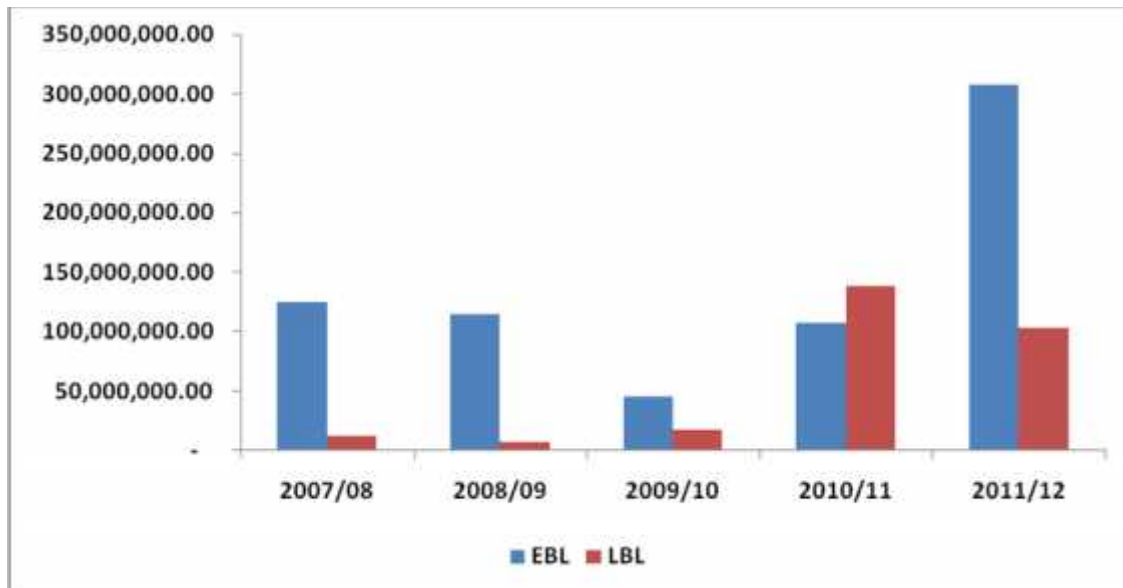
NRB has directed the commercial banks to classify their loan into two categories i.e. performing loan and non performing loan. Non performing loan to total loan and advances ratio determines the proportion of nonperforming loan in the total loan portfolio. Higher ratio Implies the bad quality of the assets of the bank in the form of loan and lower return from the loan portfolio and lower ratio implies good quality of loan. Hence lower NPL to total credit ratio is preferred. The ratio is calculated as follows:

**Table 4.9**  
**Non Performing Loan Amount (Amount in Rs.)**

Year	EBL	LBL
2007/08	124,705,781.82	12,732,769.40
2008/09	114,646,433.36	6,731,674.50
2009/10	45,050,240.00	17,683,686.00
2010/11	107,650,266.20	138,505,248.00
2011/12	307,581,388.80	103,521,790.60

Source: Annual Reports of the respective Banks and Annex-1

**Figure 4.9**  
**Non Performing Loan Amount**



(Source: Table 4.9)

Table 4.9 and figure shows the amount of NPL of the sample banks under study throughout the study period. The table shows that the amount of NPL of the sample banks is in fluctuating trend throughout the study period. Comparatively the amount of NPL of EBL is higher than that of LBL. LBL has very negligible amount of NPL in the first three FY of the study period. From the analysis its clear that EBL must maintain its NPL in comparison with LBL.

#### **4.1.10 NPA to Net Profit**

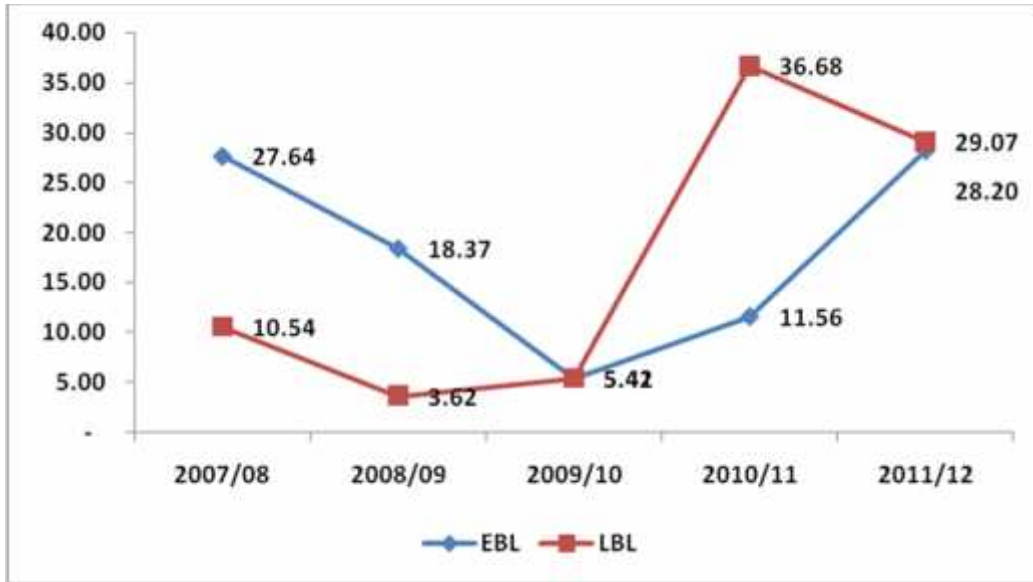
All loan and advances the principal of which are past due for a period of more than 3 months shall be included in this category. Non -performing loan is further categorizes into sub standard, doubtful and loss. Sub standard loan are those loan which are past due for period of more than 3 months or up to 6 months, doubtful are past due for a period of more than 6 months or up to 1 year and loss are past due for a period of more 1 year. Non- performing loans have negative impact in banks growth as well as in economic growth. NPA have direct impact in the net profit of a bank. Following table presents the ratio of NPA to net profit of the sample banks.

**Table 4.10**  
**NPA to Net Profit**

<b>Year</b>	<b>EBL</b>	<b>LBL</b>
<b>2007/08</b>	<b>27.64</b>	<b>10.54</b>
<b>2008/09</b>	<b>18.37</b>	<b>3.62</b>
<b>2009/10</b>	<b>5.42</b>	<b>5.41</b>
<b>2010/11</b>	<b>11.56</b>	<b>36.68</b>
<b>2011/12</b>	<b>28.20</b>	<b>29.07</b>

*Source: Annual Reports of the respective Banks and Annex-1*

**Figure 4.10**  
**NPA to Net Profit**



(Source: Table 4.10)

Table 4.10 and figure represents the level of NPA as compared to the net profit of the sample banks under study. Lower the ratio higher will be the efficiency of a bank and vice versa. In the above analysis the ratio is fluctuating in case of both the banks. In the beginning EBL has higher ratio and at the end of the study period LBL has the higher ratio comparatively.

## 4.2 Statistical Analysis

### 4.2.1 Correlation Analysis

Correlation is a statistical tool that can be used to describe the degree of linear relationship of one variable to other variables. Correlation analysis is another important tool of statistics. It describes the relationship between variables and degree of dependency of one variable with another variable. Two variables are said to be correlated when the change in one variable results the change in another variables. Different model for correlation analysis has been formulated and we have used Karl Pearson Coefficient of correlation to determine the relationship between variables studied. Karl Pearson coefficient of correlation is calculated as follows:

#### 4.2.2 Correlation between Loan and Advances to Deposit

Accepting deposit and granting loan are the major function of commercial banks. The relationship of deposit and loan and advances should always be perfect positive.

Following table exhibits the correlation between deposit and loan and advances.

**Table 4.11**

##### **Correlation coefficient between Loan & Advances to Deposits**

Bank	Correlation Coefficient (r )	P.E.	6*P.E.	Remarks
EBL	0.992422808	0.23	1.429	Significant
LBL	0.977150852	0.48	1.198	Significant

*Source: Appendix-1 & MS Excel*

Table 4.11 shows the relationship between Total Deposit and Loan and Advances for sample commercial banks. It is clear to see that all banks have perfect positive correlation between Deposit and Loan and Advances for review period.

Perfect positive correlation between Deposit and Loan indicates that loan and advances largely depends on deposit volume of these banks which means if one want to increase loan and advances, it has to accept the additional deposit. Likewise, correlations of these banks are higher than the six times of its P.E. which proves that the correlation calculated above are highly significant and reliable.

#### 4.2.3 Correlation between Non performing Loan & Total Loan

Accepting deposit and granting loan are the major function of commercial banks. The relationship of deposit and loan and advances should always be perfect positive.

Following table exhibits the correlation between deposit and loan and advances.

**Table 4.12**

##### **Correlation coefficient between Non performing Loan & Total Loan**

Bank	Correlation Coefficient (r )	P.E.	6*P.E.	Remarks
EBL	0.562776962	0.123	0.74	Significant
LBL	0.659683094	0.241	1.45	Significant

*Source: Appendix-1 & MS Excel*

Table 4.12 shows the relationship between Non performing loan to total loan for sample commercial banks. It is clear to see that all banks have perfect positive correlation between NPL and Loan and advances for review period.

Perfect positive correlation between NPL and Loan and advances indicates that NPL largely depends on loan and advances volume of these banks which means if one want to increase loan and advances, it has to accept the additional NPL. Likewise, correlations of these banks are higher than the six times of its P.E. which proves that the correlation calculated above are highly significant and reliable.

### 4.3 Primary Data Analysis

To assess the level of NPA and the reasons behind increasing NPL in Nepalese banking industry a survey is conducted. For this purpose a primary questionnaire with 10 questions has been developed and distributed to 40 respondents. The findings from the primary data analysis were compiled, calculated and is furnished as follows on the basis of each question.

#### 4.3.1 Amount of Loan

Respondents were asked about the amount of loan they are enjoying from the bank and FI's. The result is furnished as follows:

**Table 4.13**  
**Amount of Loan**

S.No.	Particulars	Respondents	Percentage
1	less than Rs.1,000,000.00	4	10
2	Rs.1,000,000.00 to Rs.5,000,000.00	27	67.5
3	Rs.5,000,000.00 to Rs.10,000,000.0	6	15
4	Above Rs. 10,000,000.00	3	7.5
	<b>Total</b>	<b>40</b>	<b>100</b>

*Source: Field Survey 2012*

**Figure 4.11**  
**Amount of Loan**

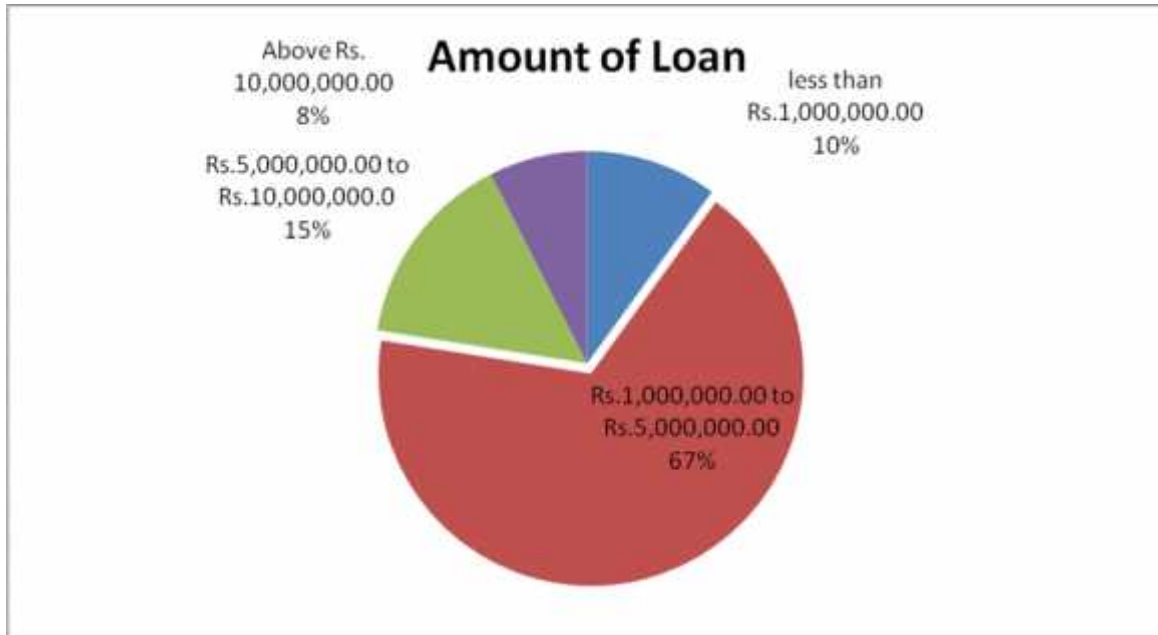


Table 4.12 and figure it can be concluded that majority of the respondents i.e. 67.5% are enjoying loan of NPR 1 million to 5 million. 15% of the respondents replied that they are enjoying loan of NPR 5 million to 10 million. 10% of the respondents replied that they are enjoying loan amount below 1 million and 7.5% of the respondents replied that they are enjoying loan amount of more than 10 million.

### **4.3.2 Sources of Lending**

Respondents were asked about the sources of lending to find out whether they are enjoying loan facility from organized sector or unorganized sector. The result is furnished as below.

**Table 4.14**  
**Sources of Lending**

S.No.	Particulars	Respondents	Percentage
1	Commercial Banks	12	30
2	Development Banks	10	25
3	Finance Companies	14	35
4	Cooperatives	3	7.5
5	Personal Lenders	1	2.5
	<b>Total</b>	<b>40</b>	<b>100</b>

*Source: Field Survey 2012*

**Figure 4.12**  
**Sources of Lending**

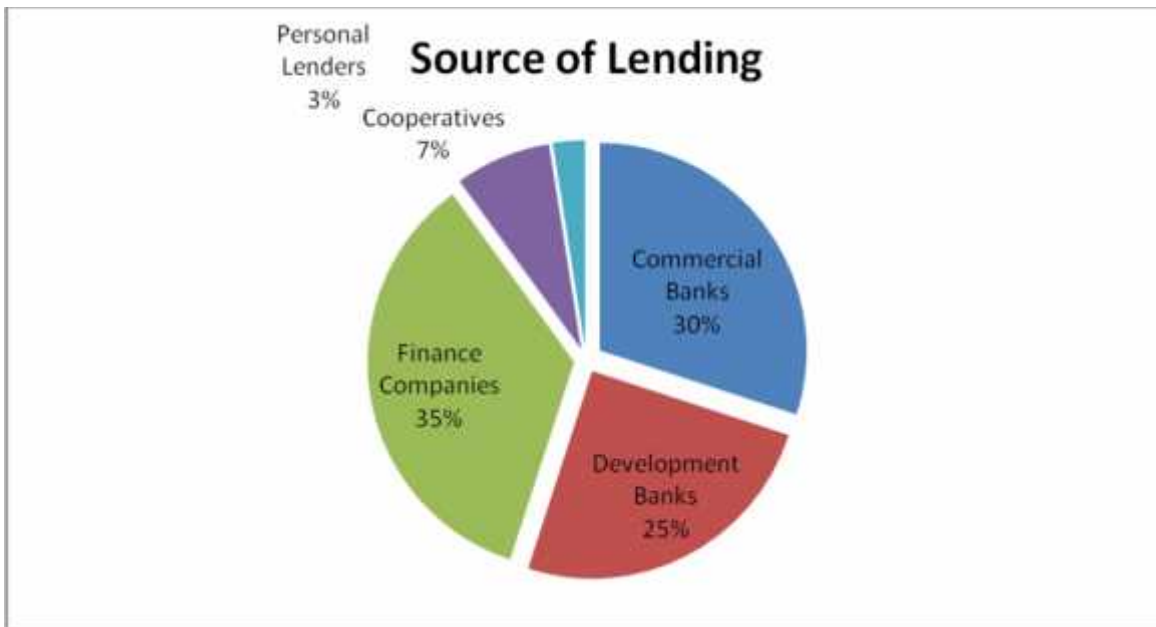


Table 4.13 and figure it can be concluded that majority of the respondents i.e. 35% are enjoying loan from finance companies. 30% of the respondents replied that they are enjoying loan from commercial banks. 25% of the respondents replied that they are enjoying loan from development banks and 7.5% of the respondents replied that they are enjoying loan amount from personal cooperatives and remaining from personal lenders.

### 4.3.3 Types of Loan

Respondents were asked about the types of loan they are enjoying from different banks.

The result is furnished as below.

**Table 4.15**  
**Types of Loan**

S. No.	Particulars	Respondents	Percentage
1	Housing Loan (purchase of land/house/apartment)	23	57.5
2	Housing Loan (commercial complex construction)	2	5
3	Housing Loan (construction of house)	5	12.5
4	Real Estate Loan (professional land housing development)	8	20
5	Others (Specify)	2	5
	<b>Total</b>	<b>40</b>	<b>100</b>

Source: Field Survey 2012

**Figure 4.13**  
**Types of Loan**

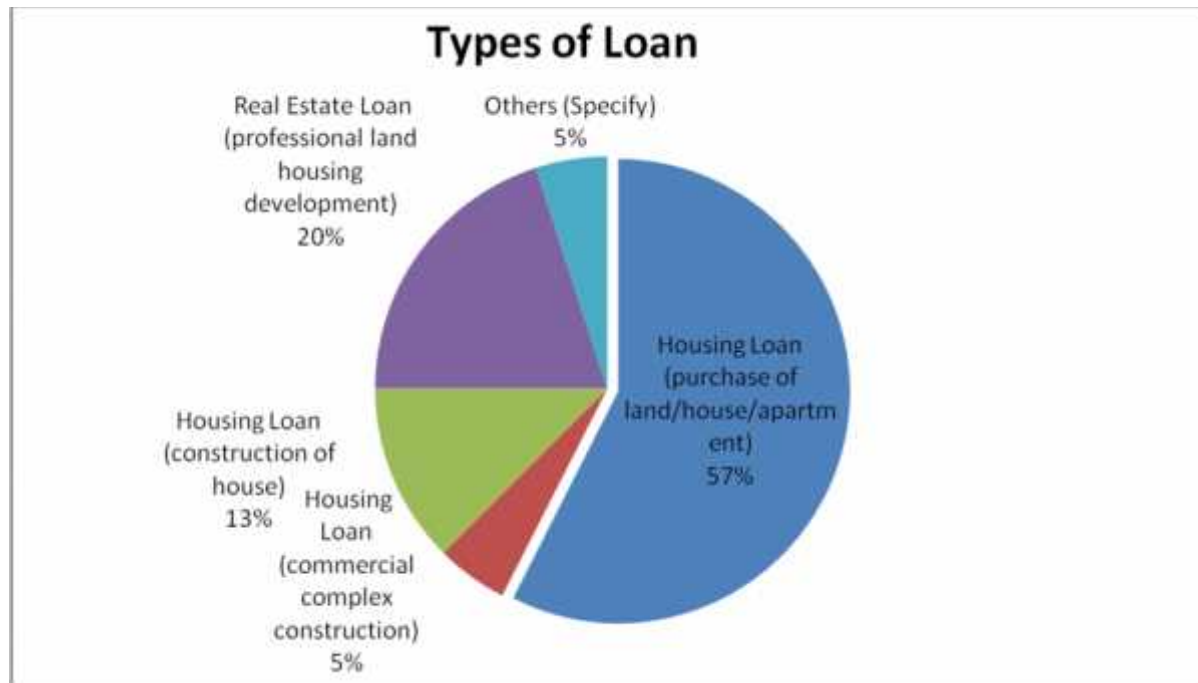


Table 4.14 and figure it can be concluded that majority of the respondents i.e. 57.5% are enjoying loan for purchase of land, house & apartments. 20% of the respondents replied

that they are enjoying loan for real estate purpose. 12.5% of the respondents replied that they are enjoying loan for construction of house and rest of the 5% of the respondents replied that they are enjoying loan for commercial complex construction and other purpose.

#### 4.3.4 Interest Rate

Respondents were asked about the rate of interest they are enjoying on different loan facility from banks. The result is furnished as below.

**Table 4.16**  
**Types of Loan**

S.No.	Particulars	Respondents	Percentage
1	below 13%	0	0
2	13% to 15%	2	5
3	15% to 17%	30	75
4	Above 17%	8	20
	<b>Total</b>	<b>40</b>	<b>100</b>

Source: Field Survey 2012

**Figure 4.14**  
**Types of Loan**

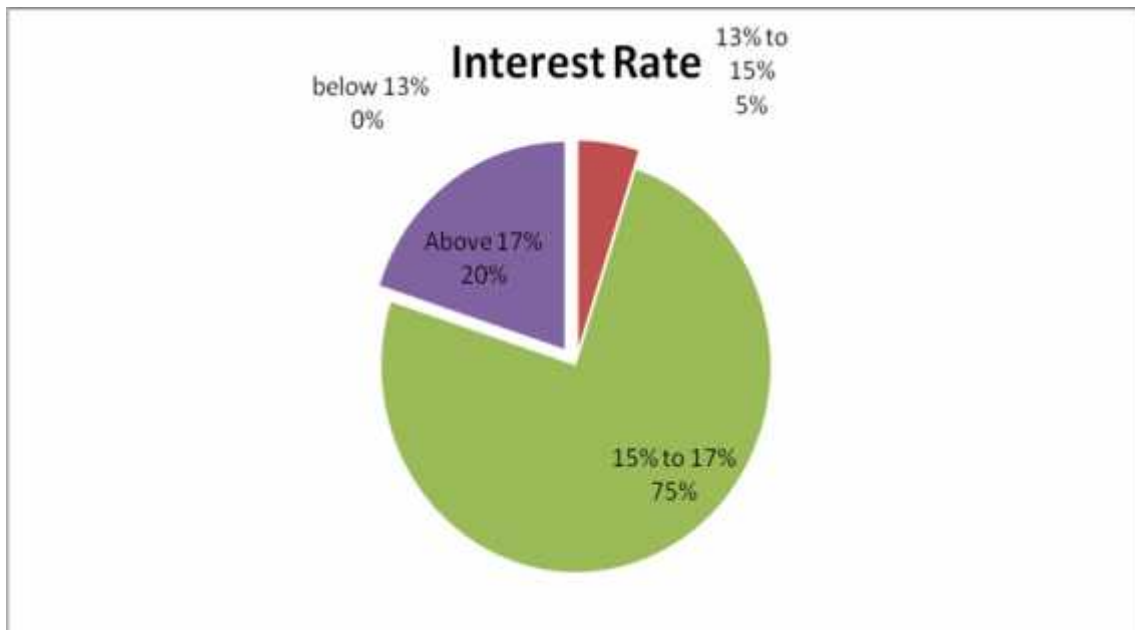


Table 4.15 and figure it can be concluded that majority of the respondents i.e. 75% are paying 15-17% of interest rate. 20% of the respondents replied that they are paying more than 17% of interest rate annually. Remaining 5% of the respondents replied that they are paying 13-15% of interest rate annually on the loan and advances they are enjoying.

### 4.3.5 Loan Processing Time

Respondents were asked about the loan processing time for the loan and advances they are enjoying from different banks. The result is furnished as below.

**Table 4.17**  
**Loan Processing Time**

S.No.	Particulars	Respondents	Percentage
1	less than 7 days	0	0
2	7-15 days	5	12.5
3	15-30 days	29	72.5
4	above 30 days	6	15
	<b>Total</b>	<b>40</b>	<b>100</b>

Source: Field Survey 2012

**Figure 4.15**  
**Loan Processing Time**



Table 4.16 and figure it can be concluded that majority of the respondents i.e. 72.5% replied that it took 15-30 days for the loan processing time. 12.5% of the respondents replied that it took 7-15 days for the loan processing time. 15% of the respondents replied that it took more than 30 days for their loan processing time.

#### 4.3.6 Awareness about NRB Directives

Respondents were asked about the awareness about NRB directives regarding the loan and advances they are enjoying from different banks. The result is furnished as below.

**Table 4.18**

**Awareness about NRB Directives**

S.No.	Particulars	Respondents	Percentage
1	well aware	1	2.5
2	little aware	13	32.5
3	heard about it	20	50
4	do not care	6	15
	<b>Total</b>	<b>40</b>	<b>100</b>

Source: Field Survey 2012

**Figure 4.16**

**Awareness about NRB Directives**

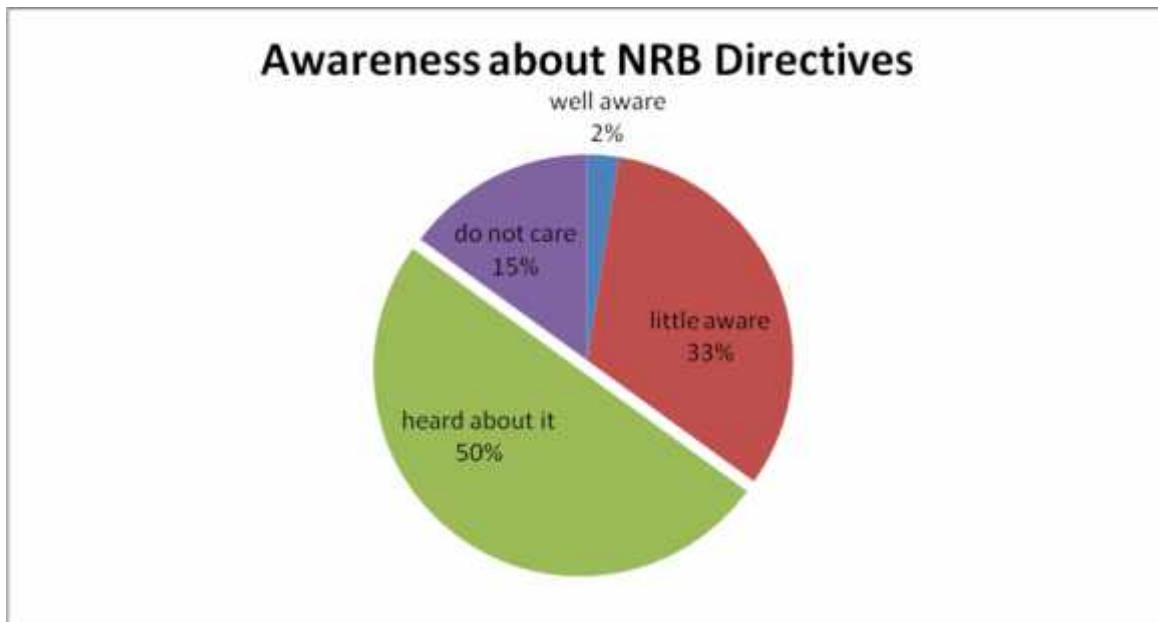


Table 4.17 and figure it can be concluded that majority of the respondents i.e. 50% said that they have heard about the NRB directives regarding the loan and advances made by banks. 33% of the respondents replied that they are little aware about the NRB directives and remaining 15% replied that they don't care about the NRB directives.

### 4.3.7 Differences between Real Estate & Housing Loan

As most of the NPL these days have been raised by real estate loan and the depression on this kind of loan. Respondents were asked about difference between real estate loan and housing loan. The result is furnished as below.

**Table 4.19**

**Differences between Real Estate & Housing Loan**

S.No.	Particulars	Respondents	Percentage
1	well aware	1	2.5
2	little aware	4	10
3	heard about it	7	17.5
4	do not care	28	70
	<b>Total</b>	<b>40</b>	<b>100</b>

Source: Field Survey 2012

**Figure 4.17**

**Differences between Real Estate & Housing Loan**

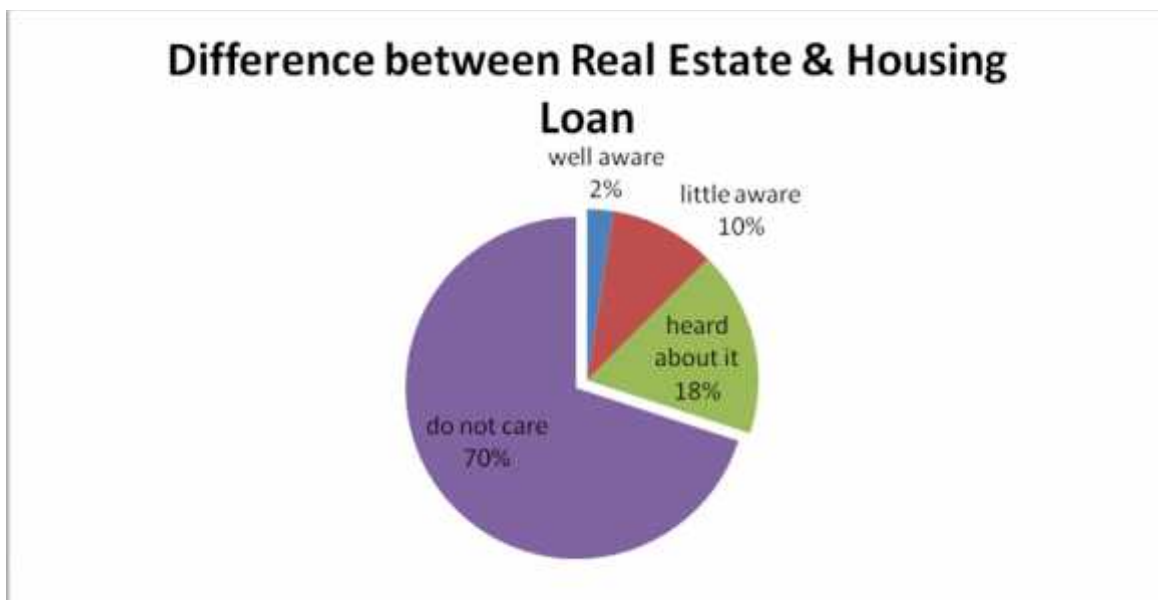


Table 4.18 and figure it can be concluded that majority of the respondents i.e. 70% don't care about the difference between real estate loan and housing loan. 18% of the respondents replied that they have heard about it. 10% of the respondents replied that they are little aware about the difference between real estate loan and housing loan and 2% of the respondents replied that they are well aware about it.

#### 4.3.8 Reasons of Increasing NPL

Respondents were asked about the reasons of increasing NPL these days in Nepalese commercial banks. The result is furnished as below.

**Table 4.20**  
**Reasons of Increasing NPL**

S.No.	Particulars	Respondents	Percentage
1	Liquidity Problem	9	22.5
2	Low turnover of real estate	20	50
3	Unwillingness	4	10
4	High Interest Rate	7	0
5	Others (specify)	0	0
	<b>Total</b>	<b>40</b>	<b>100</b>

Source: Field Survey 2012

**Figure 4.18**  
**Reasons of Increasing NPL**

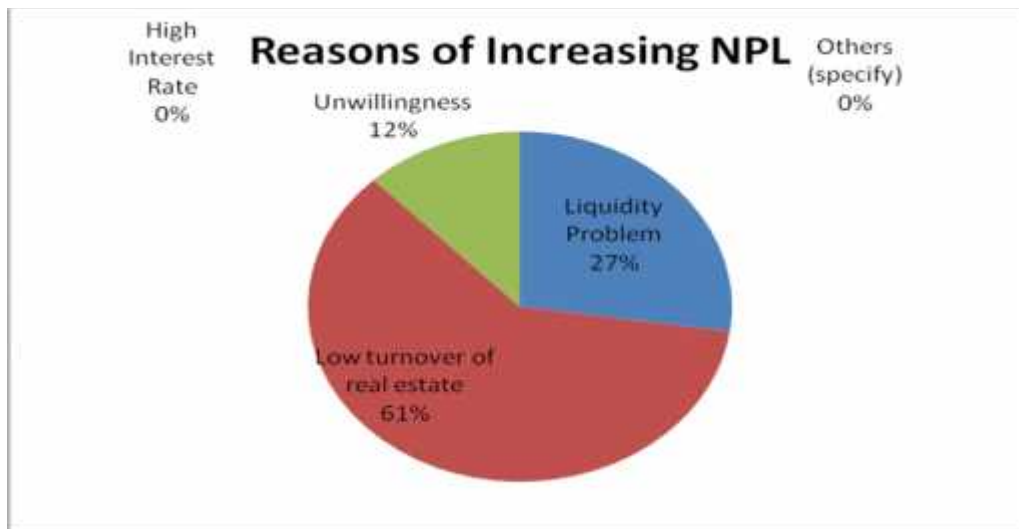


Table 4.19 and figure it can be concluded that majority of the respondents i.e. 61% are of the opinion that low turnover of real estate business is the main cause of increasing NPL. 27% of the respondents replied that liquidity problem is the main reason of the increasing NPL. Rest of the 12% of the respondents replied that unwillingness of the client to pay back the repayment on time is the main reason behind increasing level of NPL.

### 4.3.9 Opinion towards NRB Directives regarding NPL

Respondents were asked about their opinion toward tight NRB directives regarding the loan and advances of a commercial bank. The result is furnished as below.

**Table 4.21**  
**Opinion towards NRB Directives regarding NPL**

S. No.	Particulars	Respondents	Percentage
1	Unnecessarily tight	2	5
2	Reasonable	25	62.5
3	Further tight regulation is required	5	12.5
4	Gradual tightness is required	8	20
5	Others (specify)	0	0
	<b>Total</b>	<b>40</b>	<b>100</b>

Source: Field Survey 2012

**Figure 4.19**  
**Opinion towards NRB Directives regarding NPL**

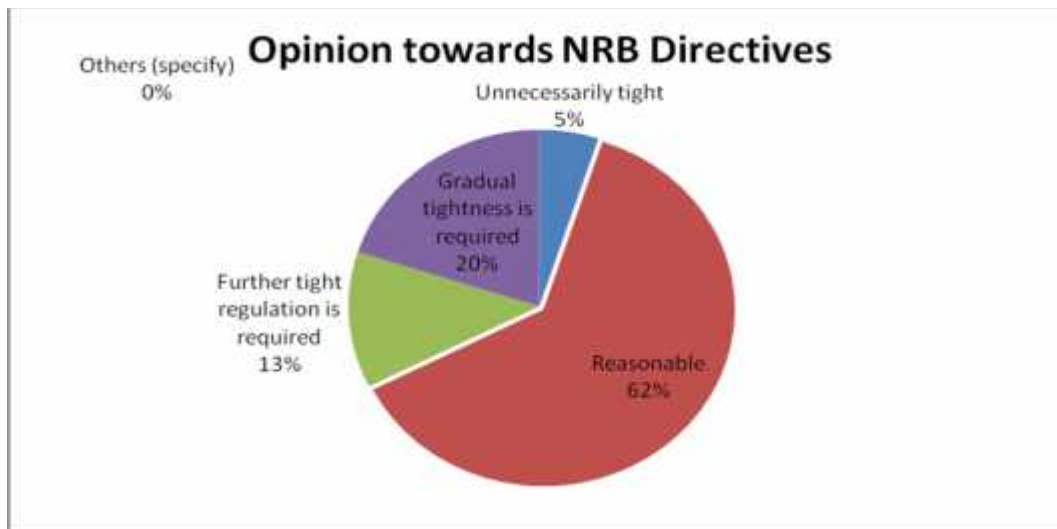


Table 4.20 and figure it can be concluded that majority of the respondents i.e. 62% are of the view that the NRB directives are reasonable. 20% of the respondents replied that they are of the view to gradually tightening the policy. 13% of the respondents replied that further tight regulation is required and 5% of the respondents replied that the NRB is unnecessarily tightening the bank FI's.

#### **4.4 Major Findings of the Study**

The major findings of the study are as follows:

##### **4.4.1 Findings from Secondary Data Analysis**

- ) The ratio of loan and advances to total assets of both the bank is in the range of 64% to 76%. This clearly shows that both the banks are facing low risk towards managing the loan and advances.
- ) The CD ratio of both the sample bank is found to be in fluctuating trend during the study period but at the last of the study period the ratio is in decreasing trend. NRB has prescribed all the Banks & FI's to maintain the CD ratio within 75%. Both EBL and LBL CD ratio was found higher in the first four FY but both of the banks have reduced the ratio within 75% in the FY 2011/12.
- ) The loan loss provision to total NPL of the sample banks under study throughout the study period. From the analysis it can be depicted that the ratio of LLP to NPL of EBL is constant throughout the study period i.e. 100% whereas the ratio of LBL is in fluctuating trend. The cushion to cover the NPL is extremely high in case of LBL in FY 2008/09 i.e. 2357.71%. LBL has maintained more than 100% of provision each year which shows that the loan and advances and NPL of LBL is more risk inherent than that of EBL.
- ) NPL of the sample bank is found to be in fluctuating trend. The NPL percentage of EBL was found to be decreasing for the first three FY of the study period and then it started to increase. Similarly in case of LBL the portion of NPL decreased in the first FY then started to increase and finally decreased in the last FY of the study period. From the above calculation it can be depicted that Nepalese commercial banks are not being able to maintain their NPL level in a uniform

standard but the level of NPL of both the bank is found within 1% which is a very good sign and plus point for both the sample banks under study.

- ) The ratio of return on loan and advances of both the bank is found to be in an increasing trend. It shows that both the banks are effectively utilizing the loan and advances to generate a profit there from. It also shows that there is a positive correlation between the net profit and loan and advances of both the banks. The ratio is continuously increasing in case of EBL.
- ) The total loan and advances of both the sample banks under study is increasing continuously throughout the study period. The total portfolio of EBL is higher than the total portfolio of LBL throughout the study period. Therefore it can be concluded that Nepalese commercial banks are being able to increase their lending portfolio annually. The growth ratio of loan and advances of EBL is higher than that of LBL.
- ) The amount of provision is in fluctuating trend throughout the study period. The level of provision amount is higher in case of EBL than LBL comparatively. EBL has highest amount of provisioning in FY 2011/12 whereas LBL has highest amount of provisioning in FY 2008/09.
- ) EBL has provisioned much fund for possible loss in future in comparison with LBL. The amount of provision set aside by LBL is in decreasing trend where the same is in increasing trend in case of EBL. The amount of provision for possible loss of LBL in the last two FY is negligible in comparison with EBL. The amount set for provision by EBL in FY 2011/12 is excessively high in comparison than the rest of the FY.
- ) NPL of the sample banks is in fluctuating trend throughout the study period. Comparatively the amount of NPL of EBL is higher than that of LBL. LBL has very negligible amount of NPL in the first three FY of the study period. From the analysis its clear that EBL must maintain its NPL in comparison with LBL.
- ) Both banks have perfect positive correlation between Deposit and Loan and Advances for review period.
- ) Both banks have perfect positive correlation between NPL and Loan and advances for review period.

#### **4.4.1 Findings from Primary Data Analysis**

- ) Majority of the respondents i.e. 67.5% are enjoying loan of NPR 1 million to 5 million.
- ) Majority of the respondents i.e. 35% are enjoying loan from finance companies.
- ) Majority of the respondents i.e. 57.5% are enjoying loan for purchase of land, house & apartments.
- ) Majority of the respondents i.e. 75% are paying 15-17% of interest rate.
- ) Majority of the respondents i.e. 72.5% replied that it took 15-30 days for the loan processing time.
- ) Majority of the respondents i.e. 50% said that they have heard about the NRB directives regarding the loan and advances made by banks.
- ) Majority of the respondents i.e. 70% don't care about the difference between real estate loan and housing loan.
- ) Majority of the respondents i.e. 61% are of the opinion that low turnover of real estate business is the main cause of increasing NPL.
- ) Majority of the respondents i.e. 62% are of the view that the NRB directives are reasonable.

## CHAPTER-V

### SUMMARY, CONCLUSION AND RECOMMENDATIONS

This segment includes the major findings and conclusion of the study. This chapter deals about the main themes of the study and gives recommendations for improvement non-performing loan.

#### 5.1 Summary

Development of a country always depends upon the economic development of that country. Financial institutions play vital role for economic development. Basically it works as financial intermediary by taking deposit and lending that money to deficit group of society. Loan and advances reflected in assets side of balance sheet of commercial banks. Loan and advances is direct contributor to banks income. Loan can be divided into two categories namely performing loan and non-performing loan.

Performing loan are those loan and advances, which service the banks on time. Which means the loan, which pays its installment and interest within the time, is known as performing loan. Performing loan is the contributor of bank's growth and prosperity. Non-performing loan is such loan, which fails to pay its interest to bank within stipulated time. Non-performing loan is the major concern of management because non-performing loan needs to make provision and it hampers the profitability of bank.

This study mainly focuses on analyzing the non-performing loan issue of Nepalese commercial banks. Among total banks, two banks have been selected as sample. Required data have been collected either from the annual report of the bank or from the website of Nepal Rastra Bank. Summary of the study are as follows:

- ) The ratio of loan and advances to total assets of both the bank is in the range of 64% to 76%. This clearly shows that both the banks are facing low risk towards managing the loan and advances.

- J The CD ratio of both the sample bank is found to be in fluctuating trend during the study period but at the last of the study period the ratio is in decreasing trend. NRB has prescribed all the Banks & FI's to maintain the CD ratio within 75%. Both EBL and LBL CD ratio was found higher in the first four FY but both of the banks have reduced the ratio within 75% in the FY 2011/12.
- J The loan loss provision to total NPL of the sample banks under study throughout the study period. From the analysis it can be depicted that the ratio of LLP to NPL of EBL is constant throughout the study period i.e. 100% whereas the ratio of LBL is in fluctuating trend. The cushion to cover the NPL is extremely high in case of LBL in FY 2008/09 i.e. 2357.71%. LBL has maintained more than 100% of provision each year which shows that the loan and advances and NPL of LBL is more risk inherent than that of EBL.
- J NPL of the sample bank is found to be in fluctuating trend. The NPL percentage of EBL was found to be decreasing for the first three FY of the study period and then it started to increase. Similarly in case of LBL the portion of NPL decreased in the first FY then started to increase and finally decreased in the last FY of the study period. From the above calculation it can be depicted that Nepalese commercial banks are not being able to maintain their NPL level in a uniform standard but the level of NPL of both the bank is found within 1% which is a very good sign and plus point for both the sample banks under study.
- J The ratio of return on loan and advances of both the bank is found to be in an increasing trend. It shows that both the banks are effectively utilizing the loan and advances to generate a profit there from. It also shows that there is a positive correlation between the net profit and loan and advances of both the banks. The ratio is continuously increasing in case of EBL.
- J The total loan and advances of both the sample banks under study is increasing continuously throughout the study period. The total portfolio of EBL is higher than the total portfolio of LBL throughout the study period. Therefore it can be concluded that Nepalese commercial banks are being able to increase their lending portfolio annually. The growth ratio of loan and advances of EBL is higher than that of LBL.

- ) The amount of provision is in fluctuating trend throughout the study period. The level of provision amount is higher in case of EBL than LBL comparatively. EBL has highest amount of provisioning in FY 2011/12 whereas LBL has highest amount of provisioning in FY 2008/09.
- ) EBL has provisioned much fund for possible loss in future in comparison with LBL. The amount of provision set aside by LBL is in decreasing trend where the same is in increasing trend in case of EBL. The amount of provision for possible loss of LBL in the last two FY is negligible in comparison with EBL. The amount set for provision by EBL in FY 2011/12 is excessively high in comparison than the rest of the FY.
- ) NPL of the sample banks is in fluctuating trend throughout the study period. Comparatively the amount of NPL of EBL is higher than that of LBL. LBL has very negligible amount of NPL in the first three FY of the study period. From the analysis its clear that EBL must maintain its NPL in comparison with LBL.
- ) Both banks have perfect positive correlation between Deposit and Loan and Advances for review period.
- ) Both banks have perfect positive correlation between NPL and Loan and advances for review period.
- ) Majority of the respondents i.e. 67.5% are enjoying loan of NPR 1 million to 5 million.
- ) Majority of the respondents i.e. 35% are enjoying loan from finance companies.
- ) Majority of the respondents i.e. 57.5% are enjoying loan for purchase of land, house & apartments.
- ) Majority of the respondents i.e. 75% are paying 15-17% of interest rate.
- ) Majority of the respondents i.e. 72.5% replied that it took 15-30 days for the loan processing time.
- ) Majority of the respondents i.e. 50% said that they have heard about the NRB directives regarding the loan and advances made by banks.
- ) Majority of the respondents i.e. 70% don't care about the difference between real estate loan and housing loan.

- ) Majority of the respondents i.e. 61% are of the opinion that low turnover of real estate business is the main cause of increasing NPL.
- ) Majority of the respondents i.e. 62% are of the view that the NRB directives are reasonable.

## **5.2 Conclusion**

From the study following conclusion has been drawn.

- ) Loan and advances are the major determinant of earning of commercial banks and major portion of their earning assets. The study of loan and advances to total assets has sighted that most of the banks have maintained sixty per cent of their total assets in the form of loan and advances which obviously indicate high attention of management towards of loan and advances.
- ) Loan and advances largely depends upon the level of deposit. The banks having more deposit have higher portion of loan and advances and vice versa. The study has revealed that most of the banks has maintained CD ratio around 80 per cent.
- ) Loan loss provision is a safeguard against future contingencies, which NRB has made mandatory to all type of loan and advances. Higher portion of LLP indicates high portion of NPL in total loan Portfolio and bad conditions of banks too. Our analysis of loan loss provision in total loan and advances has cleared that LBL is the bank who have high loan loss provision of around per cent in respect of total loan but they are in decreasing trend.
- ) NRB has directed to divide the total loan onto two parts- performing loans and non-performing loan. Non-performing loan are those loans which fails to service in time and it is bad for financial health of any bank therefore, we have analyzed the portion of non performing loan in total loan and advances which reveals that non performing loan of commercial banks have been decreasing. Due to strict NRB regulations regarding loan loss provision, all banks have been focusing on quality loan, which has resultant lower non-performing loan ratio. which indicates that these banks have been making continuous effort to maintain their NPL level low.
- ) Provision to non performing loan of bank shows that the level of provision of all banks are increasing and almost all commercial banks have created provision greater

than the amount of non performing loan which shows that all banks are safe against the future contingencies that may be created due to non payment of loan.

- ) Correlation between LLP and NPL of almost all banks are perfect positive which shows that increment in loan increases the non-performing loan due to poor loan disbursement decision of commercial banks. The perfect positive correlation shows that there is still lack of experts in analyzing loan in commercial banks of Nepal.
- ) Correlation between total deposit and total loan and advances indicates perfect positive correlation between deposit and loan and advance for review period. Perfect positive correlation between deposit and loan indicates that loan and advance largely depends on deposit volume of these banks.

### **5.3 Recommendations**

Based on the findings of the study and taking into consideration, the relevant issues, the appropriate recommendations are made as far as possible to make the study useful.

- ) Commercial banks should follow a policy regarding loan disbursement. Loan and advances are risky assets. In the one hand, it generates high return to banks. On the other hand, it may become the cause of bank collapse. Therefore a tread off between risk and return should be maintained and the portion of loan in total assets should be monitored closely.
- ) The major job of bank is to collect deposit and invest that money in profit making projects. For every rupee, banks have to pay interest. Therefore banks should be conscious to utilize the depositor's money. Banks should be ready to pay depositor's money on demand. This increases the creditability of banks. Therefore banks should not invest its all money in loan and advances. Banks should maintain certain level of CD ratio. Some banks have been found to have very high CD ratio and some have very low. High CD ratio generated more earning and less liquidity available with bank and vice versa. Therefore, banks have to utilize the depositor's money optimally.
- ) Non-performing loan of all banks have been found to have decreased. It is good symptom. Banks should focus on quality loan in coming days and maintain their loan portfolio more productive.

) Most of the banks have been maintaining the level of loan loss provision above the level of non-performing. Still some banks are not maintaining loan loss provision for their entire non-performing loan. Uncovered non-performing loan may create future loss to banks and certainly hampers the profitability of banks. Therefore banks having uncovered non-performing loan should make adequate provision. In other word the ratio of provision to non-performing loan should be higher than 100 per cent.

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### **Unpublished Dissertations:**

Amatya S. (2011). "*Non Performing Assets and its Impact on Profitability of  
Commercial Banks*". Kathmandu, An unpublished Master's degree thesis; Faculty  
of Management, Tribhuvan University.

Ghimire R. (2009). *NPA: Efficiency Indicators of Commercial Banks: A Comparative  
Analysis*. Kathmandu, An unpublished Master's degree thesis; Faculty of  
Management, Tribhuvan University.

Giri R. (2011). *“Non Performing Assets; A Major Obstacle on Profitability of Commercial Banks”*. Kathmandu, An unpublished Master’s degree thesis; Faculty of Management, Tribhuvan University.

Khadka D. (2007). *Non Performing Assets of Nepalese Commercial Banks*. Kathmandu, An unpublished Master’s degree thesis; Faculty of Management, Tribhuvan University.

Koirala S. (2010). *Non Performing Assets and Profitability of Commercial Banks*. Kathmandu, An unpublished Master’s degree thesis; Faculty of Management, Tribhuvan University.

Rimal (2011). *“Interrelationship between Real Estate Lending & NPL of Nepalese Banks”*. Kathmandu, An unpublished Master’s degree thesis; Faculty of Management, Tribhuvan University.

Shrestha Narayan (2008). *Non Performing Loans and loan loss provisioning of Commercial Banks*. Kathmandu, An unpublished Master’s degree thesis; Faculty of Management, Tribhuvan University.

**Websites:**

<http://www.google.com>  
<http://www.nrb.org.np>  
<http://www.laxmibank.com.np>  
[www.investopedia.com](http://www.investopedia.com)  
[www.everstbankltd.com](http://www.everstbankltd.com)

## RESEARCH QUESTIONNAIRE

I hereby request you to fill up the questionnaire designed for proposed survey of the surveyor. The precious views and opinions from your side will be helpful for facilitating the research entitled “**A STUDY ON NPA LEVEL OF NEPALESE COMMERCIAL BANKS**”. The views expressed by you here in the questionnaire will be used for the research purpose only and kept confidential.

Name (Optional) :

Address :

Qualification :

Occupation :

**1. What is the amount of the loan you are enjoying from a Bank FI's?**

- a. less than Rs.1,000,000.00
- b. Rs.1,000,000.00 to Rs.5,000,000.00
- c. Rs.5,000,000.00 to Rs.10,000,000.0
- d. Above Rs. 10,000,000.00

**2. What kind of institution you are using to take loan?**

- a. Commercial Banks
- b. Development Banks
- c. Finance Companies
- d. Cooperatives
- e. Personal Lenders

**3. What kind of loan you are enjoying?**

- a. Housing Loan (purchase of land/house/apartment)
- b. Housing Loan (commercial complex construction)
- c. Housing Loan (construction of house)
- d. Real Estate Loan (professional land housing development)
- e. Others (Specify)

4. **How much interest rate are you being charged for the loan?**
  - a. below 13%
  - b. 13% to 15%
  - c. 15% to 17%
  - d. Above 17%
  
5. **How much time did the Bank/FI's took to grant you the loan?**
  - a. less than 7 days
  - b. 7-15 days
  - c. 15-30 days
  - d. above 30 days
  
6. **How much are you aware about the tight rules imposed by NRB regarding real estate loans?**
  - a. well aware
  - b. little aware
  - c. heard about it
  - d. do not care
  
7. **How much aware are you regarding the differences between real estate loan and residential housing loans?**
  - a. well aware
  - b. little aware
  - c. heard about it
  - d. do not care
  
8. **What are the main reasons for increasing NPL in commercial banks?**
  - a. Liquidity Problem
  - b. Low turnover of real estate
  - c. Unwillingness
  - d. High Interest Rate
  - e. Others (specify)
  
9. **How is the current price movement of land/house/plot rate in Kathmandu Valley?**
  - a. Increasing
  - b. Constant
  - c. Decreasing

**10. What is your opinion regarding changes in NRB Directives to the Bank FI's for real estate lending?**

- a. Unnecessarily tight
- b. Reasonable
- c. Further tight regulation is required
- d. Gradual tightness is required
- e. Others (specify)

**Thank You!**

## Appendix II

### 1) Calculation of NPL to Total Loan Ratio

**For EBL,**       $\frac{\text{NPL}}{\text{Total Loan}}$   
=  $\frac{124,705,781.82}{18,339,085,562}$   
= 0.68%

**For LBL,**       $\frac{\text{NPL}}{\text{Total Loan}}$   
=  $\frac{12,732,769.40}{9,794,438,000}$   
= 0.13%

### 2) Calculation of Loan and Advances to Total Assets Ratio

**For EBL,**       $\frac{\text{Loan \& Advances}}{\text{Total Assets}}$   
=  $\frac{18,339,085,562}{27,149,342,884}$   
= 0.68%

**For LBL,**       $\frac{\text{Loan \& Advances}}{\text{Total Assets}}$   
=  $\frac{9,794,438,000}{12,809,273,000}$   
= 0.76%

### Amount of Loan

S.No.	Particulars	Respondents
1	less than Rs.1,000,000.00	4
2	Rs.1,000,000.00 to Rs.5,000,000.00	27
3	Rs.5,000,000.00 to Rs.10,000,000.0	6
4	Above Rs. 10,000,000.00	3
	<b>Total</b>	<b>40</b>

### Source of Loan

S.No.	Particulars	Respondents
1	Commercial Banks	12
2	Development Banks	10
3	Finance Companies	14
4	Cooperatives	3
5	Personal Lenders	1
	<b>Total</b>	<b>40</b>

### Type of Loan

S.No.	Particulars	Respondents
1	Housing Loan (purchase of land/house/apartment)	23
2	Housing Loan (commercial complex construction)	2
3	Housing Loan (construction of house)	5
4	Real Estate Loan (professional land housing development)	8
5	Others (Specify)	2
	<b>Total</b>	<b>40</b>

### Interest Rate

S.No.	Particulars	Respondents
1	below 13%	0
2	13% to 15%	2
3	15% to 17%	30
4	Above 17%	8
	<b>Total</b>	<b>40</b>

### Processing Time

S.No.	Particulars	Respondents
1	less than 7 days	0
2	7-15 days	5
3	15-30 days	29
4	above 30 days	6
	<b>Total</b>	<b>40</b>

### Awareness about NRB Directives

S.No.	Particulars	Respondents
1	well aware	1
2	little aware	13
3	heard about it	20
4	do not care	6
	<b>Total</b>	<b>40</b>

### **Difference between Real Estate & Housing Loan**

<b>S.No.</b>	<b>Particulars</b>	<b>Respondents</b>
1	well aware	1
2	little aware	4
3	heard about it	7
4	do not care	28
	<b>Total</b>	<b>40</b>

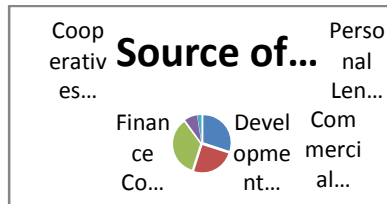
### **Reasons of Increasing NPL**

<b>S.No.</b>	<b>Particulars</b>	<b>Respondents</b>
1	Liquidity Problem	9
2	Low turnover of real estate	20
3	Unwillingness	4
4	High Interest Rate	7
5	Others (specify)	0
	<b>Total</b>	<b>40</b>

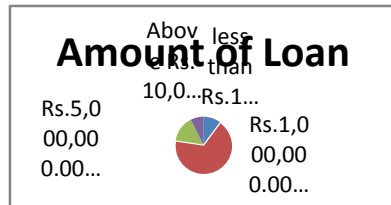
### **Opinion towards NRB Directives**

<b>S.No.</b>	<b>Particulars</b>	<b>Respondents</b>
1	Unnecessarily tight	2
2	Reasonable	25
3	Further tight regulation is required	5
4	Gradual tightness is required	8
5	Others (specify)	0
	<b>Total</b>	<b>40</b>

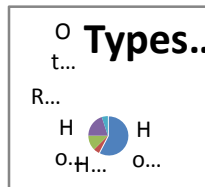
<b>Percentage</b>
10
67.5
15
7.5
<b>100</b>



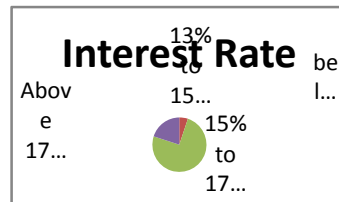
<b>Percentage</b>
30
25
35
7.5
2.5
<b>100</b>



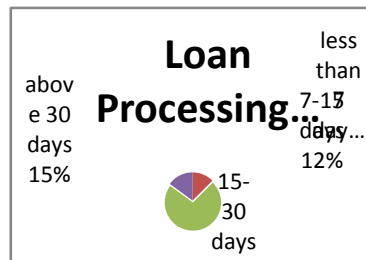
<b>Percentage</b>
57.5
5
12.5
20
5
<b>100</b>



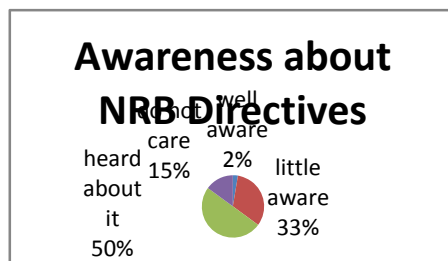
<b>Percentage</b>
0
5
75
20
<b>100</b>



<b>Percentage</b>
0
12.5
72.5
15
<b>100</b>



<b>Percentage</b>
2.5
32.5
50
15
<b>100</b>



Percentage
2.5
10
17.5
70
<b>100</b>

Percentage
22.5
50
10
0
0
<b>100</b>

Percentage
5
62.5
12.5
20
0
<b>100</b>

