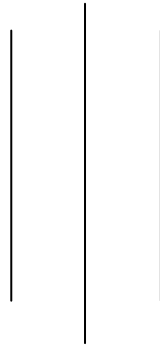


Implementation of Nepal Rastra Bank's Directives on Commercial Banks of Nepal

(A case study on Bank of Kathmandu Ltd, Himalayan Bank Ltd,
Everest Bank Ltd and Nepal Investment Bank Ltd)



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I hereby declare that the outcome of this thesis entitled “Implementation of Nepal Rastra Bank’s Directives on Commercial Banks of Nepal” submitted to Patan Multiple Campus, Patan Dhoka, Lalitpur, Faculty of Management, TU, Kathmandu, is my original work done in the form of partial fulfillment of requirements for the MBS under supervision of Associate Professor Mr. Yuga Raj Bhattarai of Patan Multiple Campus.

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List of Abbreviation

NRB	:	Nepal Rastra Bank
BOK	:	Bank of Kathmandu
EBL	:	Everest Bank Ltd.
NIBL	:	Nepal Investment Bank Ltd.
HBL	:	Himalayan Bank Ltd.
CIB	:	Credit Information Bureau
CAR	:	Capital Adequacy Ratio
NPA	:	Non – Performing Assets
RWA	:	Risk Weighted Assets
GLL	:	General Loan Loss
IMTC	:	Instant Money Transfer Companies
PNB	:	Punjab National Bank
SCT	:	Smart Choice Technology
BIS	:	Bank for International Settlement
RBI	:	Reserve Bank of India

CHAPTER 1

INTRODUCTION

1.1 General Background

Nepal is a developing country with an agricultural economy. About 90 % of Nepalese people are engaged in farming. In recent years, the country's efforts to expand into manufacturing industries and other technological sectors are in a progress. Farming is the main economic activity followed by manufacturing, trade and tourism. The chief sources of foreign currency earnings are merchandised export, services, tourism and remittances. In the absence of a stable political environment, structural reforms have been delayed, new investments are sluggish, pervasive weakness in the fiscal and financial sectors persist, and a back drop for sustained economic growth has been impaired. Repeated threats to business and industrial communities and growing industrial insecurity have added uncertainties to long-term investment in the country.

Nepal's foreign trade is growingly re-concentrating towards India. Till mid 1980s, about half of the country's trade used to be concentrated with India. By the end of the 1980s, the share of India in Nepal's total trade came down to a quarter. In the recent years, both exports to and imports from India are growing at faster rate than the overall growth. Healthy growth of trade and financial sector is essential for sustainable economic development. For this huge amount of capital fund has to be allocated. This is fulfilled by financial sector reforms. Towards this goal, Nepal has initiated a financial reform project in association with the Asian development Bank. So far, an examination of the status and the planned management change of major government owned banks have been carried out. Additionally, a study on reforms of the banking regulation to strengthen the supervisory function of the Nepal Rastra Bank (NRB) has also been completed. All these reforms are aimed towards having the financial sector which play crucial role in economic development of Nepal. While the progress of these financial sector reforms

thus far has been satisfactory, challenges like growing non - performing assets, high operational expenses, and narrow banking coverage exist in the financial system.

Bank is the most crucial institution of the financial sector. This institution has more responsible towards the development of the country as well as people. Banking system is becoming much important to meet more effectively and adequately the needs of the development of the economy and to promote the welfare of the people's. This institution helps the business and industrial communities and growing industrial security. They will help the country to providing adequate necessary capital and unlimited fund for sustainable economic development. So, Nepal is a developing country and it needs more capital, man power and resources. To meets all these dignity things adequate funds are required. Bank is the only one institution which helps the country to do the healthy growth of the trade by providing efficiently allocating funds. Allowing the financial sector to play its important role in Nepal's economic development necessitates financial sector reforms.

In Nepal, competitive practices were introduced in the banking and financial sector only in the early 1980s. Prior to that, a system of controlled regime prevailed wherein the number of financial institutions, their area of operations, and their transactions were limited. Although there was an expansion in the number of financial institutions and a concomitant increase in the regulatory and supervisory responsibilities of the Nepal Rastra Bank (NRB), the expected outcome relating to the expansion and strengthening of the financial sector was not achieved due to the prevailing problems and weaknesses in implementation. However, clear signs of improvements have been noticed recently. As Nepal is undertaking various efforts in the light of its accession to the World Trade Organization (WTO), it is necessary to continue with the financial sector liberalization policy and accord priority to both the quantitative and qualitative developments of financial institutions. In this perspective, the NRB has taken the initiative in implementing as well as enforcing the compliance of the prudential regulations based on international standards. Corresponding supervisory arrangements are under implementation to

strengthen the country's financial sector. Although it could be a little difficult for the financial institutions to comply with the regulatory arrangements in the context of economic slowdown, these provisions are *sine qua non* to make these institutions efficient players in the growing competitive environment in the days to come.

Accepting deposit is the most important function of commercial banks and the deposits collected from the customers are the main source of the require fund of banks. Customer's deposits depend on the banks confidence and the capacity to pay in cash on demand. So, the customer has taken the high risk by depositing fund without any collateral. There is a high chance of bank to quit. So, this type of responsible is taken by NRB to safeguard the people's capital and fund. Today the commercial banks are the heart of the modern business. They pool together the savings of the community and arrange for their productive use. They act as bridge between the two parties of the society (i.e. money borrowers and lenders). They have significant role in the smooth functioning of economy.

In fact, banks played a pioneering role in the enhancement of economy of the country and hence, it is the life – blood of the modern commerce and can be said that modern commerce is so much dependent upon banking that any cessation of banking activities even, for a couple of days will completely paralyze the modern business and economic life of a Nation. Modern bank had gained paramount trust in the public.

Though, the banks have more responsible towards the customers and country. So the activities of the commercial banks are vital that the central bank has to seriously focus on commercial banks. Thus to control the commercial banks the central bank has to make law and act, rules and regulation and directive and guidelines. These all the rules and regulation issued by central bank has to follow by the commercial banks. After the restoration of multiparty democracy, openness and liberalization policy in the financial system several commercial banks started its business and at present commercial banks hold a large share of economic activities of the country.

Central bank being the leader of entire banking system needs to maintain the financial sector stable. So for the effective functioning of the commercial banks, central bank issues some directives to the commercial banks. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public credibility towards it.

The financial sector reform of Nepal was initiated in mid 1980s and from then onward Nepal Rastra Bank, has been playing pioneer role by issuing directives to the financial sector. These directives are compiled by all financial institutions of the country. The directives consist of 16 volumes.

1.2 Introduction to Central Bank

The evolution of banking industry had started a long time back, during ancient times. There was reference to the activities of money changers in the temple of Jerusalem in the New Testament. In ancient Greece the famous temples of Delphi and Olympia served as the great depositories for people's surplus funds and these were the centers of money lending transaction. Indeed the traces of "rudimentary banking" were found in the Chaldean, Egyptian and Phoenician history. The development of banking in ancient Rome roughly followed the Greek pattern. Banking suffered oblivion after the fall of the Roman Empire after the death of Emperor Justinian in 565 AD and it was not until the revival of trade and commerce in the middle ages that the lessons of finance were learnt a new from the beginning. However, as a public enterprise, banking made its first beginning around the middle of the twelfth century in Italy and the Bank of Venice, founded on 1157 AD was the first public banking institution. Following it were established the Bank of Barcelona and the Bank of Genoa in 1401 and 1407 AD respectively. Similarly Bank of Amsterdam set up in 1609 AD became very popular. The Bank of Venice and the bank of Genoa continued to operate until the end of eighteen century. With the expansion of commercial activities in northern Europe there sprang up a number of private banking houses in Europe and slowly it spread throughout the world. The Lombard migrated to England and other parts of

Europe from Italy are regarded for the development and expansion of the modern banking.

The development of banking activities in our country Nepal is of relatively recent. The record of banking system in Nepal gives detail account of mixture of slow and steady evolution in the financial and global economy of Nepalese life. Similar to other countries, landlords, rich merchants, shopkeepers and other individual money lender has acted as fence to institutional credit in presence of unorganized money market. In ancient times, some crude banking operations were in practice. In Nepalese Chronicle, it was recorded that the new era known as Nepal Sambat was introduced by Shankar Dhar, a sudra merchant of Kantipur in 880 AD after having paid all the outstanding debts in the country. Towards the end of 8th century, GunaKam Dev had borrowed money to rebuild the Kathmandu valley. The establishment of the "Tejarath Adda" during the year 1877 AD (1933 BS) was fully subscribed by the government of Kathmandu valley, which played a vital role in the banking system and was the first step in institutional development of banking sector in Nepal. This establishment helped the general public to provide credit facilities at a very low rate. The Tejarath Adda distributed credit facilities to the public especially on the collateral of gold and silver. Hence the establishment of Tejarath Adda could be regarded as pioneer foundation of banking in Nepal. The development of trade with India and Tibet increases the necessity of the institutional bankers. As a result, the "Udyog parishad (Industrial development Board) was constituted in 1936 AD. One year after its formulation, it formulated the "Company Act" and "Nepal Bank Act" in 1937 AD. In 1956 AD Nepal Rastra Bank was created as the central bank of Nepal.

Giving definition of central bank is vague. Different people give different definition in the introduction of central bank. When we define central bank we do question what does central bank do or we go on the basis of functions it performs the entity responsible for overseeing the monetary system for a nation (or group of nations). Central banks have a wide range of responsibilities - from overseeing monetary policy to implementing specific goals such as currency stability, low inflation and full employment. Central

banks also generally issue currency, function as the bank of the government, regulate the credit system, oversee commercial banks, manage exchange reserves and act as a lender of last resort. Central bank is the father of the banks. All the decision whether the monetary policy or fiscal policy, all are decided by the central bank. Thus central bank is one which acts as the banker to the government and the commercial banks, enjoying the monopoly of note issue, operates the currency and credit system of the country and does not perform the ordinary commercial banking functions. The functions of the central bank varied from country to country and with the passage of time, its functions have grown considerably. Central bank is the central arch of the monetary and fiscal framework in every country of the world and its functions are indispensable for proper functioning of the economy and fiscal operations of the government.

Different authors have given different definition of central bank according to situation and need. Which reflex that, the term central bank is a broad to define it in a single sentence. Most of the authors define central bank by laying emphasis on one or more functions it performs.

Kisch and Elkin defined, as the essential function of a central bank is the maintenance of the stability of the monetary standard which involves the control of the stability of the monetary standard which involves the control of the monetary circulation (Vaidya, 2001:52).

According to M. H. DeKock, A central bank is a bank which constitutes the apex of the monetary and banking structure of its country and which performs as best as it can in the national interest, the following functions (Vaidya, 2001:52).

1. The regulation of currency in accordance with the requirements of business and the general public, for which purpose it is granted either the sole right of note issue or at least a partial monopoly thereof.
2. The performance of general banking and agency services for the state.
3. The custody of the cash reserves of the commercial banks.

4. The custody and management of the nation's reserves of international currency.
5. The granting of accommodation, in the form rediscounts or collateral advances to commercial banks, bill brokers and dealers or other financial institutions and the general acceptance of the responsibility of lender of the last resort.
6. The settlement of clearance balances between the banks and
7. The control of credit in accordance with the needs of business and with a view to carrying out the broad monetary policy adopted by the state."

In the statute of the Bank for International Settlements, a central bank is defined as, the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country.

Vera Smith defines it as; the primary definition of central banking is a banking system in which a single bank has either a complete or a residuary monopoly in the note issue (Vaidya, 2001:52).

The central banking system in the U.S. is known as the Federal Reserve System (commonly known as "the Fed"), which is composed of twelve regional Federal Reserve Banks located in major cities throughout the country. The main tasks of the Federal Reserve are to supervise and regulate banks, implement monetary policy by buying and selling U.S. Treasury bonds (T-bills), and steering interest rates. Ben Bernanke currently serves as the chairman of the Board of Governors of the Federal Reserve.

Government agency that performs a number of key functions: (1) issues the nation's currency; (2) regulates the supply of credit in the economy; (3) manages the external value of its currency in the foreign exchange markets; (4) holds deposits representing reserves of other banks and other central banks; (5) acts as Fiscal Agent for the central government, when the government sells new issues of securities to finance its operations; and (6) attempts to maintain an orderly market in these securities by actively participating in the government securities market.

The Federal Reserve System, the central bank in the United States, regulates Bank Credit by raising or lowering the Discount Rate and by buying and selling government securities in the open market. This process, known as Open Market Operations, aims to promote stable economic growth while controlling the rate of inflation. Other major central banks are the Bank of England, the European Central Bank, and the Bank of Japan.

The Central Bank is a financial institution charged with several different functions, the most important of which is managing a country's monetary policy. In addition, central banks typically manage a government's debt, they participate in the formulation of exchange rate policy, together with the government, and in many countries they are the principal regulator for the financial sector. Modern central banks were first developed during the late seventeenth century, most notably with the foundation of the Bank of England in 1694. While many major central banks before 1945 were privately owned, today central banks operate as agencies of government. Recently, there has been much debate over the extent to which central banks should be independent from political control when they set monetary policy. During the post-war period governments in many OECD countries retained the authority to intervene with or override central bank decisions. This was a provision seen as a necessary corrective to the perceived failure of policies pursued by several central banks during the 1930s. Since the 1980s, with the increasing popularity of rational expectations models of monetary policy and the perceived post-war success of independent central banks like Germany's Bundes bank, it has become increasingly popular to emphasize the benefits of making central banks independent from day-to-day political interference. This intellectual shift has helped lead to reforms of central bank statutes in numerous countries, while also influencing the development of the European Central Bank, which has a very high degree of legal independence. Political scientists have begun to examine a number of issues related to this debate, asking whether *de jure* independence will only result in *de facto* independence in certain types of political systems, whether independence can only result in both low inflation and low unemployment if it is accompanied by centralized

wage-bargaining institutions, and more generally how partisan political considerations influence central bank policy.

A **central bank, reserve bank, or monetary authority** is the entity responsible for the monetary policy of a country or of a group of member states. It is a bank that can lend money to other banks in times of need.^[1] Its primary responsibility is to maintain the stability of the national currency and money supply, but more active duties include controlling subsidized-loan interest rates, and acting as a lender of last resort to the banking sector during times of financial crisis (private banks often being integral to the national financial system). It may also have supervisory powers, to ensure that banks and other financial institutions do not behave recklessly or fraudulently.

Richest countries today have an "independent" central bank, that is, one which operates under rules designed to prevent political interference. Examples include the European Central Bank (ECB) and the Federal Reserve System in the United States. Some central banks are publicly owned, and others are privately owned. For example, the United States Federal Reserve is a quasi-public corporation.

Central banking is of recent origin. Prior to the commencement of the twentieth century, there had been no clearly defined concept of central banking. But today there is no country in the world, which does not have a central bank. Due to its various functions and fundamental rights, it has become, an essence for the proper functioning of the economy. Before the commencement of the twentieth century, some banks in England, Europe, Sweden etc were assuming more powers and enjoying the right of note issue and were acting as the government's banker and agent. They were not originally called the central banks but were generally known as the bank of issue or the national banks.

The oldest central bank is the Riks Bank of Sweden, established in 1656 then after Bank of England came into being in 1694 which was assumed

to be a first central bank, to develop, what are now, generally recognized as the fundamentals of the art of central Banking. The fundamentals, principles and tools and instruments developed, by bank of England was universally accepted by all the Banks all over the country. The successful working of Bank of England, stimulate the development of central banking in the world. As a result, The Bank of France was established in 1800 with the assistance of state funds and private capital. Similarly, The Bank of Russia was established in 1860, as a state bank, with the declared object of consolidating the monetary circulation and the floating debt of the Russian Empire. The Bank of Netherland was founded in 1814 on the ruins of old Bank of Amsterdam. The National Bank of Austria is the result of the reorganization of Bank of Austria – Hungary in 1877, was established in 1817 to manage the deteriorated situation of over issue of paper currency. In nineteenth century, the Bank of Norway, the National Bank of Denmark and Bank of Spain was also established in 1817, 1818 and 1856 respectively. Bank of Japan was established in 1882, to manage the currency. Establishment of Federal Reserve System of USA in 1914, International Financial Conference held in Brussels in 1920 and establishment of the International Monetary Fund, the highest body in the world to control monetary system, in 1944 is considered as milestone in the history of central bank. Today the number of central banks stands over 150. Previously, central banks were privately owned and in a form of Joint Stock Banks. They were managed by shareholders with the objectives to finance the government from the private sector. Gradually the trend towards nationalization of central banks gathered momentum and now become important organs of the government. They actually support the policy of the government in the economic field. The dynamism of economic raised the status of the central banks to the position of the leader of the entire banking system. Today's' position of central bank is attained in past three centuries and yet it is in the growing stage. In the words of M. H. DeKock, Central Bank have developed their own code of rules and practices, which can be described as the art of central banking but which, in a changing world, is still in the process of evolution and subject to periodical readjustment (Vaidya, 2001:51).

1.2.1 Central Bank in Nepal

Nepal Rastra Bank (NRB), the Central Bank of Nepal, was established in 1956 AD (2013 BS) under the Nepal Rastra Bank Act, 1955, to discharge the central banking responsibilities including guiding the development of the embryonic domestic financial sector. Since inception, there has been a significant growth in both the number and the activities of the domestic financial institutions.

To reflect this dynamic environment, the functions and objectives of the Bank have been recast by the new NRB Act of 2002, the preamble of which lays down the primary functions of the Bank as: to formulate necessary monetary and foreign exchange policies to maintain the stability in price and consolidate the balance of payments for sustainable development of the economy of Nepal; to develop a secure, healthy and efficient system of payments; to make appropriate supervision of the banking and financial system in order to maintain its stability and foster its healthy development; and to further enhance the public confidence in Nepal's entire banking and financial system.

The Bank is eminently aware that, for the achievement of the above objectives in the present dynamic environment, sustained progress and continued reform of the financial sector is of utmost importance. Continuously aware of this great responsibility, NRB is seriously pursuing various policies, strategies and actions, all of which are conveyed in the annual report on monetary policy.

As per the Nepal Rastra Bank Act 2058 following are the rights, duties and functions:

- a) To issue currency notes and coins in the market.
- b) To formulate and implement necessary monetary policy for price stability.
- c) To formulate and implement foreign exchange policy.
- d) To determine the foreign exchange rate adjustment regime.
- e) To operate and manage foreign exchange reserves.

- f) To issue license to commercial banks and financial institutions for carrying out financial transactions and regulate, inspect, supervise and monitor such transactions.
- g) To function as the banker, advisor and financial agent of Nepal Government.
- h) To function as a bank of commercial banks and financial institutions, and as a lender of last resort.
- i) To establish, promote and regulate the systems of payments, clearing and settlements and
- j) To carry out other important functions as necessary towards realizing the objectives enjoyed by the Act.

Vision

To become “A modern, dynamic, credible and effective Central Bank”

Mission

To maintain macro-economic stability through sound and effective monetary foreign exchange and financial sector policies.

In order to exercise adequate control and supervision over the banking and credit system of the country, NRB has been given wide regulatory responsibility under the various provisions of the following legislations:

1. Nepal Rastra Bank Act 2012 BS (1955 AD), 2058 BS
2. Commercial Bank Act 2031 BS (1974 AD)
3. Foreign exchange Act 2019 BS (1962 AD)
4. Bank and Financial Institutions ordinance, 2060 BS
5. Bank and Financial Institutions Debt Recovery Act 2058 BS (2002 AD)

These regulatory responsibilities are performed by the following departments of the bank:

1. Banking operation department
2. Inspection and supervision department
3. Foreign exchange department
4. Development finance department

1.2.2 Brief Introduction of sample Banks

Bank of Kathmandu Ltd

Bank of Kathmandu Ltd. (BOK) was incorporated in 1993 and came into operation in March 1995 as a joint venture bank with Siam Commercial Bank of Thailand. The head office of the bank is situated at Kamalpokhari, Kathmandu, Nepal. Its authorized capital is 1,000,000,000, issued capital is 606,173,300 and paid up capital is 603,141,300.

At the beginning, this bank was managed by Siam commercial bank of Thailand and later on Siam commercial bank divests their share holding and now it is fully owned and managed by Nepali professional. The majority of the shares are owned by general public which is 58%.

Bank of Kathmandu, since its inception, has been using information technology for its mainstream banking activities. All its branches including rural areas are interconnected to the bank's intranet system providing online real time Any Branch Banking system to its valued customers. Continuous updates, upgrades and replacements of its equipments and software have become one of the major focuses of the bank to stand up to the challenges posed by the fast changing environment.

Bank of Kathmandu has well – developed correspondent relationships with over 250 banks globally to help its customers to carry out their business worldwide promptly and conveniently. Bank of Kathmandu have maintained accounts in major currencies in the internationally renowned banks as well tied up with various Instant Money Transfer Companies (IMTC) like Xpress Money Service Ltd., Money Gram, International Money Express P. Ltd. Etc for efficient execution of International Banking business and also enables inflow of foreign exchange earnings to the country with high security.

This bank came into operation with a objectives of catering new business yet not identified and offering new banking products and services with a modern look by adopting modern banking technology.

Bank of Kathmandu has just entered into the eleventh year of successful operation. During its tenth year of operation, it has become one of the leaders in the banking sector and was able to establish a good banking image in the banking history of Nepal. It has gain lot of popularity among its customer, due to its pioneer service provided to its customer.

Objectives of Bank of Kathmandu

- To contribute to the sustainable development of the nation by mobilizing domestic savings and channeling them to productive areas.
- To use the latest technology in banking, to provide better, reliable and efficient services at a reasonable cost.
- To facilitate trade and transactions by making financial transactions easier, faster and more reliable through relationships with foreign banks and money transfer companies.
- To contribute to the social development in Nepal.

Vision

Bank of Kathmandu's vision is to become a significant contributor to the economic development of Nepal by distinguishing themselves as an efficient, competitive and top quality financial institution.

Mission

Bank of Kathmandu's mission is to become the "Bank of Choice" by dedicating themselves to the progress and growth of our institution for our community, customers, employees and stockholders by:

- Promoting economic growth and becoming a caring corporate citizen.
- Providing excellent customer services by offering personalized quality services and products.
- Enhancing shareholder value.
- Providing challenging career and learning opportunities for employees.

Authorized Capital of the Bank of Kathmandu is 1 billion which is divided into 1 crore share of Rs. 100 each. Its issued capital is 606 million that is 50 lacs shares of Rs. 100 each and its paid up capital is 603 million. The equity participation of BOK, from financial institutions is 12 % of share capital, organized institutions are having 40 % of total share capital and remaining 58 % is owned by general public.

Everest Bank Ltd

Everest Bank Limited (EBL) was established in 1994 and started its operations with a view and objective of extending professionalized and efficient banking services to various segments of the society. EBL, joined hands with Punjab National Bank (PNB), India as its joint venture partner in 1997. PNB is the largest Public Sector Bank of India having 109 years of banking history with more than 4400 offices all over India and is known for its strong systems and procedures and a distinct work culture.

Drawing its strength from its joint venture partner, EBL has been steadily growing in its size and operations ever since its inception and today it has established itself as a leading Private Sector Bank of the Nation, reckoned as one of the fastest growing Commercial Bank of the country.

The Bank's Paid – Up Capital has increased to 831.4 million against the Authorized Capital of 1 billion. The local Nepalese promoters hold 50 % stake in the Bank's equity, while 20 % of equity is contributed by joint venture partner PNB whereas remaining 30 % is held by the public.

Despite fragile law and order situation especially during last 2–3 years, the Bank total deposits have reached Rs. 2397.63 million recording an annual growth of 31.8 % and post a after tax net profit of Rs. 451.2 million which is 52.2 % higher than the last.

The bank provides a wide range of banking facilitates through a wide network of 26 branches covering all the 5 regions of the country and over more than

250 reputed correspondent banks across the globe. All the branches in the valley and as also those at important business centers like Biratnagar, Birgunj, Butwal and Bhairahawa are interconnected through Anywhere Branch banking Systems (ABBS), a facility which enables its customers to do banking transactions from any of these branches irrespective of their having accounts in the other branch.

Being a pioneer in opening a representative office in New Delhi, India, EBL has successfully taken another historical step in the banking history of the country. The representative office facilitates the remittance of Nepalese workers residing in India by opening their accounts from the identified branches of joint venture partner, Punjab National Bank, India and also attracts Indian Investment to Nepal.

EBL is playing a pivotal role in arranging remittance of funds to and from India through instant transfer facility in addition to the Drafts Drawing Arrangement with 170 branches of PNB all over India. The Bank is also offering Cash Management System for managing the funds of corporate exporting to India by collecting their funds from about 183 locations in India. EBL, in order to help Nepalese citizens working abroad, has entered into arrangements with banks and finance companies in different countries which enables quick remittance of funds by the Nepalese citizens in countries like UAE, Kuwait, Baharain, Qatar, Saudi Arabia, Malaysia, Singapore and UK.

Not to be left behind in technology advancement, a continuous review and upgrading of the technology is undertaken for the convenience of its customers. The Bank has also introduced "EBL Debit Card" and installed two ATM's at its main branches at Naya Baneshwor and New Road. Besides this, the Bank has tied up with Smart Choice Technology (SCT) for ATM switch shoring that enables the EBL Debit Card holder to have access at 26 different locations of SCT member banks. The Bank also provides 365 days banking services at its branch at New Road along with extended banking facilities at New Road, New Baneshwor and Teku in Kathmandu.

Recognizing the value of offering a complete range of services not only to corporate but also to individuals, EBL has pioneered in the banking sectors in extending various customer friendly products like Home Loan, education loan, EBL Flexi Loan, Loan against future lease rentals and home equity loan, car loan, loan against shares and loan against insurance policies etc., thus helping people realize their dreams.

Serving the value customers and the society for 10 years means knowing each other better, building relationships, bonding as partners in progress and will continue working with each other by meeting our customer's expectations. Thus the outstanding performance and the commitment to customer satisfaction have earned us the reputation of being "The Name You Can Bank Upon."

The authorized capital of EBL is 1 billion. Its issued capital is 843.2 million and its paid up capital is 831.4 million. The local Nepalese promoters hold 50 % stake in the Bank's equity, while 20 % of equity is contributed by joint venture partner PNB whereas remaining 30 % is held by the public.

Himalayan Bank Limited

Himalayan Bank Limited (HBL) was incorporated in 1992 by the distinguished business personalities of Nepal in partnership with Employees Provident Fund and Habib Bank Limited, one of the largest commercial banks of Pakistan. Banks operation was commenced from January 1993. It is the first commercial bank of Nepal with maximum share holding by the Nepalese private sector. Besides commercial activities, the Bank also offers industrial and merchant banking.

The Bank at present has total twenty-four branches and five branches in Kathmandu valley namely Thamel, New Road, Maharajgunj, Pulchowk (Patan) and Suryavinayak (moved from Nagarkot). The bank is also operating a counter in the premise of the Royal Palace. The Bank has a very aggressive

plan of establishing more branches in different parts of the kingdom in near future.

Himalayan Bank's policy is to extend quality and personalized service to its customers as promptly as possible. All customers are treated with utmost courtesy as valued clients. The Bank, as far as possible, offers tailor made facilities to its clients, based on the unique needs and requirements. To extend more efficient services to its customers, Himalayan Bank has been adopting innovative and latest banking technology. This has not only helped the Bank to constantly improve its service level but has also kept it prepared for future adaptation of new technology. Himalayan bank is committed to be a "Banking with a difference".

Vision

To become a leading Bank of the country by providing premium products and services and then ensuring attractive and substantial return for the stakeholders.

Objectives

To become the bank of first choice.

The promoters hold 51 % stake in the Bank's equity, 20 % of equity is contributed by joint venture partner Habib Bank Ltd. Of Pakistan, 14 % of equity is contributed by financial institutions and remaining 15 % is held by the Nepalese public. Authorized capital of HBL is 2 billion. Its issued capital is 1013 million and paid up capital is 1013 million. Its equity is divided into one million share of Rs 100 each.

Nepal Investment Bank Ltd

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50 % of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one of the largest banking group in the world. With the decision of Credit Agricole Indosuez to divest, a group of

companies comprising of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50 % shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd.

The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank's Annual General Meeting, Nepal Rastra Bank and Company Registrar's office with the following shareholding structure.

- A group of companies holding 50 % of the capital
- Rastriya Banijya Bank Holding 15 % of the capital
- Rastriya Beema Sansthan holding the same percentage
- The remaining 20 % being held by the General Public (which means that NIBL is a company listed on the Nepal Stock Exchange)

NIBL has made large strides on all fronts after the French left the bank. Like they increase branches, loan amount increased, growth in interest income, and as well they were able to introduced new products and services etc. Thus this bank gives the example that not only the foreigner, Nepali bankers are also able to manage the bank independently. The authorized capital of NIBL is 4 billion, issued capital is 2409 million and its paid up capital is 2407 million.

1.3 Statement of the Problem

The Directives is a cornerstone of Nepalese safe policy strategy and is intended to be a radical reform of the current legislative framework for the protection of consumers, economic interest. The key issues of directives are effectiveness of consumer protection, legal environment for business and impact on improving the internal market.

With the increasing importance of banking in the country, there is a mushrooming growth of commercial banks in private sector as well as in joint venture. A large number of banking, serving in the small sector, will obviously increase the keen competition for survival which might leads to keen rivalry among them to occupy the bigger part. So, there may be offering of uneconomic rate of interest, indulging in risky enterprises, unhealthy competition etc. such situation may endanger the deposits of general public.

In order to safe guard the public deposits and ensure the economic stability in the country, NRB issues Directives from time to time. The directives are related to various performances of the banks and the banks are required to follow the directives.

In the beginning, due to lack of proper regulations Nepalese Commercial banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector faced the problem of bad debts, overdue loans, accrued interest, accumulation of non – banking assets and excess liquidity in the banking system. Viewing the need of structural reform amidst these adverse implications, NRB must issued suitable directives to run commercial banks in a healthy competitive manner to ensure the sustainable developments of the overall banking system.

In the year 2001, NRB issued a set of directives to commercial banks consisting of nine parts; claiming that these directives are based on internationally accepted banking norms of Basel Committee. NRB ordered the commercial banks to increase its authorized capital to Rs. 1 billion which was almost impossible for Nepalese commercial banks. Such regulation may have negative impact on commercial banks and may ruins the conditions of commercial banks. Later on commercial banks were allowed to comply with the norms stage by stage within specific time period. So the impact of NRB directives must be regularly studied and examined so that the shortcoming in the directives can be eliminated and healthy directives is ruled. The directives are revised considering the need of time as well as considering other factors which will affect the economy of the country. The directives cover various aspects of the banking sector and aims at keeping the financial scenario of the country in balance.

The directives are only tools of NRB to supervise, monitor and control the financial institution; it must be formulated, taking into consideration, the positive as well as negative impact on the commercial banks. Issue of wrong or unsuitable directives, may ruin the conditions of commercial banks instead

of enhancing its situation. NRB should take necessary actions to ensure that its recent directives have been compelled by all commercial banks equally. However, commercial banks should not be forced to comply with the norms.

- a. How does NRB manage and control the commercial banks by issuing the directives?
- b. Does NRB successful in applying their directives?
- c. What kind of effectiveness can be found by NRB in implementing the directives?
- d. What is the impact of capital requirements on overall risk taking?

1.4 Objectives of the study

The main objectives of the study are as follows:

- To point out the role of NRB on monitoring and inspection of commercial banks.
- To indicate the extent effectiveness of Directives issued by NRB.
- To examine the implementation of NRB Directives on commercial banks.
- To analyze the steps taken by commercial banks to fulfill the requirements of NRB Directives.

1.5 Limitation of the Study

This study is for the partial fulfillment of MBS. The effort has made to present and analyze the fact clearly, truly and within the boundary. Like other study, the study has the following limitations:

- This study is focused on only two directives among eleven directives issued by NRB for commercial banks namely provision of minimum capital fund to be maintained by commercial banks and provision of loan classification and loan loss provisioning on the credit.
- This study is mainly on secondary data collected from NRB and sample commercial banks. As well primary data were also collected and analyzed to support the secondary information.

- Among seventeen commercial banks this study is based on only four commercial banks namely Bank of Kathmandu Ltd., Everest Bank Ltd., Nepal Investment Bank Ltd. and Himalayan Bank Ltd. Hence the result drawn from this study may not be applicable to other commercial banks.
- In this study independent opinions of respondents have been analyzed thus therefore there may be response bias questioned.
- Past four years data (Fiscal Year 2061/062 to Fiscal year 2064 / 065) have been collected for analysis.

1.6 Chapter Schemes

The chapter schemes of this proposal comprise a total of five chapters which have been briefly described as follows:

Chapter One: Introduction

Introduction chapter is the first chapter which includes the General Background, Introduction to central bank, Central bank in Nepal, Brief introduction of sample banks, Statement of the problem, objective of the study and limitation of the study. This part will help the reader to understand the banking industry or thesis.

Chapter Two: Review of the Literatures

This part includes Theoretical reviews and Reviews of the previous studies with respect to capital adequacy norms and loan classification and loan loss provisions. The chapter briefly looks into the conceptual framework with descriptive about the central bank, role of central bank and directive of central bank, Theories of the Central bank's directives. The chapter also reviews the related imperial studies and also includes the concluding remarks.

Chapter Three: Research Methodology

Research methodology explains various terminologies related to research. The chapter explains about the research design, sources of data collected,

data collection process, population and sample of data and methods of data analysis.

Chapter Four: Data Presentation and Analysis

It deals with presentation and analysis of relevant secondary data and information through a definite course of research methodology. For analysis of data appropriate mathematical, financial as well as statistical tools are used. Such as ratio analysis, correlation, probable error, coefficient of determination etc. This section is the actual output of the whole research and some conclusion can be drawn from the analysis and interpretation of the collected data.

Chapter Five: Summary, Conclusion and Recommendation

In this chapter, the summary of the entire thesis has been comprised. This chapter further describes the major findings of the thesis. Conclusions of the study have also been included in this chapter. As well as, possible and viable recommendations has also been presented in this chapter.

CHAPTER 2

REVIEW OF THE LITERATURES

2.1 Conceptual Framework

A central bank, reserve bank or monetary authority is one of the country's most powerful economic institutions. It is an entity responsible for the monetary policy of its country or of its group of member states, such as in the European Union. Its primary responsibility is to maintain the stability of the national currency and money supply, but more active duties include controlling subsidized loan interest rates and acting as a "bailout" lender of last resort to the banking sector during times of financial crisis.

Central bank is the organ of government that undertakes the major financial operation of the government and by its conduct of these operations and by other means influences the behaviors of financial institutions so as to support the economic policy of the government.

It may also have supervisory powers to ensure that banks and other financial institutions do not behave recklessly or fraudulently. A central bank is usually headed by a Governor. In most countries the central bank is state-owned and has a minimal degree of autonomy, which allows for the possibility of government intervening in monetary policy. An independent central bank is one which operates under rules designed to prevent political interference.

The central bank is government owned but separate from the country's ministry of finance. Although the central bank is frequently termed the "government's bank" because it handles the buying and selling of government bonds and other instruments. Political decisions should not influence central bank operations. Of course, the nature of the relationship between the central bank and the ruling regime varies from country to country and continues to evolve with time. To ensure the stability of a country's currency, the central

bank should be the regulator and authority in the banking and monetary systems.

2.1.1 Important and Functions of Central Bank

As a apex Bank of Nepal to observe the overall economic indicator, it is difficult to mention it's important and functions. **Shekhar & Shekhar(1998)** comment that it is difficult to lay down any hard and fast rule regarding the functions of a central bank. The powers and the range of functions of central banks vary from country to country.

The most important and the earliest functions to be discharged by a central bank is that of acting as a bank of issue. As well as it is a banker's bank. The central bank also acts as a lender of the last resort. In case of any problems and emergency to any of the banks operating under it, central bank comes forward to rescue them temporarily from such problems. It also plays the role of an agent, an advisor and banker to the Government. Central bank is a custodian of the nation's metallic reserves and controller of currency.

A central bank has sole right to issue national currency notes. It controls money flow in the market by imposing monetary policy. It issues notes after full analysis of unemployment, inflation, economic growth, etc. of the country. Central bank is the holder of all the Government balances. It is the holder of all the reserves of the other banks and financial institutions in the country.

Objectives between a central bank and other commercial banks are different. The main objective of a central bank is to assist the government to implement economic politics without any profit motive, where as the main objectives of other banks is to earn profit by mobilizing funds collected from the general public. As well as the central bank plays the role of guardian and parents to other commercial banks.

As a regulatory body of all other banks and financial institutions, a central bank is the origin of all banking policies under which all the banks are

suppose to operate. Therefore, a central bank guides and assists in operating banking system as a whole. A central bank has full authority to interfere in the banking market i.e. to all banks in terms of implementing its policies. It can penalize the banks in case they go out of the central bank's policy or the termination of the license and also can restrict their working dimensions to a large extent. A central bank is also important in the context to co-ordinate with different international institutions such as International Monetary Fund (IMF) etc. It works under the supervision and guidance of such institution to develop the monetary system of a country.

Important of Central bank

Jim Clark (1997) says that Central Bank and monetary policy is important because:

- Monetary policy can dominate fiscal policy in certain circumstances.
- Inflation is determined by monetary policy.
- The Central Bank influences interest rates.
- The Central Bank stabilizes the financial system.

These functions are important, for example, because they imply that the Central Bank controls and hence is responsible for the management of total spending or aggregate demand as well as inflation. In carrying out its monetary policy management (via manipulating reserves), the Central Bank influences interest rates-especially short-term rates-as well as foreign exchange rates and other financial market prices. And in times of financial crisis, the Central Bank's lender-of-last-resort function stabilizes the entire financial system.

The supervision aspect of the Central Bank mainly assist it in keeping the financial health of the country in good condition there by helping to stabilize the financial system.

Functions of Central Bank

The functions of the Central Bank are as follows:

- Monopoly on the issue of banknotes

- The Government's banker and the bankers' bank ("Lender of Last Resort")
- Manages the country's foreign exchange and gold reserves
- Manages Government's stock register;
- Regulation and supervision of the banking industry;
- Setting the official interest rate - used to manage both inflation and the country's exchange rate.

The central bank's main responsibility is the management of monetary policy to ensure a stable economy, including a stable currency. It aims to manage inflation (rising average prices) as well as deflation (falling prices). It is the lender of last resort, and will (at a price) assist banks in cases of financial distress (see also bank runs).

Furthermore, it will hold foreign exchange reserves (usually in the form of government bonds) and official gold reserves, and will often have some influence over exchange rates. Some exchange rates are managed, some are market based (free float) and many are somewhere in between ("managed float" or "dirty float").

Typically a central bank controls certain types of short-term interest rates. These influence the stock- and bond markets as well as mortgage and other interest rates. The European Central Bank for example announces its interest rate at the meeting of its Governing Council (in the case of the Federal Reserve, the Board of Governors).

The Central Bank is also responsible to devise rules, guidelines and directives that need to be obeyed by all the financial institutions so that the financial health of the country is in check.

2.1.2 Directives of Central Bank

The financial sector reform of Nepal was initiated in mid 1980s and from then onward Nepal Rastra Bank, has been playing pioneer role by issuing

guidelines to the financial sector. At present the number of guidelines issued by Nepal Rastra Bank to commercial bank reaches eleven which are as follows:

Directive no. 1:

The provision of minimum Capital fund to be maintained by the commercial banks

Directive no. 2:

Provision of Loan Classification and Loan Loss Provisioning on the Credit

Directive no. 3:

The provision relating to single borrower limit

Directive no. 4:

The provision of accounting policy and the structure of financial statements to be followed by the commercial banks

Directive no. 5:

Minimization of risk inherent in the activities of commercial banks

Directive no. 6:

The provision of institutional good governance to be followed by commercial banks

Directive no. 7:

Time frame for implementation of regulatory directives issued in connection with inspection and supervision and supervision of the commercial banks

Directive no. 8:

Investment in shares and securities by commercial banks

Directive no. 9:

The provision of submission of statistical data to the Nepal Rastra Bank, Banking Management Division and Inspection and supervision Division

Directive no. 10:

The provision of sale and re – registration of foundation shares of commercial banks

Directive no. 11

Introduction of stringent blacklisting procedure for loan defaulters

Directive no. 12

Provision made for loan defaulters and blacklisting procedure

Directive no. 13

Provision made for regular cash balance

Directive no. 14

Provision made for branch office

Directive no. 15

Provision made for interest rate

Directive no. 16

Provision made for capital resources

2.2 Theory of the Central Bank's Directives

Central bank being the leader of entire banking system needs to maintain the financial sector stable. So for the effective functioning of the commercial banks, central bank issues some guidelines to the commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public credibility towards it.

Regulatory and Supervisory role of NRB

Central bank has power and full authority to supervise and regulate the banking sector. The main objective of the supervising the banks are financially sound, well managed and not posing a threat to the interest of their depositors. A central bank makes rules, issues instructions from time to time. For this NRB established Banking Operation and Development Department in 1966 AD to effectively mobilize the capital for promoting industry and the banking system. In December 1974 AD, Agriculture Loans Department and Industrial Loans Department were merged and the Department was renamed as Banking Operation and Loans Department. Again in 1986 AD, it was divided into two different departments namely Bank Operation and Development Finance Department.

In 2002 AD it came in its present form of Bank and Financial Institutions Regulation Department (BFIRD). The main function of the BFIRD include steering the financial sector reform, providing license to banks and financial

institutions, issuing regulations and directives to the banks and financial institutions, refinancing the commercial banks to rehabilitate and sick industries, devising laws relating to banks and financial institutions and make timely amendments, compiling, processing and publishing the data on banking and financial sectors.

NRB's ongoing re – engineering to upgrade its inspection, supervision and regulation capacity at par with the international standard is another important part of the reform process.

The functions of the Department have been guided by its goal to develop a healthy, transparent and competitive financial system in the country. In this connection, it has issued a new directive to the commercial banks and financial institutions on Credit Information and Black Listing of defaulting borrowers.

Capital and Capital Adequacy Ratio

Capital can be defined as the money invested in the business. It is required to conduct the business activities and is the primary requirement for initiation of business. Capital refers to those funds contributed by the bank's owners, consisting mainly of stock, reserve and earnings that are retained in the bank rather than paid out to the stockholders. Capital is required for conducting several important functions like supplying resources to get operate a new bank, further expansion and defend against risk as well it also assist in maintaining public confidence in the bank's management and shareholders.

Capital is envisaged as a provision or buffer to meet potential losses and to act as a motivational factor to the owners of the business to manage it prudently. Capital helps to absorb loss and to assure the society that the bank can play active role even at the time of adversity.

According to Microsoft Encarta reference Library (2003), Capital is a stock of resources that may be employed in the production of goods and service and the price paid for the use of credit or money, respectively.

No one can say how much capital is adequate for bank. It is really a difficult question to answer. It is not right to think that having high capital to asset ratio can keep bank alive, in fact if the bank has risk free asset and bank management is efficient then even lower capital to total assets can sustain bank life.

In the past, regulators used to fix minimum capital to total assets ratio, minimum capital to risk assets (Total assets – cash and bank balance) ratio etc. However, such criteria could not set capital requirement based on risks undertaken by the banks, Hence, concept of risk adjusted capital came into force from 1988 when developed countries adopted “Basel Agreement” on capital management developed by Bank for International Settlement (BIS), Basel, Switzerland.

Accordingly, effective from 16th July 2001 (1st Shrawan 2058 B.S) Capital of the bank has been categorized into two part by NRB as follows:

1. Tier – 1 Capital / Core Capital, which consists following components:
 - a. Share Capital,
 - b. Share Premium,
 - c. Non – Redeemable Preference Shares,
 - d. General Reserve Fund,
 - e. Cumulative Profit / Loss (Up to previous fiscal year) and
 - f. Current Year Profit / Loss (According to Balance Sheet)

Note: Amendment done through unified directives 2062

Under Core capital no 6 item Current Year Profit / Loss (P/L) – (According to Balance sheet) is deleted and capital redemption reserve, capital adjustment reserve and other free reserve are added.

2. Tier – 2 Capital / Supplementary Capital, which consists following components:
 - a. General Loan Loss Provision (GLLP),
 - b. Exchange Equalization Reserve,
 - c. Asset Revaluation Reserve,

- d. Hybrid Capital Instruments,
- e. Unsecured Subordinated Term Debt,
- f. Interest Rate Fluctuation Fund and
- g. Other Free Reserves (Investment Adjustment Reserve etc) not allocated for specific reserves.

Notes:

- GLLP up to 1.25 % of total risk weighted assets is considered as Supplementary capital.
- 25 % of Exchange fluctuation Gain is transfer to Exchange Equalization Reserve from P / L appropriation account.
- Gain from revaluation of assets is transferred to Asset Revaluation Reserve but fund in Asset Revaluation Reserve up to 2 % of Supplementary Capital is treated as Supplementary Capital.
- If the average interest spread between deposit and loan exceeds 5 %, the excess interest is to be deposited in Interest Spread Reserve / Interest Rate Fluctuation Fund.

Note: Amendment done through unified directives 2062

- Under supplementary capital “Exchange Equalization Reserve” is deleted

Tier one capital is capital which is permanently and freely available to absorb losses without the bank being obliged to cease trading. An example of tier one capital is the ordinary share capital of the bank. Tier one capital is important because it safeguards both the survival of the bank and the stability of the financial system.

Tier two capital is capital which generally absorbs losses only in the event of a winding-up of a bank, and so provides a lower level of protection for depositors and other creditors. It comes into play in absorbing losses after tier one capital has been lost by the bank. An example of tier two capitals is subordinated debt. This is debt which ranks in priority behind all creditors except shareholders. In the event of a winding-up, subordinated debt holders

will only be repaid if all other creditors (including depositors) have already been repaid.

Clark (1999) has defined Capital Adequacy as a legal requirement that a financial institution should have enough capital to meet all its obligations and fund the services it offers.

The provision of minimum Capital fund to be maintained by the commercial banks as per directed by NRB since fiscal year 2061 / 062 are as follows:

Table 1
Capital fund to be maintained

Time Limit	Capital Fund in % on the basis of Total Risk Weighted Assets		
	Core Capital	Supplementary Capital	Capital Fund
F.Y 2061 / 062	5.5	5.5	11
F.Y 2062 / 063	5.5	5.5	11
F.Y 2063 / 064	5.5	5.5	11
F.Y 2064 / 065	5.5	5.5	11
F.Y 2065 / 066	6	6	12
F.Y 2066 / 067	6	6	12

(Source: www.nrb.org.np)

Banks are required to submit the report of Capital Adequacy along with other required data related with it, on a quarterly basis within one month from the end of each quarter starting from Ashwin, Poush, Chaitra and Asadh of every fiscal year. In case capital adequacy ratio is found shortfall, banks are required to cover the shortfall within next six months by the way of reallocating assets or by issuing new share or by appropriating from the net profit. While increasing its paid – up capital, it should increase its paid – up capital at least by 10 % per year.

Action against not fulfilling the requirement of Capital Adequacy Ratio:

1. Prohibition on declaration and distribution of dividend,
2. Prohibition on opening of new branch,
3. Prohibition on loan distribution,
4. Prohibition on accepting new deposits,
5. Refinancing facility from NRB is not provided and
6. NRB can take any other charges as per Clause no 32 of NRB Act 2012.

Risk weights prescribed by NRB for different types of assets are as follows:

Table 2
On Balance Sheet Items

On – Balance – Sheet Items	Risk weights (%)
Cash Balance	0
Gold (Tradable)	0
Balance on NRB	0
Investment on HMG Securities / Bonds	0
Investment on NRB Securities / Bonds	0
Fully secured Loan against own FDR	0
Fully secured loan against HMG Securities / Bonds	0
Accured	0
Balance at Local Banks & Financial Institutions	20
Fully secured Loan against other banks' FDR	20
Balance at Foreign Banks	20
Money at call	20
Loan against Guarantee of A + rated Int'l Banks	20
Other investment on A + rated Int'l Banks	20
Investment on Share, Debenture and Bond	100
Other Investments	100
Other Loans, Advs. & Bills Purchased / Discounted	100
Fixed Assets	100
Other Assets	100

(Source: www.nrb.org.np)

Table 3
Off Balance Sheet Items

Off – Balance – Sheet items	Risk weights (%)
Bills Collection	0
Forward Foreign Exchange Contract	10
L / C with maturity < 6 months	20
Guarantee against CG of A + rated Int'l Banks	20
L / C with maturity > 6 months	50
Bid Bond	50
Performance Bond	50
Advance Payment Guarantee	100
Financial Guarantee	100
Other Guarantee	100
Irrevocable Loan Commitment	100
Contingent Tax Liability	100
Other Contingent Liabilities	100

(Source: www.nrb.org.np)

Capital adequacy requirement is a must for effective running of banks. Capital Adequacy plays a catalytic role in protection of banks from getting failure and as well as it also helps generate sufficient confidence among depositors and creditors. Thus purpose of capital adequacy ratio is to protect the interest of depositors and creditors by making bank keep more risk – free assets and by increasing their capital base. Adequate capital keeps the bank healthy and robust against all the contingencies and enhances the image of the bank in the financial market. Higher the capital adequacy ratio, the more sound the bank is.

Regarding the capital adequacy ratio, there is always been conflict between management and regulatory authorities. Regulatory authorities always focus on increasing capital adequacy ratio in order to stabilize the financial system while management wish to reduce the ratio so as to increase shareholders'

rate of return on investment. Thus capital management has been most important and most controversial issues in the financial institutions.

Loan and loan loss provision

In short, loan means money lent at interest. In commerce and finance, term loan is used as the transfer of money or other property on promise of repayment along with interest, usually at a fixed future date. Loan loss provision is an arrangement made in order to safeguard from bankruptcy if loaned amount is not recovered or if the debtors default on repayment of loan. It provides buffer against future unexpected losses.

Loan and advances are the most profitable of all the assets of a commercial bank. This is the primary source of income and the most profitable of all the assets of the bank. Loan and advances account for the largest part of the revenue of the bank. But bank need to be careful about the safety of such loan and advances because bank may be influenced by bad debts and since loan and advances are least liquid of the entire banker's assets, so may feel difficult to realize them on short notice.

There are different types of loan and advances. Such as secured and unsecured loans. Those loans which were granted against the personal security of the borrower is secured loan i.e. against the promissory notes. While unsecured loan means they are not backed by any tangible assets or securities.

Effective from 16th July 2001 (1st Shrawn 2058 B.S), NRB are classified the loan and advances on the basis of aging of the principle into four types.

- Pass Loan: Loans and advances not past due and past due up to 3 months shall be included in this category. These are classified and defined as performing loan.
- Sub – standard Loan: Loans and advances past due for a period of over 3 months to 6 months.

- Doubtful Loan: Loans and advances past due for a period of over 6 months to 1 year.
- Loss: Loans and advances past due for a period of over 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

All the loan and advances falling in the category of sub – standard, Doubtful and loss are classified and defined as Non Performing Loan.

Banks shall as of the end of Ashoj, Poush, Chaitra and Ashadh prepare the statement of outstanding Loan and advance classified on the basis of aging and submits the particulars to the banking operation department and inspection and supervision department of NRB within one month from the end of each quarter.

Commercial banks should classify their loan and advances on the basis of following time table.

All the loan and advances, classified as per NRB act 2012, need to be classified on the basis of following time table into four parts:

For fiscal year 2008 / 2009 A.D (2065 / 2066 B.S)

1. Pass Loan: Loans and advances not past due and past due up to 3 months.
2. Sub – standard Loan: Loans and Advances past due for a period of over 3 months to 6 months.
3. Doubtful Loan: Loans and Advances past due for a period of over 6 months to 1 year.
4. Loss: Loans and Advances past due for a period of over 1 year.

Pass Loan is defined as performing loan and where as sub – standard loan, doubtful loan and loss are defined as non – performing loan. Even if the loan

is not past due, loans having any or all of the following discrepancies shall be classified as loss.

- No security at all or security that is not in accordance with the borrower's agreement with the bank,
- Borrower has been declared bankruptcy,
- Borrower was lost or cannot be found,
- Discounted bills not repayable within 90 days from due date,
- Loan and advances amount not used for the actual purposes,
- Blacklisted borrowers

Table 4
Provision for Loan Loss

S. No.	Loan Classification	Provision
1	Pass Loan	1 %
2	Sub – standard Loan	25 %
3	Doubtful Loan	50 %
4	Loss Loan	100 %

(Source: www.nrb.org.np)

Consequences to bank for non – compliance to NRB directives:

1. Re–classification of loan and advances and need to made loan loss provision of such loan and advances within three months,
2. Prohibition on declaration and distribution of dividend,
3. Prohibition on loan distribution and
4. Prohibition on accepting of new deposits

Write back case in the loan loss provision

Can write back in the loan loss provision only in the following case:

1. In case loan and advances is totally written off.
2. If loan and advances is repaid in installment or partial payment is made then up to the amount repaid can be write back.

3. If loan and advances is re – classified and such loan and advances is paid with interest for continuous two years then such loan and advances can be transformed into pass loan.

Provision of Security on loan and advances

While accepting security for loan and advances, such security must be secured enough to recover principle as well as interest on it and must be legally secured. And also there should not be any complication on taking over the ownership of such security by bank in case of default.

Blacklisting of willful defaulter

NRB is tightening the rules for blacklisting the defaulters on bank loans by issuing revised directives. Accordingly, on September 18, 2003 NRB issued a new directive in relation to blacklisting and defaulter's list repealing previous directive on the same matter and has considerably widened its scope in relation to blacklisting.

Conditions for blacklisting

All those debtor / borrower taking loan and advances amount 2.5 million or more than that are eligible for blacklisting in one or any of the following cases:

- If principal amount of loan installment or interest payment past due by nine months. But concerned commercial bank or board of directors can increase the payment time of three months for payment if they feel it reasonable.
- If it is proved that the credit facility is misused.
- If security provided is misused.
- If the value of securities of loan and advances decreases or not sufficient or not secured enough to recover the loan and advances and its interest or is lost then either the loan or advances is not past due or past due in such situation the borrower / debtor is to be blacklisted.
- If borrower is lost.
- Insolvency of debtor.

- If borrower / debtor is held guilty by the court for fraud or attempted fraud using fake documents and instruments like fake cheque, draft, foreign currency etc.
- If borrower / debtor is proved involved in banking and financial crime.

Persons, firms, companies and corporate bodies who should be blacklisted

- Person, firm, company or corporate body enjoying the credit facility.
- Proprietor of the proprietorship firm.
- Directors of the company or corporate body which is blacklisted.
- All the partners of a partnership firm which is blacklisted.
- All the shareholder of a private company which is blacklisted.
- Person, firm, company or corporate body that has given guarantee for the repayment of credit facility availed by the blacklisted person or firm.
- Shareholder holding 15 % or more shares of a public limited company which is blacklisted.
- Any other non – government firm, company, corporate body which has, as its director, any person or representative of any firm, company, corporate body which is blacklisted.
- The person, firm, company or corporate body under the same group of business firms to which the blacklisted person or firm belongs to
- Any person, firm, company or corporate body that has given cross guarantee to the loan to the blacklisted debtor (barring some exceptions specified in the directive).

Some other obligations on banks regarding blacklisting

- Every bank should send periodic information regarding credit facility extended up to amount of 2.5 million or above within 15 days of month end and till the credit is not paid on the quarterly basis within 15 days from the end of each quarter starting from Ashwin, Poush, Chaitra and Ashad of every fiscal year.
- Bank should obtain the credit information on debtor / prospective debtor from the CIB before extending, renewing, rescheduling any credit facility amounting more than Rs. 10 lakhs.

- Bank should obtain certain particulars of the prospective debtor, for example names and details of the entire shareholder in case of a private limited company.
- Bank should give 35 days prior notice to the defaulting debtors before blacklisting.
- If two third of the amount on any property as evaluated by any valuator cannot be realized, such valuator has to be blacklisted on recommendation of the bank. Such valuator will be barred from functioning as security valuator for any bank and financial institution. The banks and financial institutions may recommend for not blacklisting such security valutors even if the two third amounts could not be realized provided that the bank feels the loss of value was due to any reason beyond control of such valutors. Such valutors shall be removed from the blacklist only when the related debtor is removed from the blacklist.
- Banks are prohibited from extending credit facility to the joint family members of a blacklisted person.
- Banks must update and publish the name of blacklisted person, firm, company or corporate body on the national daily news paper for general public information within one month from the end of asadh and poush of every fiscal year, whose loan amount along with interest exceed 10 million.

Shortfall in blacklisting provision

1. The current blacklisting provision fails to reach the frauds or those who crossed the border with the borrowed fund. It only hits the entrepreneurs who have permanent establishments in Nepal.
2. No effective mechanism to catch and punish the persons involved in the process of fraudulent lending.
3. Lack of corporate governance within the debtor company.
4. Blacklisting directives is blind, it treats all types of loan defaults equality and fails to differentiate between willful defaulters, frauds and

defaulters by chance or default caused by market forces, which are beyond the control of the borrower.

5. The CIB functions only as a registry of blacklist and it does not provide any meaningful information which the lenders can rely on while making decisions.

Regarding the blacklisting directives, there has been lot of debate, discussion and disagreements among NRB, Bankers and Businessman / Entrepreneur. It is true that the amount of non – performing loan and the amount of loan given to blacklisting businessman is alarming which is an evidence of the sickness of the banking and financial sector. This is not an enterprise level problem but the national level problem. So concerned department should be very careful in this matter and just blacklisting is not a real solution. Instead it creates new problems. Blacklisting directives treats all types of loan defaulters equally. It fails to differentiate between willful defaulters, frauds, defaulters by chance or default caused by market forces, which are beyond the control of the borrower.

Businessman argues that banks have reaped profits from businessman and are still the only sector making profits. They added banks must also face the consequences of the bad business environment of the country. And if NRB thinks that the blacklisting is the only way to recover loans then it is very hard to agree with that policy.

The world has witnessed many financial crises and their devastating consequences due to huge financial and economic losses that resulted from each episode. Every crisis was sudden in onset and their magnitude of losses was much larger than expected. If we go back to the history, then on 3 March 1997, the Asian crisis triggered in the form of liquidity problem of two finance companies which later on spread over to other financial institution within the Thai financial system. Simultaneously, crisis began to cover Malaysian, Indonesian and South Korean financial system and loomed in the form of Asian crisis. So this Asian crisis appealed the whole world for regular and timely supervision and assessment of financial system, its soundness and

vulnerabilities. This event forced the regulatory authorities for the enforcement of prudential measures in order to avoid further crisis. Review and revision in prudential regulations such as capital adequacy ratio, asset classification, provisioning for impaired assets, exposure limit and enforcement of international accounting standards etc have now become common issue all over the world since the late 1990s.

Similarly, in our country too commercial banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector faced the problem of bad debts, overdue loans, accrued interest, accumulation of non – banking assets and excess liquidity in the banking system. In addition to these expected happenings, new challenges were added to the Nepalese banking sector due to the adverse developments in the domestic economy resulting from deteriorating peace and security situation and continuous persistence of natural calamities inside the country on one hand and the global recession primarily caused by international terrorism on the other. Viewing the need of structural reform amidst these adverse implications, NRB issued directives to run commercial banks in a healthy competitive manner to ensure the sustainable developments of the overall banking system.

2.3 Reviews of related imperial studies

Ranjit (1989) in his study has indicated that capital funds have positive and significant relation with both deposits and loans. Increase or decrease in capital fund increases or decreases deposits as well as loans. Increase or decrease in capital fund increases or decreases deposits as well as loans. However the degrees of relationship were different. The relation of capital with profit is positive and insignificant that indicates less of increase or decrease in profit is due to capital fund or capital fund is least responsible in changing profit. So bank should increase capital fund to increase the capital fund ratio according to its increased deposits.

Shrestha (2002) in his study concluded that NRB has to play more active role to enhance the operation of commercial banks. Strengthening and institutionalization of the commercial banks is very important to have a meaning relationship between commercial banks and national development through shift of credit to the productive industrial sectors. At the same time the series of reforms such as consolidation of commercial banks, directing attention to venture of capital financing, appropriate risk return trade off by linking credit to timely repayment schedules, avoiding imperfections, allowing flexibility in lending, one window service from NRB, need of a strong supervision and monitoring from NRB, diversity scope of activities of commercial banks, professional culture within commercial banks etc. All these are necessary to ensure better future performance of commercial banks that have already been established and growing in Nepal.

Karmacharya (2002) has stated that financial soundness and strength of the company is largely depending upon the composition of the capital structure and assets. The proportion of debt and equity capital should be decided keeping in mind the effort of tax advantages and financial distress. Maintaining the improved capital structure by increasing equity base i.e. by issuing more equity capital, expanding general reserve and retaining more earnings is advantageous. As mandated by NRB, for the operation in all over Nepal, a commercial bank should have paid up capital base of Rs. 500 million. Hence, the banks should raise its paid up capital to Rs. 500 million as soon as possible.

Santosh Pandey (2002) in his study concluded that change in NRB directives has lot of impact on commercial banks activities. Because of new directives, commercial bank has to increase the operational cost and dividends to shareholders and bonus to the employees are scaled down due to decrease in profits of the banks. He also said that the changes in directives would bring prosperity to the shareholders, depositors, employees and the economy to the country as a whole in a long run. The tough time through which the bank is undergoing at present will prevail only for a short period. His suggestion to NRB is that the NRB should issue directives after doing proper homework.

NRB must strengthen the functioning of its CIB. NRB should be practical and should issue directives applicable in the context of Nepal and not only to meet the international standards. Otherwise complaints from commercial banks may arise. However, in the present context, the commercial banks have to comply such directives and maintain its policies.

Bhandari (2003) in his study points out that adequacy and inadequacy of bank capital will have direct affects on banking transaction. The capital adequacy is the most important aspect of the bank. The bank should pay attention to many things for the adequacy of capital.

Manoj Dumar Shrestha (2003) in his thesis stated that raising and utilization of funds are the primary functions of commercial banks. Commercial banks collect a large amount of deposits from general public so in order to protect such deposits capital must be sufficient otherwise the banks will use all the money of depositors in their own interest and depositors will have to suffer loss. NRB being the central bank has to be responsible to give special attention to the interest of depositors. Capital adequacy norm is required to safeguard the money of the depositors as the banks are playing with the money they collected from the depositors.

He also added that depositors are not aware of the fact of the necessity of adequate capital fund to safeguard their deposits. They deposit their money to any banks regardless of adequate capital fund which may endanger safety of their money. Therefore, NRB should initiate awareness programs to make the depositors aware of such fact and think before depositing money in any commercial banks.

He further stated that NRB should consult to the various bank officials before setting or resetting standards on capital adequacy norms. The complaints and criticisms of bank officials should be considered accordingly. Consequently, an optimal standard will ensure which will satisfy almost everyone.

Ms. Sabitri Shrestha in her studies “Impact and Implementation of Nepal Rastra Bank’s Guidelines on Commercial Banks: A study of Nabil Bank Ltd. And Nepal SBI Bank Ltd.” has tried to find out the impact of NRB directives on commercial banks. She has also made effort to find out whether the directives are actually implemented and are being monitored by NRB or not. She has stated that both Nabil and Nepal SBI bank are implementing the NRB directives.

In her study, she finds out that all the changes in NRB directives made both positive and negative impacts on the commercial banks. Even though the study is limited to only two sample, it is cleared that new directives issued by NRB make good impact more than bad impact on the various aspects of the banks. It can be seen that the provision has been changed and the increased provisioning amount has decreased the profitability of commercial banks. Apart from, loan exposure has been cut down to customers due to the borrower limits have been brought down by NRB. Therefore reductions in loan amount result to decrease the interest income from loans, which will decrease the profits of the banks in coming year. Decreasing profitability pushes towards lesser dividends to shareholders and lesser bonus to employees. Not only negative sides but also there are positive sides of new directives. Recently the problem of banks are increasing operating cost and decreasing loan amount resulting decrease in profits of the banks. But it shows it is only for short term because the directives are more effective to protect the banks from bad loans, which protect the banks from bankruptcy as well as protections of deposits of general public’s. Increase in capital adequacy ratio strength the banks financial position, loan related provision will made safety of loans except the risk reducing provisions will protect the bank from liquidation. Above all, it can be concluded that newly issued directives are more effective than previous one although it has brought some problems towards banks. To decrease the decreasing profits of the banks, they should research the alternative such like more investments in other business; banks should adopt new technology according to the demand of time and must not depend on only interest income for profits.”

2.4 Concluding Remarks

The previous related studies found that the commercial banks applying the norms of Nepal Rastra banks. They said that NRB should be practical and should issue directives applicable in the context of Nepal and not only to meet the international standards. The entire researchers suggest that NRB should issue directives only after doing proper homework. In the context of capital, the study shows that adequacy and inadequacy of bank capital will have direct affects on banking transaction. The capital adequacy is the most important aspects of the bank. The bank should pay attention to many things for the adequacy of capital. NRB being the central bank has to be responsible to give special attention to the interest of depositors. Capital adequacy norm is required to safeguard the money of the depositors as the banks are playing with the money they collected from the depositors. They also said that NRB should consult to the various bank's officers before setting or resetting standards on capital adequacy norms. The complaints and the criticisms of bank's officers should be considered accordingly. Consequently, an optimal standard will ensure which will satisfy almost everyone. Some researcher found that the NRB's directives have both negative and positive sides. The directives are able to success in protecting the banks from bankruptcy as well as protection of general public deposit. Somewhere they found that they lose profit due to the norms of NRB's directives. The directives also save the bank from bad loan and also give hints of provisioning for the bad loan. Increase in capital adequacy ratio strength the banks financial position, loan related provision will made safety of loans except the risk reducing provision will protect the bank from liquidator. Above all, it can be concluded that issued directives are more effective although it has brought some problems towards banks.

Chapter 3

Research Methodology

3.1 Research Design

Research is the way for seeking facts through objectives verifiable methods in order to discover the relationship among them and to deduce from them broad principles or laws. It really a method of critical thinking by defining and redefining problems, formulating hypothesis or suggested solution, collecting, organizing and evaluating data, making deductions and making conclusions to determine whether they fit the formulated hypothesis. To sum up, research is the process of a systematic and in – depth study or search of any particular topic, subject or area of investigation backed by the collection, compilation, presentation and interpretation of relevant details or data.

This study is basically concerned with examining the implementation of NRB directives on commercial banks and compares one another assuming, they represent almost all of the entire banking industry.

The research design is the strategy for conducting research work, which describes the general framework for collection, analysis and evaluation of identified data. Research design shed light on the methodology employed for collection, analysis and evaluation of the facts or data. This study is based on descriptive cum analytical research design.

3.2 Population and Sample

There are twenty–five commercial banks presently operating in Nepal. I have taken four banks as sample banks given below:

Table 5
List of the sample Commercial Banks

S. No.	Name of Banks	Head Office	Commencement Date
1	Nepal Investment Bank Ltd.	Kathmandu	1986.02.27
2	Himalayan Bank Ltd.	Kathmandu	1993.01.18
3	Everest Bank Ltd.	Kathmandu	1994.10.18
4	Bank of Kathmandu Ltd.	Kathmandu	1995.03.12

(Source: www.nrb.org.np)

3.3 Nature and Source of Data

This research study is mainly based on the secondary data. The require data for the study has been collected from the concerned organizations. Following are the secondary sources of data used in the study.

- Annual reports, newsletters, broucher etc of the selected banks.
- Text books, articles published in newspaper, journals, Magazines etc.
- Laws, NRB guidelines, NRB acts, etc.
- Unpublished thesis and project report.
- Banks websites and other related websites.

3.4 Data Collection Techniques

In order to make the study more reliable and authentic, different tools and techniques are used throughout the study. Primary data has been obtained through questionnaire, direct interviews, field visits and telephonic inquires. For secondary data annual reports, brochures, newsletters etch has been collected from different departments of concerned banks and as well websites were also used for downloading the necessary information. Various related publications of NRB were collected from concerned departments of NRB,

baluwatar. Similarly, reports of Credit Information Bureau (CIB) have been collected from office of CIB, Heritage Plaza, Kathmandu.

3.5 Data Analysis Tool

The data collected from different sources are recorded systematically as necessary. Only useful and related data are grouped as per need of the research work. Data are presented in appropriate forms of tables, graphs and charts. For analysis of data appropriate mathematical, financial as well as statistical tools are used. Some of them are Ration Analysis: Capital Adequacy Ratio, Loan Loss Provision etc and Statistical Analysis: Correlation Analysis, Probable Error, Coefficient of determination etc.

Financial Tools

For proper financial analysis of data, ratio analysis is the best tool. It is a very simple analyzing tool under which ratios are taken to express the relation between two or more data. Through ratio analysis we can establish the relationship among the data and reach into conclusion.

Under ration analysis, following ratio related to bank are analyzed.

1. Capital Adequacy Ratio:

The term used to describe or measure of a bank's capital fund. It is expressed as a percentage of a bank's risk weighted credit exposures. Capital Adequacy Ratio is calculated on the basis of core capital, supplementary capital and risk weighted assets of the bank.

This risk is used to protect depositors and promote the stability and efficiency of financial systems around the world and to examine adequacy of the total capital fund and core capital, which yielded by the following formulas:

To measure the adequacy of Capital Fund

$$\text{Capital Adequacy Ratio} = \frac{\text{Total Capital Fund}}{\text{Total Risk Weighted Assets}} \times 100 \%$$

To measure the adequacy of Core Capital

$$\frac{\text{Core Capital}}{\text{TRWA}} \times 100\%$$

Where,

Total Capital Fund = Core Capital + Supplementary Capital

TRWA = Total Risk Weighted Assets

2. **Dividend to Net Profit**

This ratio is used to calculate the portion of dividend distributed to shareholders from the Net profit earned by the bank. High ratio shows that large portion of net profit is distributed to shareholders. Due to certain norms of NRB, commercial banks are required to keep some reserves for different purpose, which is obviously deducted from net profit. Hence, Dividend is disturbed, if large portion of net profit is kept for certain reserves, retained earning etc. Through this ratio we can know what portion is separated for dividend and reserves and can also find out the impact of maintaining reserves, retaining earning etc from net profit. It is calculated as follow:

$$\text{Dividend to Net Profit} = \frac{\text{Dividend}}{\text{Net Profit}} \times 100 \%$$

3. **Non Performing Loan to Total Loans and Advances Ratio**

This ratio is used to find out the portion of Non Performing Loan in the portfolio of Total loan and advances. Higher ratio shows that bank has bad quality of assets in the form of Loan and Advances. Hence, lower ratio is preferred. There is no fixed ratio to be maintained but as per international standard only 5 % is allowed. It is calculated as follow:

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

4. **Provision held to NPL**

This ratio is used to find out the provision held for Non Performing Loan. This ratio measures up to what extent of risk inherent in NPL is

covered by Loan Loss provision held for NPL. Since higher ratio safeguard against future contingencies that may create due to non performing loan, higher ratio is preferred by bank or in other words banks have cushion of provision to cope the problem that may be cause due to NPL. It is calculated as follow:

$$\text{Provision held for NPL to NPL} = \frac{\text{Provision Held for NPL}}{\text{Non Performing Loan}} \times 100 \%$$

5. **Loan Loss Provision to Total Loan and Advances**

Loan Loss provision signifies the cushion against future contingencies created by the default of the borrowers in the payment of loans and ensures the continued solvency of the banks. Since low ratio reflects the good quality of assets in the volume of total loan and advances, low ratio is preferred. It indicates how efficiency it manages loan and advances and makes efforts to cope with probable loan loss. Since high provision has to be made for Non – performing loans, higher ratio implies, higher portion of NPL in the total loan portfolio. It is calculated as follow:

$$\text{Loan loss provision to Total Loan and Advances} = \frac{\text{Loan Loss Provision}}{\text{Total Loan \& Advances}}$$

Statistical Tools

1. **Correlation Analysis**

Correlation analysis is the statistical tool that can be use to describe the degree to which one variable is linearly related to other variables. Two or more variables are said to be correlated if change in the value of one variable appears to be related or linked with the change in the other variables. Correlation is an analysis of the covariance between two or more variables and correlation analysis deals to determine the degree of relationship between two or more variables. It refers the closeness of the relationship between two or more variables.

The correlation between two variables X and Y is calculated as follow:

$$\text{Karl Pearson's Correlation Coefficient } (r_{x_1x_2}) = \frac{n\sum X_1X_2 - (\sum X_1)(\sum X_2)}{\sqrt{n\sum X_1^2 - (\sum X_1)^2} \sqrt{n\sum X_2^2 - (\sum X_2)^2}}$$

Where,

n= Numbers of observations

X₁ and X₂ = variables

2. **Coefficient of Determination**

The Square of the correlation coefficient is called the coefficient of determination. It is used to interpret the value of the correlation coefficient. The main significance of the coefficient of determination is to represent the proportion of total variations in the dependent variable which is explained by the variations in the independent variables.

It is calculated as follows:

$$\text{Coefficient of Determination } (r_{x_1x_2})^2 = (\text{Correlation Coefficient})^2$$

3. **Probable Error**

Probable error is an old measure of ascertaining the reliability of the value of coefficient of correlation. It is used to test whether the calculated value of sample correlation coefficient is significant or not and also it is used to determine the limits within which the population correlation coefficient may be expected to lie. The probable error may lead to fallacious conclusions particularly when the number of observations is small. It is calculated as follow:

$$\text{P.E } (r) = 0.6745 * \text{S.E } (r)$$

where,

r = Correlation coefficient

$$\text{S.E} = \text{standard error} = (1 - r^2) / \sqrt{n}$$

$$\text{Limits for population correlation coefficient} = r \pm \text{P.E } (r)$$

CHAPTER 4

DATA PRESENTATION AND ANALYSIS

The most valuable and crucial tool to evaluate the true and actual position of any organization is its past information and data. The strength and weakness of the organization can be appraised from the proper analysis of data. This part of the report focuses on presentation and analysis of data related to the NRB Norms to obtain the objectives of the study.

4.1 Capital Fund Analysis

A Capital of a bank is the sum total of all the contributions made by the shareholders and the promoters. Total Capital of a bank is the sum of Core Capital and Supplementary Capital.

The Central Bank has assigned risks to various types of assets depending upon its liquidity and risk. Higher weight is given to those assets with high risk and liquidity and vice versa. Along with the liquidity and weight, NRB also takes into consideration, various international standards to assign the weight.

Capital Adequacy Ratio is basically the ratio of total capital fund to the total risk weighted assets. The central bank has revised the capital adequacy requirement of the banks over recent years. It should be noted here that the shortfall of supplementary capital can be fulfilled by adding more core capital fund. But, shortfall of core capital cannot be compensated by adding more supplementary capital.

This ratio mainly deals with the asset side of the balance sheet of the commercial banks. In order to compute the Capital Adequacy Ratio, total risk adjusted weight needs to be computed first. For calculating the TRWA, both the on-balance sheet assets and off-balance assets need to be considered.

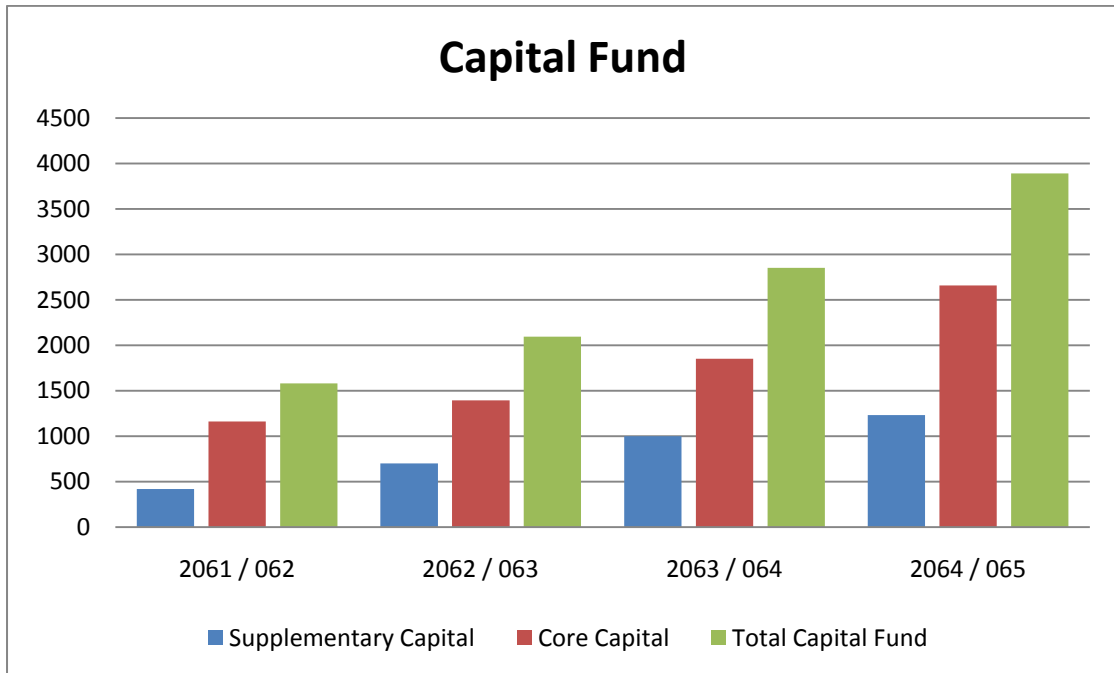
Table 6
Capital Fund of Nepal Investment Bank Ltd.

(Rs. In millions)

	2061/062	2062/063	2063/064	2064/065
Core Capital	1161.48	1393.27	1852.2	2658.91
Supplementary Capital	417.30	700.92	999.42	1232.32
Total Capital Fund	1578.77	2,094.2	2851.62	3891.23
RWA	13632.91	17491.79	23435.63	34486.51
NRB Requirement (%)				
Core Capital to RWA	5.5 %	5.5 %	5.5 %	5.5 %
CAR	11 %	11 %	11 %	11 %
Actual Maintained (%)				
Core Capital to RWA	8.52 %	7.97 %	7.90 %	7.71 %
CAR	11.58 %	11.97 %	12.17 %	11.28 %
Excess or Shortfall				
Core Capital to RWA				
In %	3.02	2.47	2.4	2.21
RWA (Rs.)	411.67	431.22	563.24	762.26
CAR				
In %	0.58	0.97	1.17	0.28
In Figure (Rs.)	79.15	170.11	273.7	97.93

Source: Annual Report 2061/062 – 2064/065

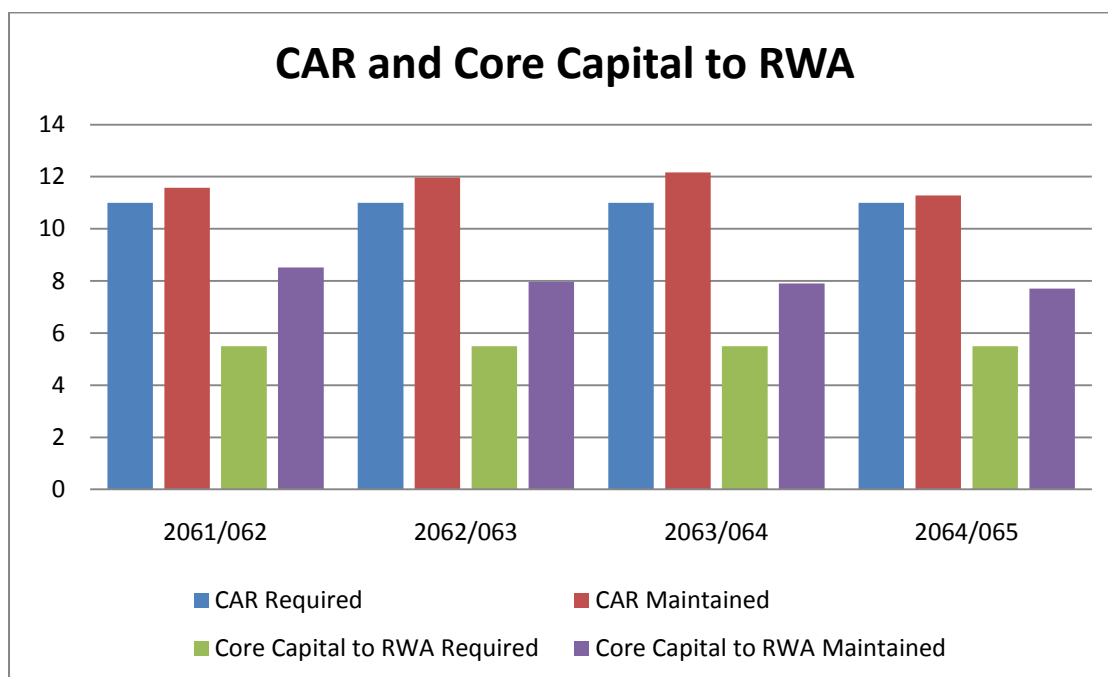
Chart 1
Capital Fund of Nepal Investment Bank Ltd.



Source: Annual Report 2061/062 – 2064/065

The chart 1 shows that the capital fund, core capital and supplementary capital are in increasing trend. In order to maintain the minimum capital requirements the bank has issued 1:1 right share at par and raised additional capital of NPR 295 million during the year 2061 / 062. Because of insufficient supplementary capital the bank purpose to issue 7 years bond worth Rs. 250 million to targeted the growth for the year 2062/063. During the year 2064 / 065 the core capital is increased by 43.55 % and supplementary capital by 23.30 % with compare to the previous year. The chart shows that the core capital is increasing in all the four years and the supplementary capital too. The bank increased the core capital in order to fulfill the requirement of NRB's directives. Core capital play important role in safeguarding both the survival of the bank and stability of the financial system so commercial banks give more priority to core capital than that of supplementary capital.

Chart 2



Source: Annual Report 2061/062 – 2064/065

The Capital Adequacy Ratio and Core capital to Risk weighted Assets of the Nepal Investment Bank during the Fiscal Year 2061/062, 2062/063, 2063/064 and 2064/065 is within the limit and even excess by 3.02 and 0.58, 2.47 and 0.97, 2.4 and 1.17, 2.21 and 0.28 respectively. In line with the directives of Nepal Rastra Bank requiring maintenance of minimum capital adequacy ratios of 5.5% and 11.0% of the total risk weighted assets respectively in core capital and supplementary capital for the fiscal year 2004/05, and a further higher ratios of 6.0% and 12.0% for the FY 2005/06 and onwards, your Bank made rights issue in the ratio of 1:1 and mopped up additional capital of NPR 295 million.

Our capital adequacy stands at 11.3% of our risk weighted assets. In order to support enhanced capital requirement due to record growth in our asset base, the Bank has also focused on retention of profits and ventures into the domestic bond market. Our Tier 1 core capital ratio at 7.71% is considerably more than the government requirement of 5.5% during the year 2064/065.

In the fiscal year 2061/062, Nepal Investment Bank Ltd., issue only right share to increase its capital fund to meet the norms of NRB. Because of insufficient supplementary capital the bank purpose to issue 7 years bond worth Rs. 250 million to targeted the growth for the year 2062/063.

In the fiscal year 2064/065, the bank issue bonus share and right share. This year the bank issue 50 % right share and 33.33 % bonus share and make the capital 2.4 billion the largest capital to fulfill the minimum requirement of Nepal Rastra Bank.

To maintain the required capital adequacy norms, NIBL has allocated huge portion of profit into different reserve fund which ultimately reduce the shareholders dividend.

Table 7
Portion of dividend on Net profit

	2061/062	2062/063	2063/064	2064/065
Net Profit	232147098	350536413	501398853	696731516
Dividend + Bonus share	73467313	327531200	240405780	491598788
Dividend	73467313	118117200	40067630	90293655
Bonus share		209414000	200338150	401305133
Percentage	31.65 %	93.44 %	47.95 %	70.56 %

Source: Annual Report 2061/062 – 2064/065

In the fiscal year 2061/062 the bank provide only dividend to shareholders. The remaining all the four years the bank distribute dividend and bonus share as well. In the fiscal year 2063/064 the bonus and dividend distribute is only 47.95 %. Because of maintain different reserves according to NRB the bank has paid less to shareholders. This may bring problem in the banking industry. So, NRB while issuing guidelines must be very careful and take into consideration the interest of investors which gives the negative feedback to such directives.

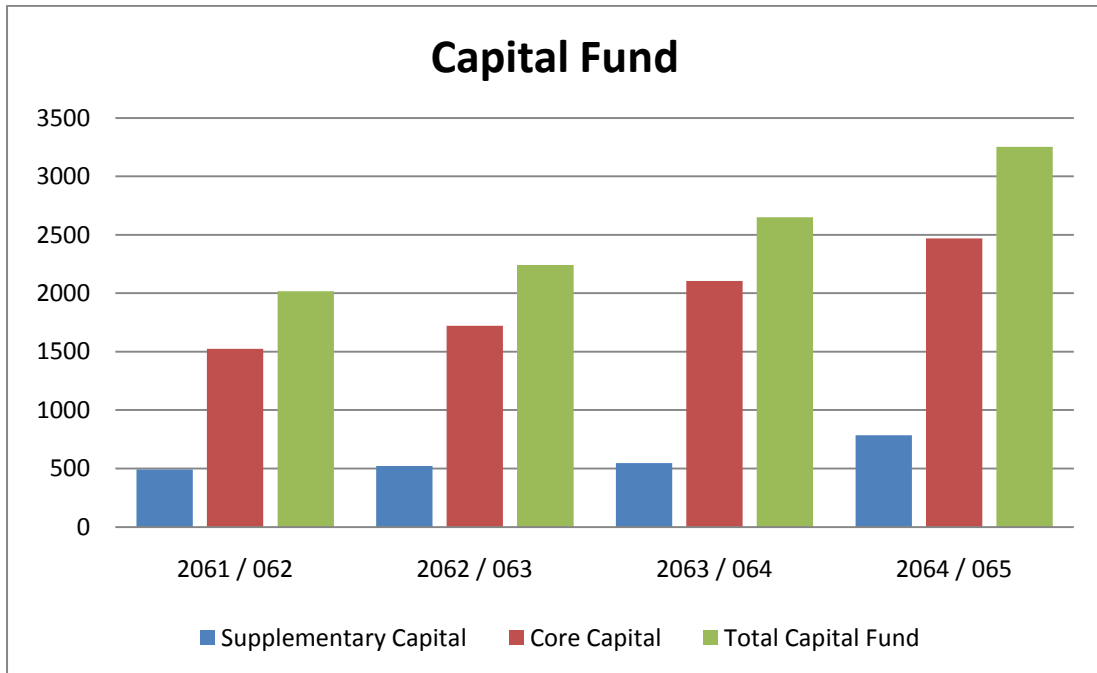
Table 8
Capital Fund of Himalayan Bank Ltd

(Rs. In millions)

	2061/062	2062/063	2063/064	2064/065
Core Capital	1525.77	1721.94	2104.6	2469.79
Supplementary Capital	491.29	520.90	546.77	783.73
Total Capital Fund	2017.06	2242.84	2651.37	3253.52
RWA	18321.72	19918.32	21889.71	25624.47
NRB Requirement (%)				
Core Capital to RWA	5.5 %	5.5 %	5.5 %	5.5 %
CAR	11 %	11 %	11 %	11 %
Actual Maintained (%)				
Core Capital to RWA	8.33	8.65	9.61	9.64
CAR	11.01	11.26	12.11	12.7
Excess or Shortfall				
Core Capital to RWA				
In %	2.83	3.15	4.11	4.14
RWA (Rs.)	518.50	627.43	899.67	1060.85
CAR				
In %	0.01	0.26	1.11	1.7
In Figure (Rs.)	1.83	51.79	242.98	435.62

Source: Annual Report 2061/062 – 2064/065

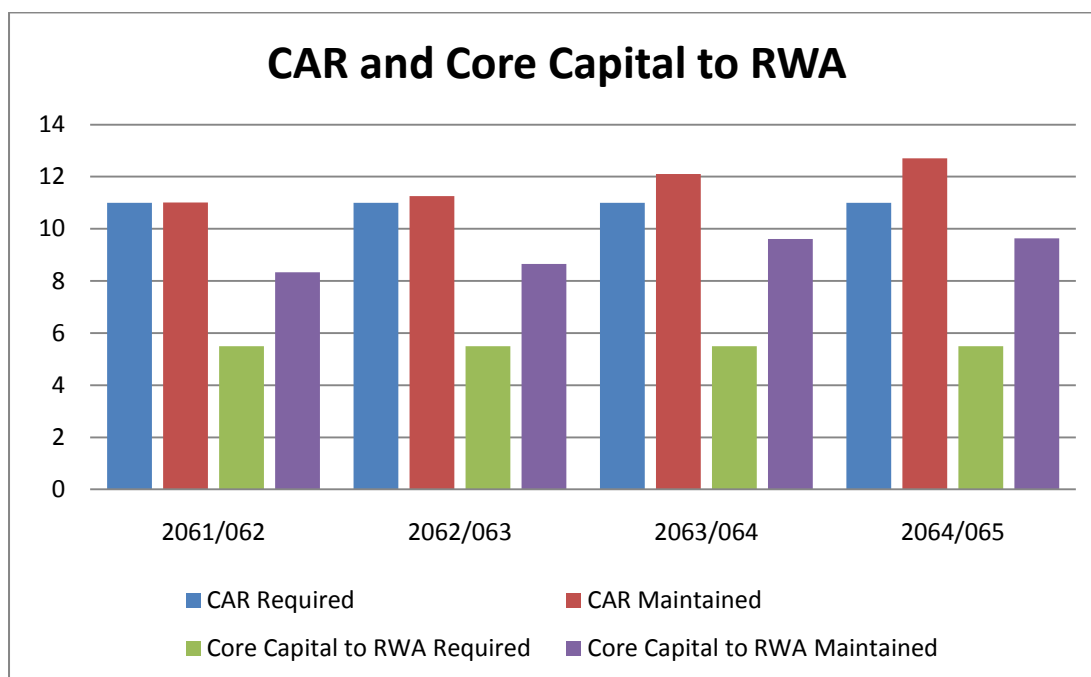
Chart 3
Capital Fund of Himalayan Bank Ltd.



Source: Annual Report 2061/062 – 2064/065

The chart 3 shows that Core Capital, Supplementary capital is in increasing trend. The portion of core capital in total capital fund is 76.95 % in four years average while supplementary capital is 23.05 %. The study shows that the Himalayan Bank gives more emphasis to core capital than supplementary capital. So it is seems to be Core capital is increasing in geometric mean where as supplementary capital is increased in arithmetic mean. In order to maintain the prescribed given by NRB for the capital adequacy ratio, the bank has plays a role in increasing the capital ratio by maintain different reserves from the net profit. The annual report also shows that there is no work in progress to increase the supplementary capital. The contribution of core capital is more in the growth of the capital fund.

Chart 4



Source: Annual Report 2061/062 – 2064/065

The Capital Adequacy Ratio and Core capital to Risk weighted Assets of the Himalayan Bank is within the limit and even excess. The Bank has appropriated 20 % of the net profit to the Statutory General Reserve Fund to increase the capital adequacy norm prescribed by Nepal Rastra Bank. So, the bank propose with pleasure a special resolution on declaring 20 % bonus share and 11.58 % cash dividend on the paid – up capital to the shareholders fiscal years 2061/062.

For the fiscal year 2062 / 063 Excess investment in shares amounting to Rs. 2331160 has been deducted from core capital while calculating capital fund as required by NRB directive. In the same year Rs. 38610000 is proposed for bonus shares and Rs. 38610000 has been transferred to Capital adjustment fund from the profit and loss appropriation account to make the Bank's paid up capital minimum Rs. 1,000 million by 2009 as per NRB Directive.

In order to maintain the paid – up capital according to NRB Directive, the bank has issue bonus share and right share in order to increase the paid up capital according to NRB Directive. The Himalayan Bank had allocated huge portion

of profit into different reserve fund which ultimately reduce the shareholders dividend in order to maintain the required capital adequacy norms. All these activities are gear up only due to meet the NRB norms of capital adequacy requirement and to increase the capital to two billion by 2009/010.

To maintain the required capital adequacy norms, HBL has allocated huge portion of profit into different reserve fund which ultimately reduce the shareholders dividend.

Table 9
Portion of dividend on Net profit

	2061/062	2062/063	2063/064	2064/065
Net Profit	308275171	457457696	491822905	635868519
Dividend+bonus share	203210526	270270000	324324000	456080625
Dividend	74,510,526	231660000	121621500	253378125
bonus share	128,700,000	38610000	202702500	202702500
Percentage	65.92 %	59.08 %	65.94 %	71.73 %

Source: Annual Report 2061/062 – 2064/065

The Table 9 data shows that the bank is trying to satisfy the shareholders by increasing the dividend provided to shareholders. The bank has play double role in this matter. In one side it has to satisfy the shareholders and in the other side it has to maintain the mandatory requirement of NRB. So, the bank distributes the dividend as well viz. fiscal year 2061/062, 2062/063, 2063/064 and 2064/065 are 65.92 %, 59.08 %, 65.94 % and 71.73 % respectively.

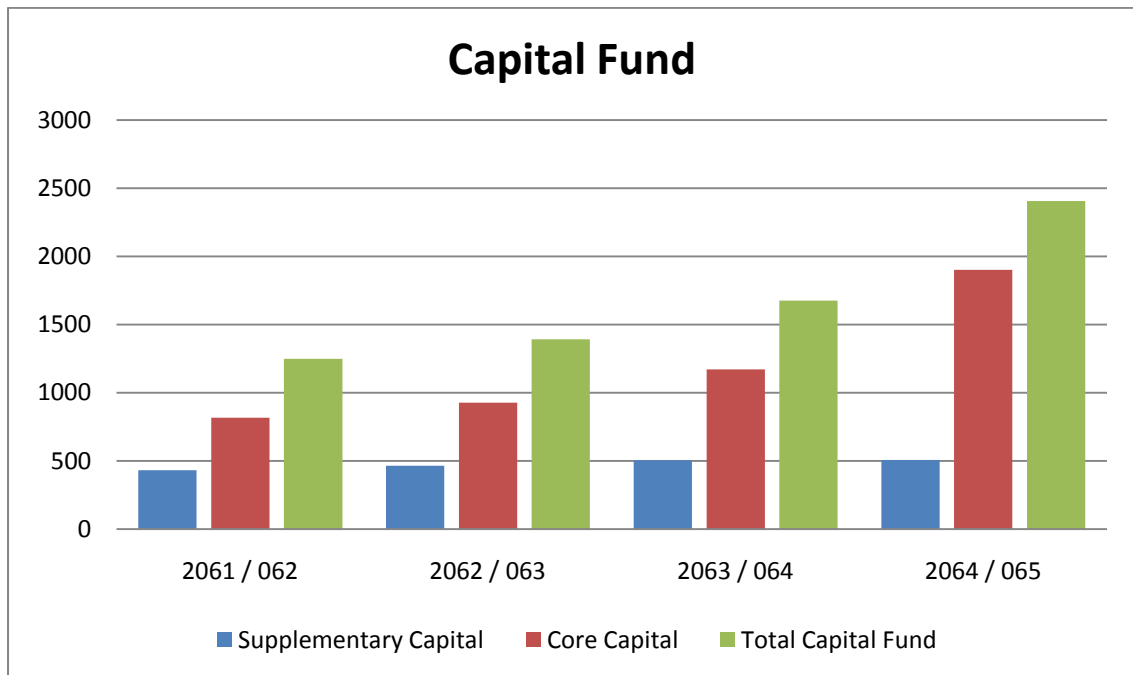
Table 10
Capital Fund of Everest Bank Ltd.

(Rs. In millions)

	2061/062	2062/063	2063/064	2064/065
Core Capital	816.79	927.55	1171.13	1900.86
Supplementary Capital	430.77	463.79	504.98	505.2
Total Capital Fund	1247.56	1391.34	1676.11	2406.06
RWA	9195.59	11291.14	14976.74	21039.88
NRB Requirement (%)				
Core Capital to RWA	5.5	5.5	5.5	5.5
CAR	11	11	11	11
Actual Maintained (%)				
Core Capital to RWA	8.88	8.21	7.82	9.04
CAR	13.57	12.32	11.20	11.44
Excess or Shortfall				
Core Capital to RWA				
In %	3.38	2.71	2.32	3.54
RWA (Rs.)	310.81	305.99	347.46	744.81
CAR				
In %	2.57	1.32	0.20	0.44
In Figure (Rs.)	236.33	149.04	29.95	92.57

Source: Annual Report 2061/062 – 2064/065

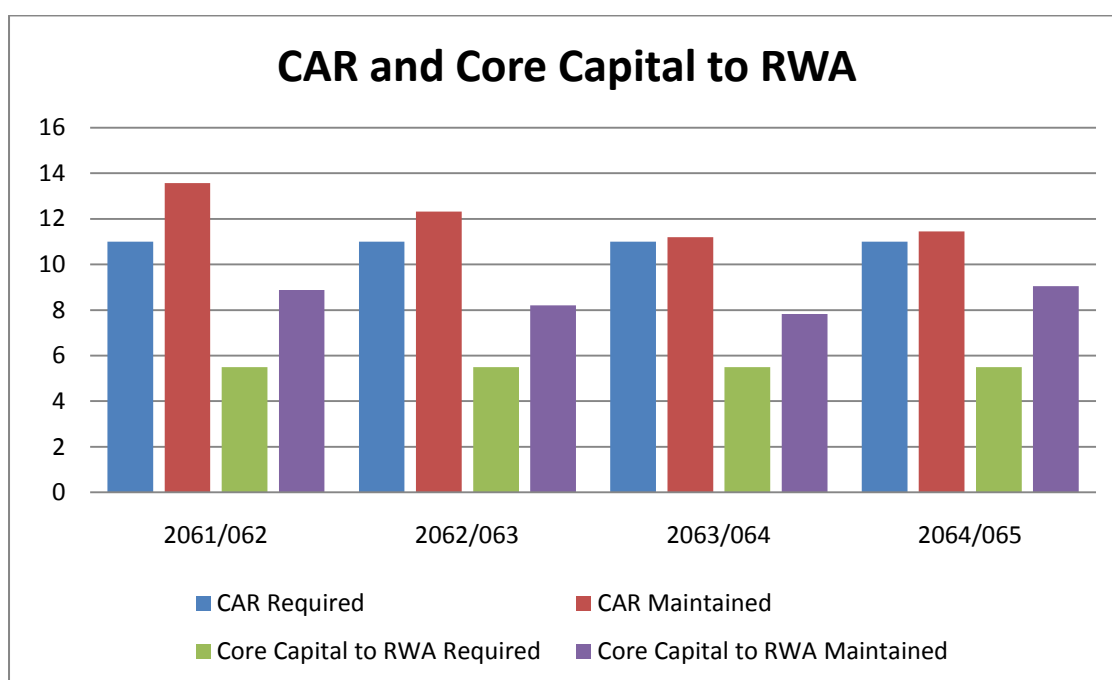
Chart 5
Capital Fund of Everest Bank Ltd.



Source: Annual Report 2061/062 – 2064/065

The chart 5 shows that the core capital, supplementary capitals are in increasing trend. But the supplementary capital is only slightly increasing. This means that the bank has increased the capital fund by increasing the core capital. The portion of core capital in total capital fund is around 71.66 % in four year average while that of supplementary capital is around 28.34 % in four year average. At the same time its risk weighted asset is also increasing each year. If we see the contribution to total capital fund then the portion of core capital is very high and is sufficient enough to meet the CAR also not taking into consideration of supplementary capital. That is shortfall of supplementary capital is fulfilled by core capital but the shortfall in core capital cannot fulfilled from supplementary capital. This means contribution of core capital is more in growth of total capital fund. It reflex that core capital is more important compare to supplementary capital.

Chart 6



Source: Annual Report 2061/062 – 2064/065

The chart 6 shows that core capital to RWA and capital adequacy ratio is in decreasing trend. But it maintained the minimum requirements of Nepal Rastra Bank norms. This chart also shows that Risk Weighted Assets is also increasing each year. If we see the contribution to total capital fund then the portion of core capital is very high and is sufficient enough to meet the CAR.

The Capital Adequacy Ratio and Core capital to Risk weighted Assets of the bank during the fiscal year 2061/062 to 2064/065 is within the limit and excess than requirement.

So, to fulfill the requirements of NRB norms, EBL is forced to increase its capital base. For the fiscal year 2061/062, the bank issued Rs. 630 Lacs bonus shares. Capital adjustment reserve is available for distribution by way of bonus shares to increase the capital. Nepal Rastra Bank had earlier issued Directives to all commercial banks to have a minimum capital base of Rs. 50 crores. This has been since amended and banks are required to have a minimum capital base of Rs. 100 crores by Asadh 2066.

NRB earlier provided that the capital Adequacy ratio should be 8%. This has since been increased to 11 % which was to be 12 % from this financial year but revised to 11 % till the Basel 2 standard comes into effect (2007). The CAR of the bank as at the yearend 16th July 2006 stands at 12.32 %. To maintain the CAR intact, proper capital back up is required. If the banks fail to maintain the required CAR , further growth in bank's business is adversely affected. In view of this, the board decided to issue convertible preference shares of Rs. 20 crores at a premium of Rs. 100 each.

In the fiscal year 2063/064, Nepal Rastra Bank had earlier issued Directive to all commercial banks to have a minimum capital base of Rs. 50 crores. This has since been amended and Banks are required now to have a minimum Capital Base of Rs. 200 crores by 2067.

Premium already received on issue of convertible preference share amounting to Rs. 200 million shall be booked in the current year 2007/08. 7% Convertible Preference Share worth Rs. 200 million has been issued and this amount of capital will be accounted for in this current year. Since we have still six years available for reaching the required figure of Rs. 200 crores, the Directors feel confident that even with the present trend of profit and the policy adopted by the Directors regarding Dividend/Bonus Shares, there will be no difficulty in reaching the figure of Rs. 200 crores by 2067. Detail capital plan has also been submitted to Nepal Rastra Bank in this respect.

To maintain the required capital adequacy norms, EBL has allocated huge portion of profit into different reserve fund which ultimately reduce the shareholders dividend.

Table 11
Portion of dividend on Net profit

	2061/062	2062/063	2063/064	2064/065
Net Profit	168214611	237290936	296409281	451218613
Dividend + bonus share	66315789	94500000	158502316	255193011
Dividend		94500000	45102316	107773011
bonus share	66315789		113400000	147420000
Percentage	39.42 %	39.82 %	53.47 %	56.56 %

Source: Annual Report 2061/062 – 2064/065

The table 11 shows that no cash dividend is provided to shareholders during the year 2061 / 062 and no bonus share at 2062/063. During this two years the remaining amount of profit was set aside as retain earning and also for general reserve. In the fiscal year 2063/64 and 2064/065 the bank has distribute almost more than 50 % of profit as dividend. Bank maintains reserve under capital adjustment reserve so as to meet sufficient capital fund. So, EBL should be very careful and must consider the interest of shareholders and concentrate towards giving good return to its shareholders since shareholders are the real owner of the bank.

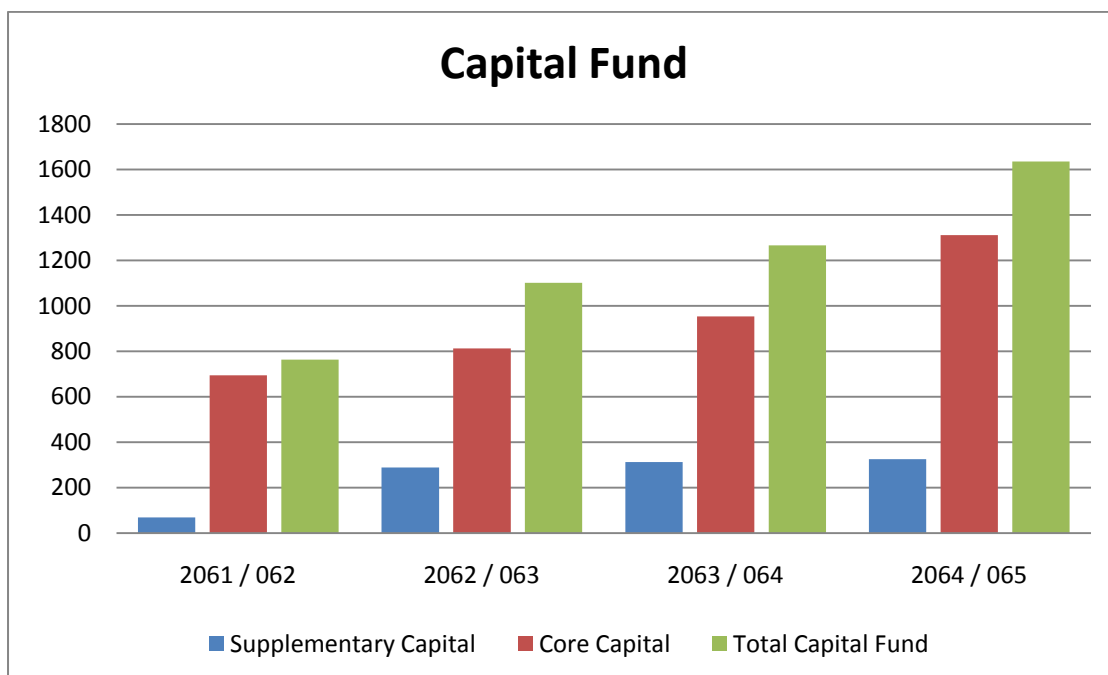
Table 12
Capital Fund of Bank of Kathmandu Ltd.

(Rs. In millions)

	2061/062	2062/063	2063/064	2064/065
Core Capital	694.35	811.92	953.26	1310.85
Supplementary Capital	69.18	288.88	312.56	324.38
Total Capital Fund	763.53	1100.8	1265.82	1635.23
RWA	6936.94	7583.65	10226.19	13702.37
NRB Requirement (%)				
Core Capital to RWA	5.5	5.5	5.5	5.5
CAR	11	11	11	11
Actual Maintained (%)				
Core Capital to RWA	10.02	10.71	9.32	9.57
CAR	11.02	14.52	12.38	11.93
Excess or Shortfall				
Core Capital to RWA				
In %	4.52	5.21	3.82	4.07
RWA (Rs.)	313.55	395.12	390.64	557.69
CAR				
In %	0.02	3.52	1.38	0.93
In Figure (Rs.)	1.39	266.94	141.12	127.43

Source: Annual Report 2061/062 – 2064/065

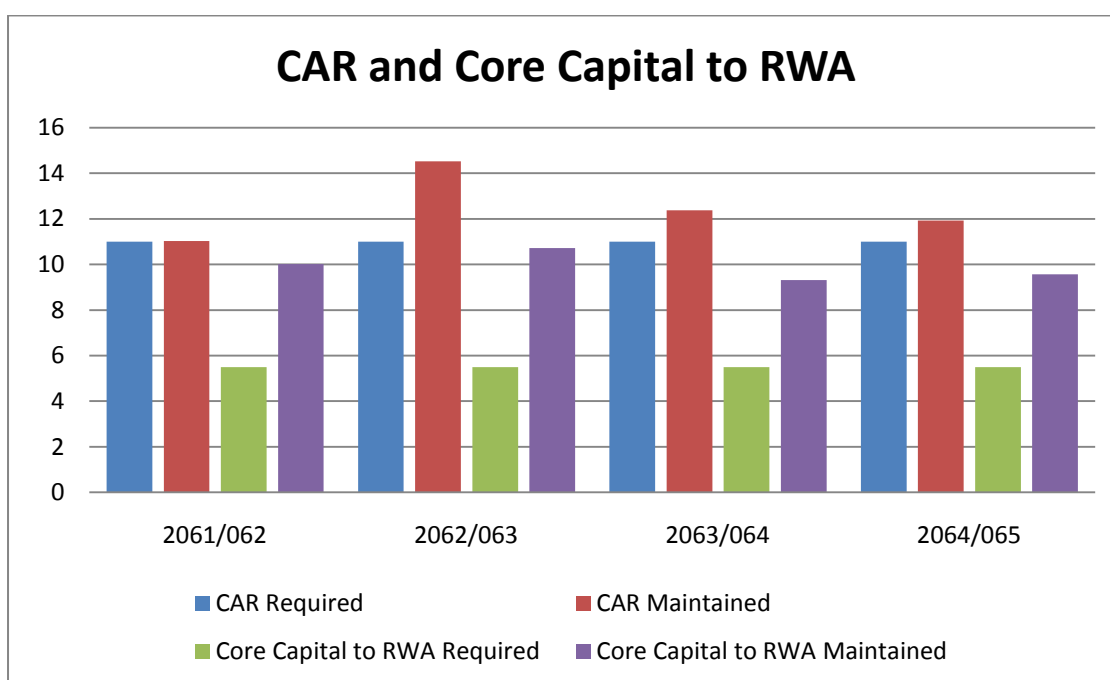
Chart 7
Capital Fund of Bank of Kathmandu Ltd.



Source: Annual Report 2061/062 – 2064/065

The chart 7 shows that the core capital and capital fund are in increasing trend. The Capital Adequate ratio according to the chart is 10.02 %, 10.71 %, 9.32% & 9.57 % respectively. The portion of core capital in total capital fund is 79 % in four year average while the supplementary capital is only 21 %. This chart shows that the bank did not give emphasis to the supplementary capital. In order to full the norms of NRB the bank only increased the core capital and which in turns increase the capital fund of the bank.

Chart 8



Source: Annual Report 2061/062 – 2064/065

The chart 8 shows that CAR and core capital to RWA is in fluctuation trend. Due to the lesser increase in core capital and supplementary capital & the high in increase of RWA the CAR and Core capital to RWA are decreasing in 2063 /064.

For the fiscal year 2062 /063, the bank has issued seven years bond of Rs. 200 million with a coupon rate of 6 % pa. This was planned in order to comply with the minimum capital requirement stipulated by the Nepal Rastra Bank. The issue was fully subscribed within the offer period, as a result of which your bank has been able to increase the capital fund. The Capital Adequacy Ratio stood at 14.52% of Risk Weighted Assets at the end of the financial year 2005/06.

For the fiscal year 2063/064, the bank has been complying the BASEL II directives of the NRB under Capital Adequacy framework.

For the fiscal year 2064 /065, the bank prepares annual budget plan for risk weighted assets and closely monitors the actual against the budget.

Prospective drawdown and repayments plans of loans and advances are watched to track the movement in the portfolio. Furthermore, bank keeps a close watch to changing business environment for strategy planning and revision in order to mitigate anticipated adverse impact on its risk assets portfolio. The bank computes capital adequacy ratios on a periodic basis to ensure sufficient coverage of its risk assets by the qualifying capital fund.

Apart from above, the bank also prepares long term capital plans to support its future activities. The capital plan is assessed to ascertain that the financial result attained is in line with the capital plan devised. Based on the actual figures, if the bank feels that the figures could deviate significantly, the bank revises its long term plan.

The bank also constantly monitors its Credit Deposit ratio in order to assess sources of funds and deployment of funds.

Table 13
Portion of dividend on Net profit

	2061/062	2062/063	2063/064	2064/065
Net Profit	139529721	202440627	262386980	361496879
Dividend + bonus share	69537135	222518832	120628260	253954454
Dividend	69537135	83444562	120628260	12697934
bonus share		139074270		241256520
Percentage	49.84 %	109.92 %	45.97 %	70.25 %

Source: Annual Report 2061/062 – 2064/065

For the fiscal year, 2061/062 the bank has distribute only dividend to shareholders and remaining profit kept as reserve for maintaining the NRB norms for future.

In order to fulfill the bank requirements towards the capital adequacy ratio, the bank issues bonus share as well during the fiscal year 2062 /063.

For the fiscal year 2064 / 065, Profit on total assets increased by 13.37 percent in the reporting period due to better recovery of bad loans, reduction in interest expenses, extension of branches, diversification in the loan portfolio and improvement in management information systems. Despite the challenges presented by the slowdown in the economy and financial market, the bank has able to increase net profit after tax by 37.79 percent in FY 2007/08 in comparison to the previous fiscal year. The bank aims to reduce the percentage of Non Performing Loans from 2.51 percent to 1.86 percent in the fiscal year.

The bank has set aside 20.00 percent from the profit, amounting to NPR 72.30 million in the General Reserve, NPR 2.50 million in Exchange Equalization Fund, NPR 28.60 million for Bond Redemption Reserve and NPR 22.10 million as Retained Earnings.

Approximately NPR 106.7 million was set aside in the Capital Adjustment Reserve up to the last fiscal year; however no addition has been made to this reserve in this fiscal year. Furthermore, no distribution has been made to the shareholders in the last fiscal year. Respected shareholders, as committed in the last AGM and the current proposal, we seek your approval to distribute 40.00 percent bonus shares and 2.11 percent cash dividend (NPR 12.70 million which amounts for 5.00 percent of advance tax adjusted in the cash dividend portion) from the afore mentioned Capital Adjustment Reserves. We would like to inform you that the bank continues to provide all respected shareholders with the facility to open a savings account in your bank at no minimum deposit requirement as in the past.

4.2 Loan and Loan Loss Provision Analysis

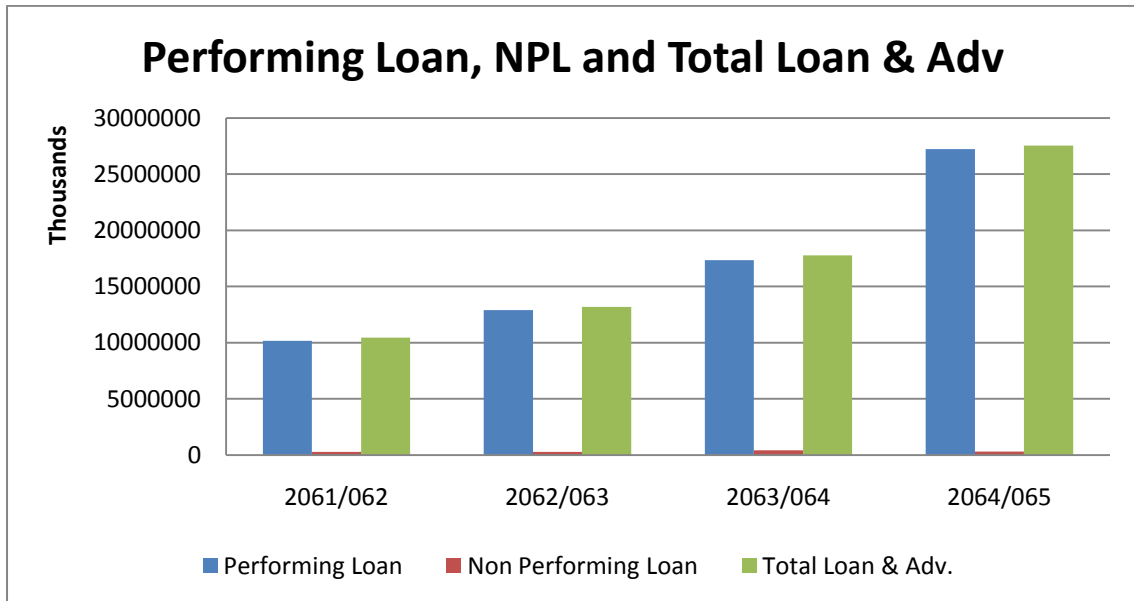
Table 14

Loan and Loan Loss Provision of NIBL

	2061/062	2062/063	2063/064	2064/065
Performing Loan	10172289866	12905658783	17347128354	27219833753
Pass Loan	10172289866	12905658783	17309513613	27176973284
Restructured Loan			37614741	42860469
Non Performing Loan (NPL)	280874131	272493041	421971550	309470983
Sub Standard	821624	44238859	96893690	61737243
Doubtful	74941884	497100	86049276	20724497
Bad	205110623	227757082	239028584	227009243
Total Loan and Adv.	10453163997	13178151824	17769099904	27529304736
Loan Loss Provision (LLP)	327108374	365562289	482678814	532652478
Pass Loan	101059649	128759941	173495470	274449428
Restructured Loan			4701842	5357559
Sub Standard	211972	11059715	24572650	15434311
Doubtful	37557734	248550	43084601	10401937
Bad	188279019	225494083	236817951	227009243
Provision Maintain in %				
Pass Loan	0.99	1.00	1.00	1.01
Restructured Loan			12.52	12.50
Sub Standard	25.80	25.00	25.36	25.00
Doubtful	50.12	50.00	50.07	50.19
Bad	91.79	99.01	99.08	100.00
NRB requirement				
Pass Loan	1 %	1 %	1 %	1 %
Restructured Loan	12.5 %	12.5 %	12.5 %	12.5 %
Sub Standard	25 %	25 %	25 %	25 %
Doubtful	50 %	50 %	50 %	50 %
Bad	100 %	100 %	100 %	100 %
LLP To Total Loan and Adv. (%)	3.13	2.77	2.72	1.93
NPL To Total Loan and Adv. (%)	2.69	2.07	2.37	1.12
LLP To NPL (%)	116.46	134.15	114.39	172.12

Source: Annual Report 2061/062 – 2064/065

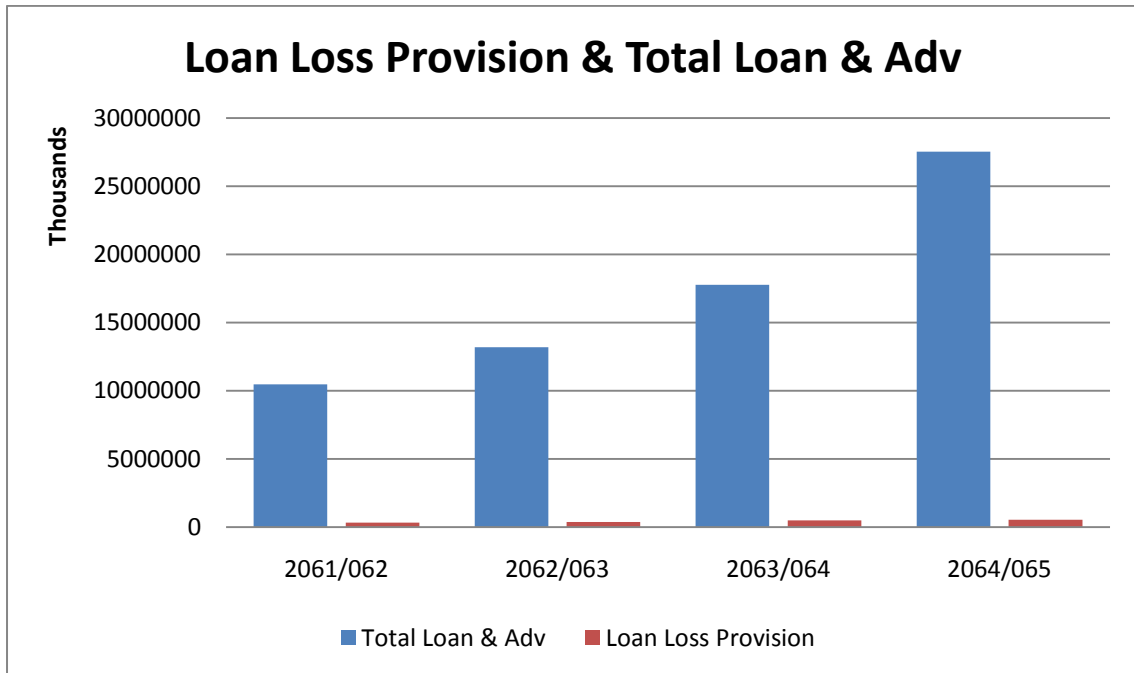
Chart 9
Portfolio of Loan and Advances



Source: Annual Report 2061/062 – 2064/065

The chart 9 shows that the portion of performing loan is increasing every year while portion of non -performing loan is increasing and decreasing. To overcome the problem of non – performing asset Nepal Investment Bank Ltd is reducing its NPA accounts as well also to reduce the burden of maintaining high provision of NPA accounts. Total loan and advances increases more than 60 % in the year 2064 /065 with the increases in performing loan which is a good sign for Nepal Investment Bank as interest earned in loan amount is the main source of income for commercial banks. Due to the norms of NRB directives Nepal Investment Bank is reducing its non - performing loan.

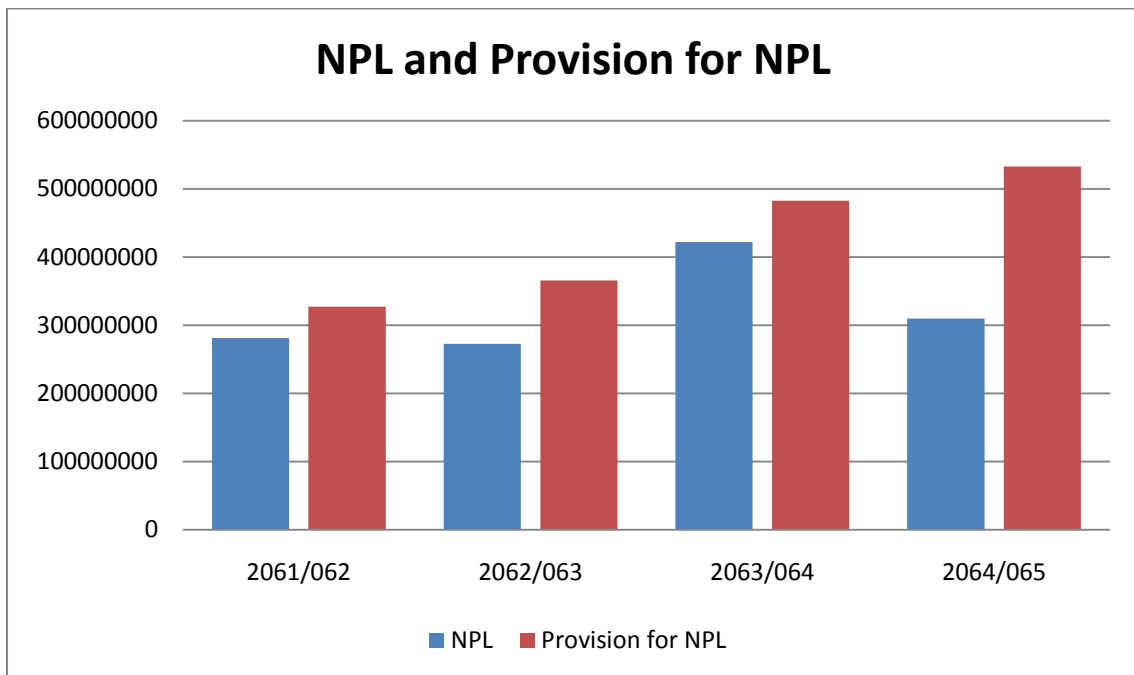
Chart 10
Loan Loss provision of NIBL



Source: Annual Report 2061/062 – 2064/065

The chart 10 shows that the ratio of non – performing loan is not so high in compare to total loan & advances. This shows that the Nepal Investment Bank is maintaining their non – performing loan. The figure also shows that the ratio of loan loss provision is decreasing from 3.13 % to 1.93 %. It signifies that the good quality of assets in the volume of loan and advances. So we can take it as Nepal Investment Bank’s efficiency and effectively managing its loan and advances and coping with probable loan loss and also complying with the NRB norms. If there had not been NRB guidelines to maintain high provision on non – performing loan, then there might be high portion of non – performing loan in the total loan portfolio.

Chart 11



Source: Annual Report 2061/062 – 2064/065

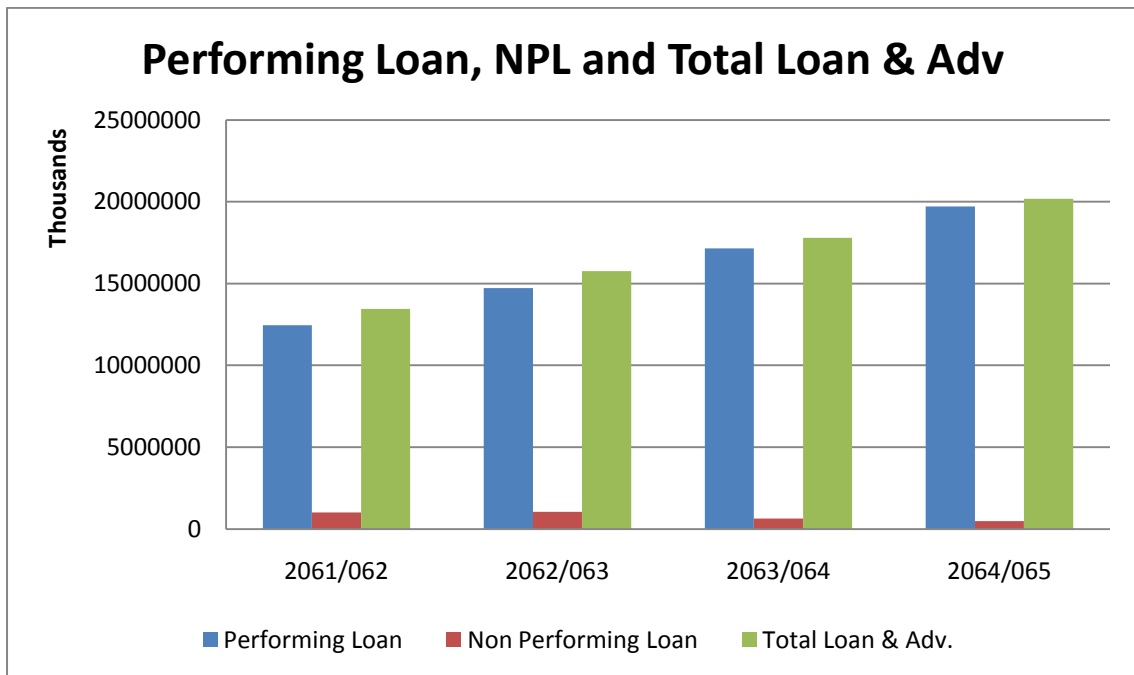
The chart 11 shows that Nepal Investment Bank is maintaining its non – performing loan with loan loss provision. In the fiscal year 2063 / 064 the non – performing loan ratio is very high in comparative to other years. If the non – performing loan of Nepal Investment Bank Ltd is in this ratio simultaneously then bank has to prepare for high loan loss provision. If the bank is not maintaining the required provision and high portion of bad loan, Nepal Investment Bank’s loan is exposed to risk and also cannot cope with the future contingencies that may cause due to NPL. High provision is better but since amount maintained for provision remains idle and does not yield any return, it may have negative impact in return or profit will be affected so, to remain unaffected, from profit point of view, the NRB norms for loan loss provision should be appropriate or NPL has to be reduced by the banks. In the fiscal year 2064 /065 the ratio of NPL is decreasing in compare to fiscal year 2063 /064. That means the Nepal Investment Bank’s bad loans are recovered.

Table 15
Loan and Loan Loss Provision of HBL

	2061/062	2062/063	2063/064	2064/065
Performing Loan	12449820947	14721218259	17152108557	19702383946
Pass Loan	11821694843	14055103815	16697714159	19357600250
Restructured Loan	628126104	666114444	454394398	344783696
Non Performing Loan (NPL)	1001347320	1040757823	641615306	477229223
Sub Standard	69549651	107227888	72076059	53919981
Doubtful	242116379	228498188	194976256	214476314
Bad	689681290	705031747	374562991	208832928
Total Loan & Adv.	13451168267	15761976082	17793723863	20179613169
Loan Loss Provision (LLP)	1026647621	1119416527	795726817	682092687
Pass Loan	117648411	141354553	167225322	196490075
Restructured Loan	66276399	53456562	140064491	156137866
Sub Standard	41866119	61953985	18349848	13479995
Doubtful	114358189	155755034	97488128	107238157
Bad	686498503	706896393	372599028	208746594
Provision Maintain in %				
Pass Loan	1	1.01	1.00	1.02
Restructured Loan	10.55	8.03	30.82	45.29
Sub Standard	60.20	57.78	25.46	25.00
Doubtful	47.23	68.16	50.00	50.00
Bad	99.54	100.26	99.48	99.96
NRB requirement				
Pass Loan	1 %	1 %	1 %	1 %
Restructured Loan	12.5 %	12.5 %	12.5 %	12.5 %
Sub Standard	25 %	25 %	25 %	25 %
Doubtful	50 %	50 %	50 %	50 %
Bad	100 %	100 %	100 %	100 %
LLP To Total Loan and Adv. (%)	7.63	7.10	4.47	3.38
NPL To Total Loan and Adv. (%)	7.44	6.60	3.61	2.36
LLP To NPL (%)	102.53	107.56	124.02	142.93

Source: Annual Report 2061/062 – 2064/065

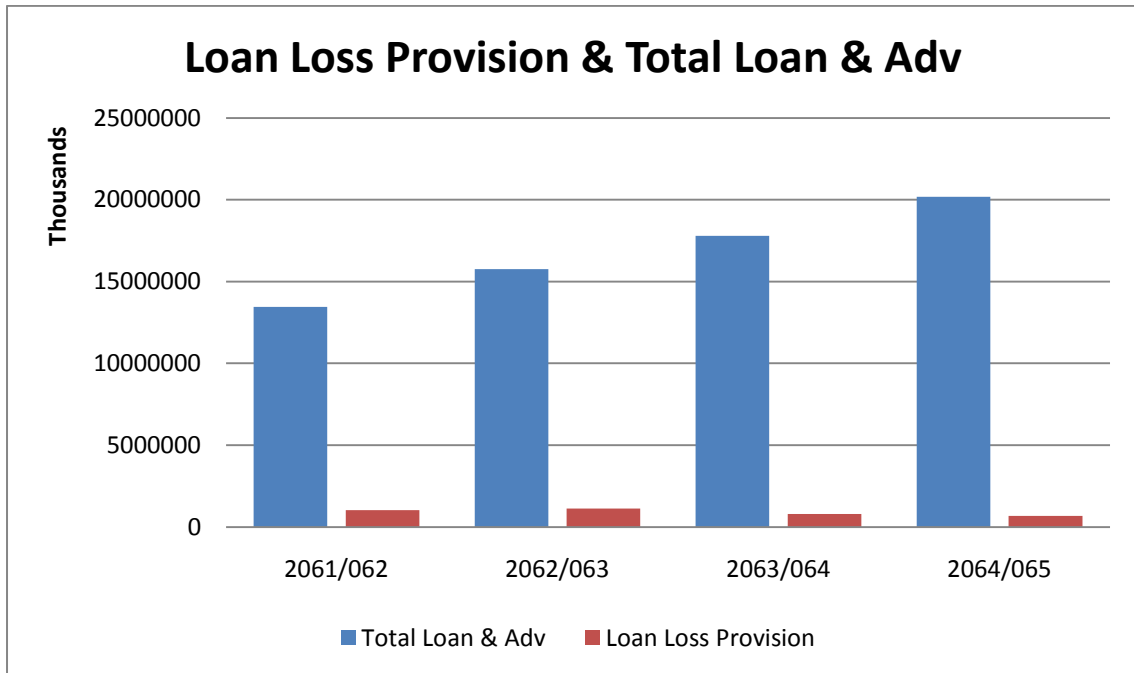
Chart 12
Portfolio of Loan and Advances



Source: Annual Report 2061/062 – 2064/065

In chart 12, we find that performing loan and total loan & advances are increasing every year whereas the non-performing loan is decreasing every year. That means the Himalayan Bank maintained in distributing loan. The non-performing loan also decrease from 7.44 % to 2.36 %. The bank does not have to maintain high Loan Loss provision. So, the Loan loss provision is also decreasing in the same way i.e. from 7.63 % to 3.38 %. Though we can say that Himalayan Bank Ltd. Is trying to make its assets good and earn interest without bearing any risk. Due to the norms of NRB directives Himalayan Bank is reducing its non-performing loans and increasing its portion of performing loan in the portfolio of total loan and advances.

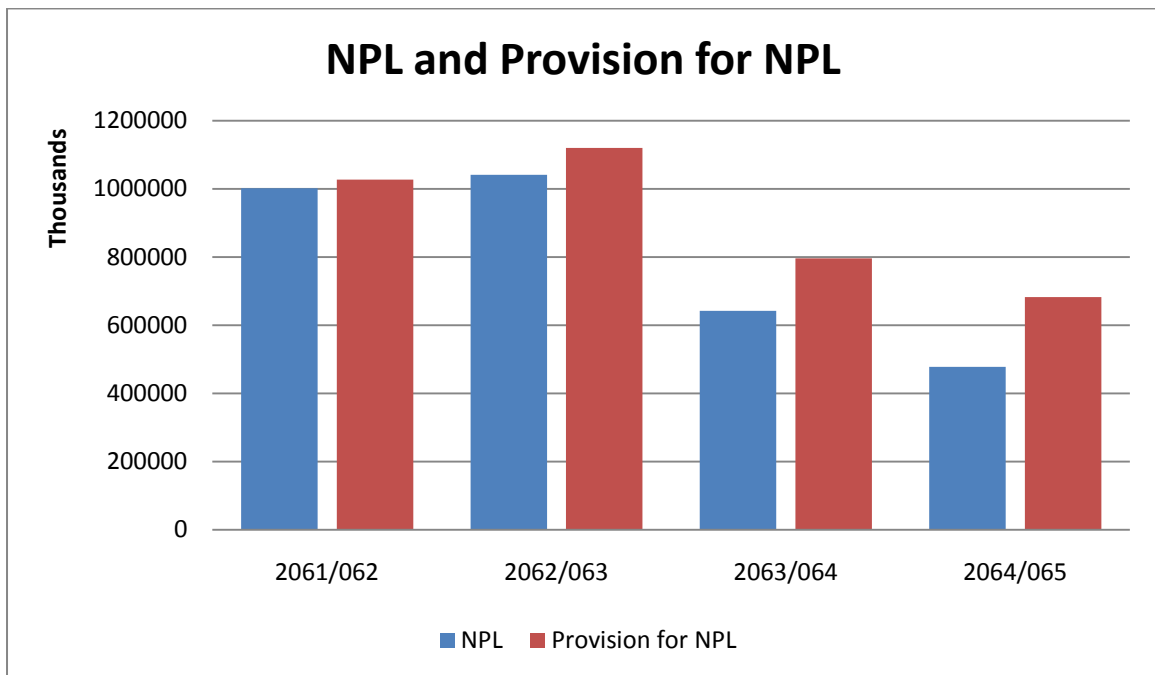
Chart 13
Loan Loss provision of HBL



Source: Annual Report 2061/062 – 2064/065

The chart 13 shows that the Total loan and advances are in increasing trend and the loan loss provision are in decreasing trend. This chart shows that the Himalayan Bank does not need to maintain high provision though the total loan and advances are indicating higher ratio. This four year non – performing loan trend also shows that the non – performing loan is decreasing trend or lower ratio. This also signifies that the quality of assets in the volume of loan and advances. We can say that Himalayan Bank is effectively managing its loan and advances. This Bank does not have to maintain high provision for NPL because of lower ratio of non – performing loan.

Chart 14



Source: Annual Report 2061/062 – 2064/065

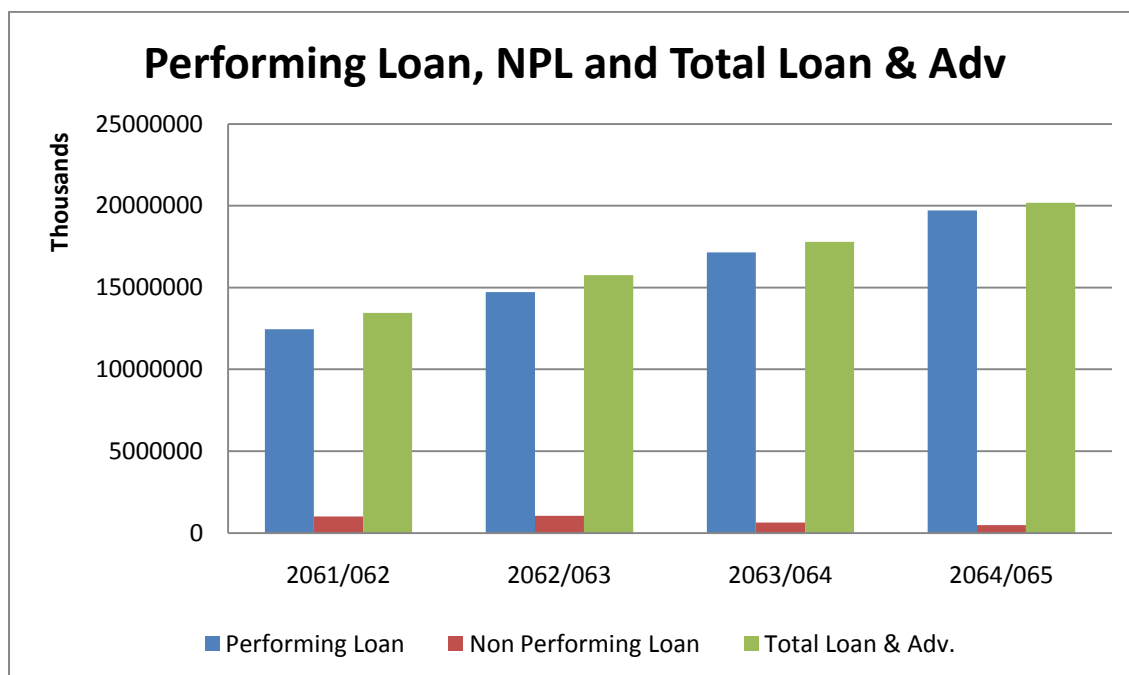
The chart 14 shows that the Himalayan Bank provision for NPL is in high ratio or more than requirements. We can assume that high provision is better but since amount maintained for provisions remains idle and does not yield any return, it may have negative impact in return or profit will be affected. So, to remain unaffected from profit point of view, the NRB norms for loan loss provision should be appropriate or NPL has to be reduced by the banks. The provision maintained by HBL under Bad debts is more or less in compare to NRB. The data shows that NRB are not complying the norms of NRB according to the directives. The loan loss provision towards Bad loan is just the requirement level, so the HBL must reduce its bad loans in order to maintain the provision.

Table 16
Loan and Loan Loss Provision of EBL

	2061/062	2062/063	2063/064	2064/065
Performing Loan	7771282526	10007018658	13969507151	18709121394
Pass Loan	7453205999	9757195136	13750623016	18555269076
Restructured Loan	318076527	249823522	218884135	153852318
Non Performing Loan (NPL)	128807745	129235790	113178916	127310368
Sub Standard	4408738	10669326	4218482	6306745
Doubtful	1977471	683784	2353269	745926
Bad	122421536	117882680	106607165	120257697
Total Loan & Adv.	7900090271	10136254448	14082686087	18836431762
Loan Loss Provision (LLP)	281418795	334946772	418604424	497346200
Pass Loan	74532060	97571951	137506230	185552691
Restructured Loan	37732600	31227941	27360517	19231540
Sub Standard	1102184	2667331	1054621	1576686
Doubtful	988735	341892	1176645	372963
Bad	122421536	117882680	106607165	120257697
Additional Provision	44641680	85254977	144899246	170354623
Provision Maintain in %				
Pass Loan	1.00	1.00	1.00	1.00
Restructured Loan	11.86	12.50	12.50	12.50
Sub Standard	25.00	25.00	25.00	25.00
Doubtful	50.00	50.00	50.00	50.00
Bad	100.00	100.00	100.00	100.00
NRB requirement				
Pass Loan	1 %	1 %	1 %	1 %
Restructured Loan	12.5 %	12.5 %	12.5 %	12.5 %
Sub Standard	25 %	25 %	25 %	25 %
Doubtful	50 %	50 %	50 %	50 %
Bad	100 %	100 %	100 %	100 %
LLP To Total Loan and Adv. (%)	3.56	3.30	2.97	2.64
NPL To Total Loan and Adv. (%)	1.63	1.27	0.80	0.68
LLP To NPL (%)	218.48	259.17	369.86	390.66

Source: Annual Report 2061/062 – 2064/065

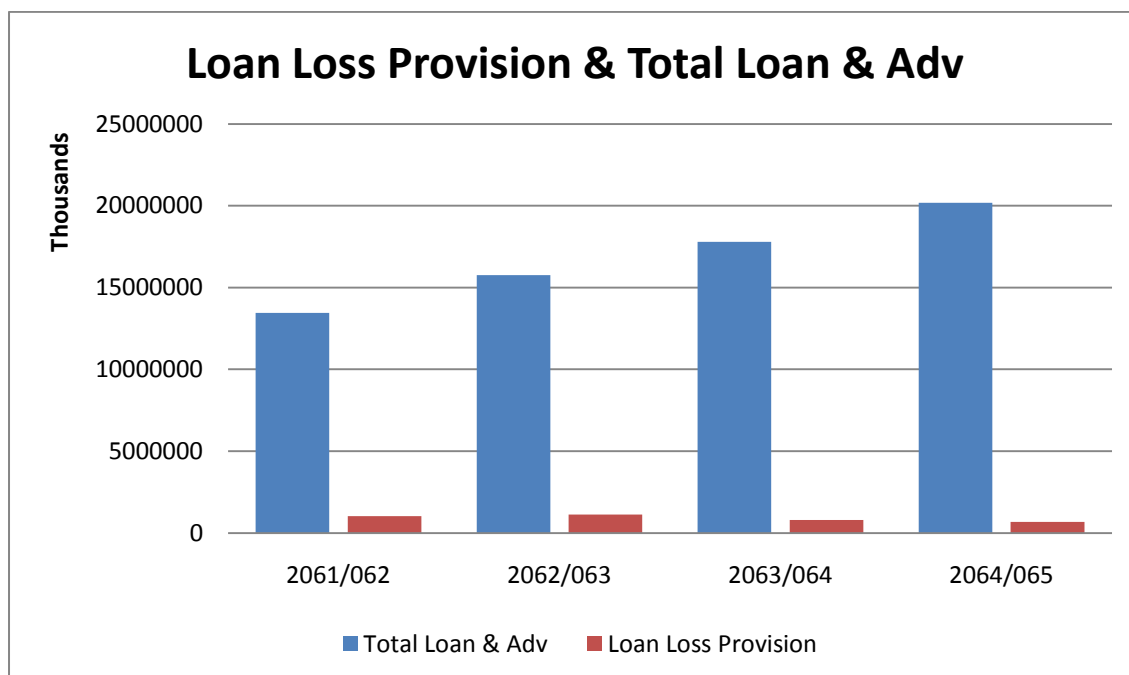
Chart 15
Portfolio of Loan and Advances



Source: Annual Report 2061/062 – 2064/065

The EBL chart 15 shows that the performing loan and total loan & advances are in increasing trend where as non – performing loan are in increasing or decreasing trend. The portion of performing loan on total loan and advances is 99 % in four years average while the non - performing loan is only 1 %. The Everest Bank Ltd does not have to maintain high portion of loan loss provision to overcome the non – performing loan. But Among the non – performing loan, the portion of bad loan is 93 %. This shows that the HBL must kept the loan loss provision according to norms of NRB. As a whole it informs that Everest Bank has a good quality of assets and earns interest without bearing any risk. Due to the norms of NRB directives Everest Bank is increasing its portion of performing loan in the portfolio of total loan and advances. There by reducing the burden of maintaining high provision for NPL.

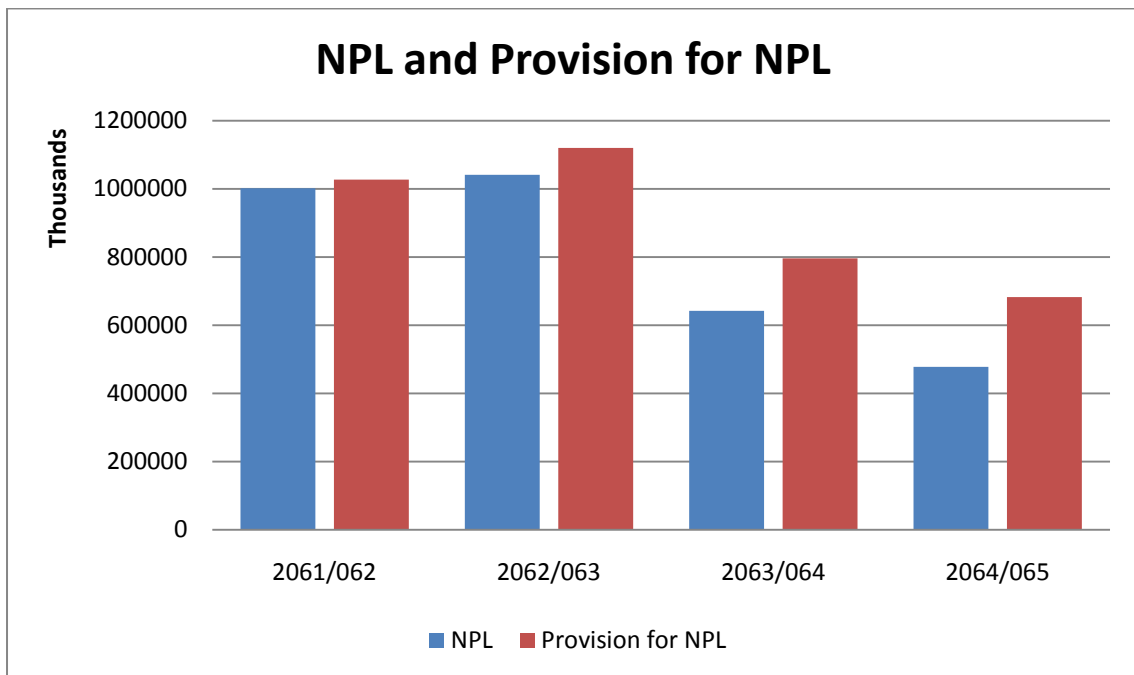
Chart 16
Loan Loss provision of EBL



Source: Annual Report 2061/062 – 2064/065

The ratio of loan loss provision to total loan and advances of Everest Bank is 3.56 % to 2.64 %. Since high provision is to be maintained for non – performing loan, higher ratio indicates high portion of non – performing loan in the total loan and advances. But here Everest Bank shows that the portion of non – performing loan is in decreasing trend. This signifies the good quality of assets in the volume of loan and advances. So we can take it as Everest Bank’s efficiency and effectively managing of its loan and advances and coping with probable loan loss and also complying with the NRB norms. If there had not been NRB guidelines to maintain high provision on non – performing loan, then there might be high portion of non – performing loan in the total loan portfolio.

Chart 17



Source: Annual Report 2061/062 – 2064/065

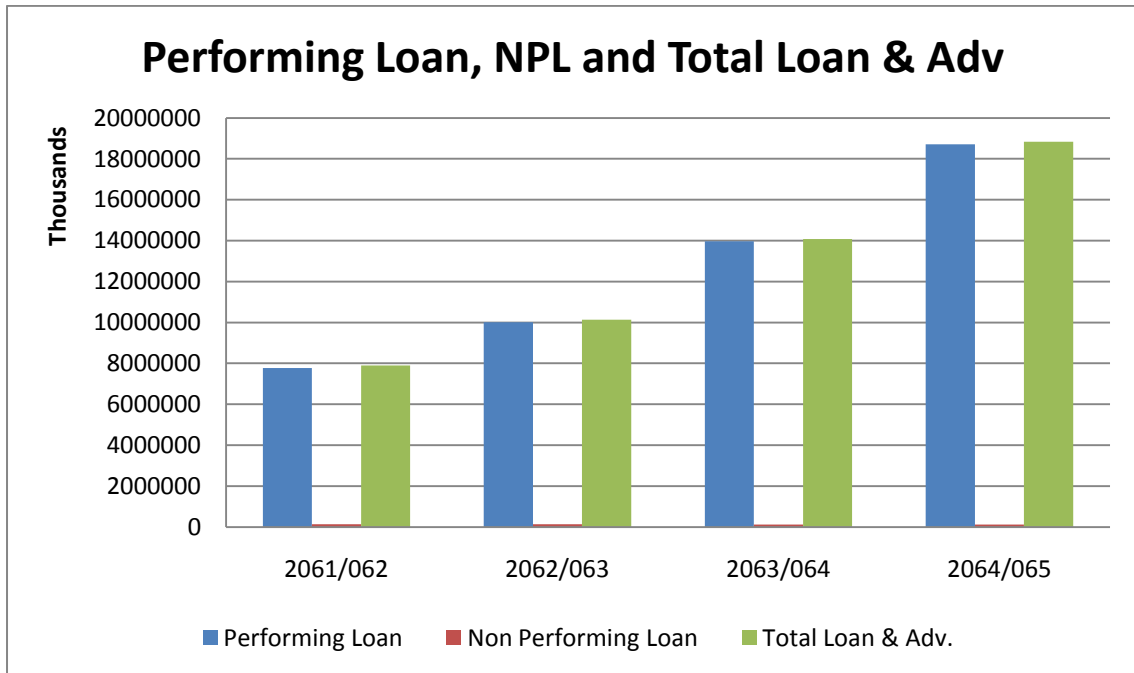
Here the Everest Bank is maintaining high ratio of provision for non – performing loan. This is maintained to recover the bad loan. But by maintaining the requirement Everest bank has corrected its mistake and complies with the NRB norms. Maintaining high provision is to provide security from loan loss but maintaining in excess may be disadvantageous to the bank. As amount maintained for provision remains idle and does not yield any return, it may have negative impact in return or profit will be affected so, to remain unaffected from profit view point bank must maintain provision as required. The provision made by EBL is just the recovered provision for the bank or only just to maintain the norms of NRB’s directives. There is no more or less in the maintaining the provision for total loan and advances of the bank.

Table 17
Loan and Loan Loss Provision of BOK

	2061/062	2062/063	2063/064	2064/065
Performing Loan	5873538981	7285076453	9450805704	12510822753
Pass Loan	5723971845	7123200804	9346807209	12435224273
Restructured Loan	149567136	161875649	103998495	75598480
Non Performing Loan (NPL)	308506039	203624470	243296250	236898850
Sub Standard	88423249	71610921	39863342	100176762
Doubtful	89806458	8804237	36576083	19246769
Bad	130276331	123209312	166856825	117475319
Total Loan & Adv.	618045019	7488700923	9694101954	12747721603
Loan Loss Provision (LLP)	269465546	229618344	294774337	285084062
Pass Loan	56712104	70834087	93163590	124039462
Restructured Loan	18695892	20234456	12999812	9449810
Sub Standard	22086406	17902730	9965836	25044190
Doubtful	42119735	4402118	18288042	9623384
Bad	129851409	116244952	160357057	116927215
Additional Provision				
Provision Maintain in %				
Pass Loan	0.99	0.99	1.00	1.00
Restructured Loan	12.50	12.50	12.50	12.50
Sub Standard	24.98	25.00	25.00	25.00
Doubtful	46.90	50.00	50.00	50.00
Bad	99.67	94.35	96.10	99.53
NRB requirement				
Pass Loan	1 %	1 %	1 %	1 %
Restructured Loan	12.5 %	12.5 %	12.5 %	12.5 %
Sub Standard	25 %	25 %	25 %	25 %
Doubtful	50 %	50 %	50 %	50 %
Bad	100 %	100 %	100 %	100 %
LLP To Total Loan and Adv. (%)	4.36	3.07	3.04	2.24
NPL To Total Loan and Adv. (%)	4.99	2.72	2.51	1.86
LLP To NPL (%)	87.35	112.77	121.16	120.34

Source: Annual Report 2061/062 – 2064/065

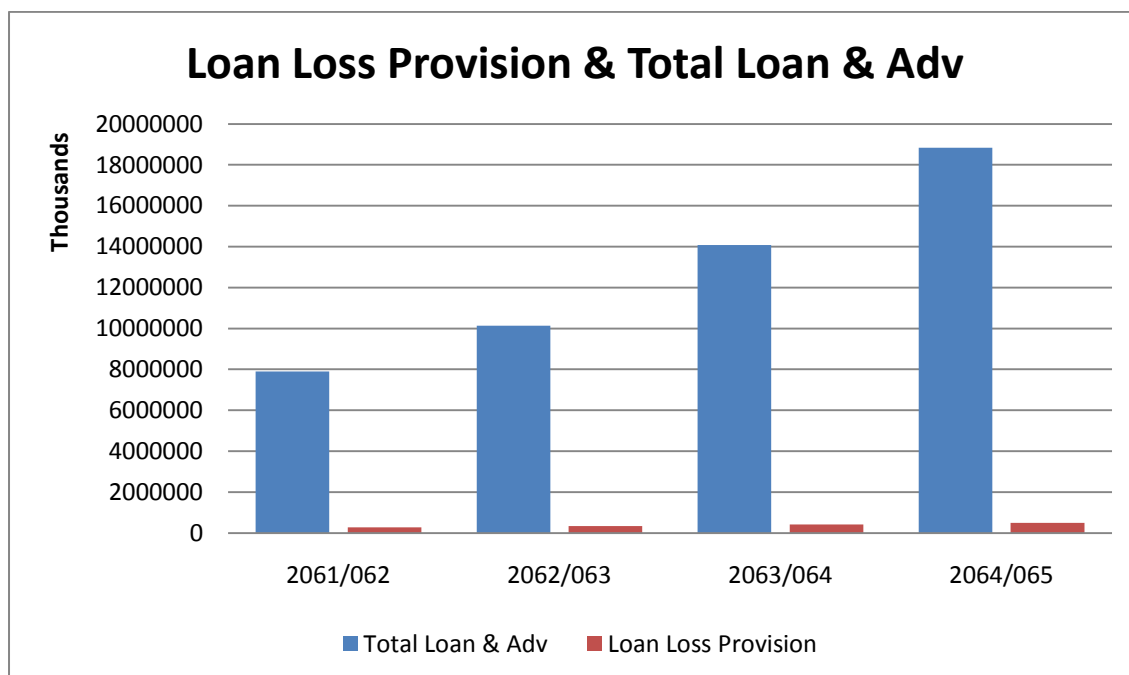
Chart 18
Portfolio of Loan and Advances



Source: Annual Report 2061/062 – 2064/065

The chart 18 shows that the performing loan and total loan and advances are in increasing trend whereas non performing loan are in fluctuation. In 2062 /063 the non – performing loan are decreased by 33.99 % where as it is increased in 2063 / 064 by 19.48 %. Thus in 2064 / 065 it is decreased by 2.62 %. Thus we can analyze that the BOK is monitoring their Performing loan, non – performing loan and total loan & advances. We can also say that BOK is distributing its loan very carefully and by increasing the portion of performing loan in the portfolio, BOK is trying to make its assets good and earn interest without bearing any risk. Due to the norms of NRB directives BOK is increasing its portion of performing loan in the portfolio of total loan and advances. There by reducing the burden of maintaining high provision for NPL.

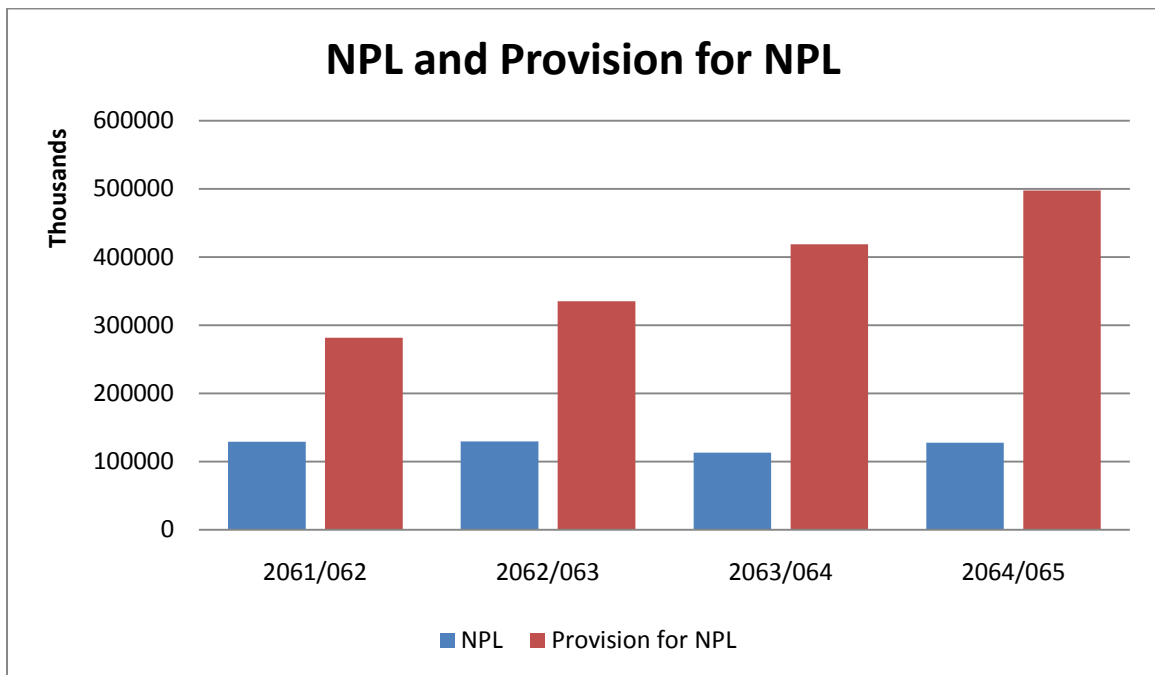
Chart 19
Loan Loss provision of BOK



Source: Annual Report 2061/062 – 2064/065

The ratio of loan loss provision to total loan and advances of BOK are 4.36 %, 3.07 %, 3.04 % and 2.24 respectively. Since the non – performing loan of BOK is in decreasing trend and so the loan loss provision is also in decreasing trend. The provision made by the BOK is not comply with the norms of NRB’s directives. More or less it is near to the norms of NRB’s directives. So, the BOK is very careful in maintaining the provisions. By maintaining high ratio of loan loss provision it also impact the company profit and the burden for bank. The total loan and advances of BOK is in increasing trend. So, they are maintaining provision according to NPA and we also signify that the bank has a good quality of assets in the volume of loan and advances.

Chart 20



Source: Annual Report 2061/062 – 2064/065

The chart 20 shows that the provision for NPL is in increasing trend throughout the above year in compare to non – performing loan. This chart shows that large amount of fund has been maintained for the non – performing loan. This seems to be good sign for bank but also burden for bank because of excess amount of fund is in idle without profit. The bank needs to be careful in managing the provision for NPL. But they are able to maintain the norms of NRB directives.

4.3 Correlation Analysis

As we know interest income is the important source of income of the bank, total loan and advances disbursed by the bank plays important role in the income of the bank. The correlation coefficient between the loan and advances and interest income describes the degree of relationship between these two variables. If we see these two variables then loan and advances is independent variable whereas interest income is dependent variable. Hence through this comparison we can find out the changes taken place in interest income with every change in loan and advances. To what extend is the impact

of loan and advances on interest income of bank can be calculated or is exhibited by the correlation coefficient.

Table 18
Statistical data of sample banks

	Co – efficient of Correlation (r)	Relationship	Co – efficient of Determination (r ²)	Probable Error (PE)	6 * PE	Significant or Insignificant
NIBL	0.991419	High degree of positive correlation	0.982911	0.0058	0.0346	Significant
HBL	0.980608	High degree of positive correlation	0.961592	0.0130	0.0777	Significant
EBL	0.987455	High degree of positive correlation	0.975067	0.0084	0.0505	Significant
BOK	0.890821	High degree of positive correlation	0.793562	0.0696	0.4177	Significant

The table 25 shows that coefficient of correlation (r) of NIBL, HBL, EBL and BOK are 0.9914, 0.9806, 0.9875 and 0.8908 respectively. I.e. there is high degree of positive correlation between loan and advances and interest income of all the four banks. It means with every increase in the volume of loan and advances there will also be increment in the interest income with the same volume. So there is a close relationship between loan and advances and interest income.

The coefficient of determination (r²) for NIBL is 0.9829; it means 98.29 % of the total variation in interest income (dependent variable) has been explained by the loan and advances (independent variable). Similarly for HBL it is 0.9616, it means 96.16 % of the total variation in interest income (dependent variable) has been explained by the loan and advances (independent variable), for EBL it is 0.9751, it means 97.51 % of the total variation in interest income (dependant variable) has been explained by the loan and advances (independent variable) and finally for BOK it is 0.7936, it means 79.36 % of the total variation in interest income (dependant variable) has been explained by the loan and advances (independent variable).

The correlation coefficient of NIBL, HBL, EBL and BOK are 0.9914, 0.9806, 0.9875 and 0.8908, which are greater than 6 times the values of their respective probable error, hence we can interpret that the correlation between two variables loan and advances and interest income of all the four banks is certain and significant and as well there is closeness between these two variables.

Complying with the NRB norms, the bank will be financially healthy and stronger in the long run. The money of depositors is secured through capital adequacy norms and loan and loan loss provisioning, protect the bank from bankruptcy, Credit risk is minimized through loan loss provisioning, NRB directives will bring prosperity not only to the bank but also to its shareholders, depositors, employees and also to the economy of the country as a whole. At the moment when the country has already acceded to WTO and the regional economic integration being a seriously discussed issue, adopting international standard in the banking industry will make it efficient and competitive with the international banks.

4.4 Major Findings

The major findings of the study are as follows:

Nepal Investment Bank Ltd

The core capital to RWA and CAR are within the limit and excess, during the study period. The core capital and supplementary capital in all four years are in increasing trend. The bank issue right share 1:1 and raised the capital of NPR 295 million during the year 2061 / 062 in order to maintain the minimum capital requirements. In the year 2062 / 063 the bank issued 7 years bond worth Rs 250 million because of insufficient supplementary capital. In the fiscal year 2064 /065, the bank issue bonus share and right share 33.33 % and 50 % and make the capital 2.4 billion which fulfill the minimum requirements of Nepal Rastra Bank. According to Tier 1 core capital ratio of 5.5 % required by the government, the bank has successfully fulfilled the norms of Nepal Rastra Bank.

During the study, performing loan of NIBL is in increasing trend which is the good sign for NIBL whereas NPL is in increasing or decreasing trend. In 2064 / 065 the NPL is only 1.12 % and the provision is 172.12 %. The provision made for NPL are 116.46 %, 134.15 %, 114.39 % and 172.12 % respectively during the year 2061 / 062, 2062 / 063, 2063 / 064 and 2064 / 065. Provision value is increasing every year.

Himalayan Bank Ltd

The core capital and supplementary capital of HBL is in increasing trend. The capital adequacy ratio and core capital to risk weighted assets is in limit and even excess. The bank has appropriation 20 % of the net profit to the Statutory General Reserve fund to increase the capital adequacy norm prescribed by NRB. In the fiscal year 2062 / 063 excess investment in share amounting to Rs 2331160 has been deducted from core capital as required by NRB directive. In the same year Rs 38610000 is proposed for bonus shares and Rs 38610000 has been transferred to capital adjustment fund from Profit and Loss appropriation account to make the bank's minimum paid up capital as per Nepal Rastra Bank's directive.

The loan loss provision is maintained according to the ratio of NPL. The NPL of HBL is in decreasing trend. The HBL has increased the performing loan in the portfolio of total loan and advances.

Everest Bank Ltd

The core capital and supplementary capital are in increasing trend but here the huge amount of capital is increase only in core capital. That means EBL gives more emphasis to core capital. So, to fulfill the requirements of NRB norms, EBL is forced to increase its capital base. In the year 2061 / 062 the bank issue Rs 630 lacs bonus share. The bank has also issue convertible preference shares of Rs 20 crores at premium of Rs 100 each. In the fiscal year, NRB had earlier directive to all commercial banks to have a minimum capital base of Rs. 50 crores. This has since been amended and banks are required to have minimum capital base of Rs 200 crores by Asadh 2067. Premium already received on issue of convertible preference share

amounting to Rs 200 million shall be booked in the current year 2007 / 08. 7 % convertible premium share worth Rs 200 million has been issued and this amount of capital will be accounted for in this current year. So, the EBL has successfully maintained the requirements of Nepal Rastra Bank.

The performing loan of EBL is in increasing trend whereas the NPL is in decreasing trend and all the required norms are complied by EBL according to NRB.

Bank of Kathmandu Ltd

The core capital and supplementary capital is in increasing trend. This bank also maintains the minimum requirement of NRB in case of CAR and core capital to RWA. During this year 2062 / 063, the bank has issued seven years bond of Rs 200 million with a coupon rate of 6 % pa. This was planned in order to comply with the minimum capital requirements stipulated by NRB. The capital adequacy ratio stood at 14.52 % of RWA at the end of the financial year 2005 / 06. For the fiscal year 2063 / 064, the bank has been complying the Basel II directives of the NRB under the capital adequacy framework. For the fiscal year 2064 / 065, the bank computes CAR on a periodic basis to ensure sufficient coverage of its risk assets by the qualifying capital fund.

During this periodic study, the performing loans are in increasing trend whereas NPL are in decreasing trend. So here the BOK has a good quality of assets. The provision made by the banks for the NPL or Bad loan is also maintained under the norms of NRB's directives.

The coefficient of correlation, coefficient of determinants and probable error of all the banks show that interest income is closely related with loan and advances and with every increase in the value of loan and advances, there is increase in interest income too. So, interest income is dependent on total loan and advances.

CHAPTER 5

SUMMARY, CONCLUSION & RECOMMENDATION

5.1 Summary

This study is based on guidelines or directives issued by NRB. Here the study shows the implementation of directives on commercial bank and its effects. The study shows the improvement of directives applied on commercial bank. At present NRB has issued sixteen directives for the financial sector. This study is focus only on two directives of NRB viz. Capital Fund and Loan classification and Loan loss provision. The four banks (NIBL, HBL, EBL and BOK) are taken as sample for this study. This study is based on to finds out the repercussion of the directives. It also analyzes the performance of selected banks in regards with the selective directives of the specific period. This study also shows the reaction of commercial bank towards NRB's directives. This study tells us the successful implementing of NRB's directives on commercial banks. Along with these the study is finding that how the banks have been implementing the directives and how the central bank has been monitoring and supervising the directives in the performance and activities of commercial banks.

For the data analysis, financial tools such as CAR, Core capital to RWA, Loan loss provision to NPL, Loan loss provision to Total loan, NPL to total loan ratio has been study for the capital fund analysis and loan classification and loan loss provision. For the statistical tools, the relation between the two variables interest income and loan and advances are used for the correlation analysis.

The study shows that core capital and supplementary capital are in increasing trend. Basically the sample commercial banks give more emphasis to core capital. In order to increase the core capital the banks has maintained different reserves from the profit and issue the shares. The provision made for

loan loss is also maintained by these banks according to NRB. The loan and advances and interest income is the independent and dependent variable. The relation between these two variables is analysis. In the context of correlation analysis the study shows that there is high degree of positive correlation between loan and advances and income interest of all the four banks. We can also interpret that the correlation between two variables of all the four banks are significant. In this context the only the satisfactory sector is banking and financial institution.

5.2 Conclusion

Based on the above summary and findings, the study has drawn the following conclusion. Commercial banks of Nepal are bound by the NRB Directives and are currently bound by Unified Directives issued for all financial institutions. The directive 1 has set norms on capital adequacy for commercial banks. Every commercial bank has to meet the requirement of capital adequacy as stated by the directive. Capital adequacy is the portion of capital fund with regards to risk weighted assets that a commercial bank holds. Capital adequacy is required to safeguard the money of the depositors as well as the sound movement of financial institutions. The NRB issued this directive in order to maintain the international standard and control the financial institution. Similarly the directive 2 has set norms on Loan classification and loan loss provision for commercial banks. The provision for loan loss made by NRB mandatory is likely to apply by the commercial banks. This provision is made in order to safeguard from bankruptcy if loaned amount is not recovered. This provide buffer against future unexpected losses.

The study analyzed that all the banks are successful to comply with the requirements of capital adequacy norms. The provision maintained by sample commercial banks for loan loss provision is likely to NRB's directives. The loan loss provisions of all the banks are more or less with provision maintained by the central bank. The bank must make the provision under the

norms of NRB in order to save the bank from the bankruptcy. This is to maintained not only to fulfill the norms of NRB's directives, the bank also has to realize that the banks are responsible towards the interest of depositors. The correlation analysis is done between two variables interest income and total loan and advances as the interest is the main source of income of all the banks. The correlation analysis shows that there is the high degree of positive correlation. The study concludes that the loan flow operations of these banks are significant. The banks under study, these all bank are successful to comply with requirement of NRB's directives norms.

5.3 Recommendation

The central bank has recently come up with new circular to the commercial banks to comply with the recently amended directives. The directive vows to improve the overall economy of the financial sector in the long run. It is in accord to various international norms and standards. In this regard, NRB and commercial bank has to take into consideration the following points.

- NRB must do enough homework to come up with new directives or modifying the existing directives to apply.
- NRB must consult with various banks officials before setting or resetting standards on such capital norms. The complaints and criticisms of bank officials should be considered accordingly. Consequently, an optimal standard will be ensured which will satisfy almost everyone.
- NRB should not succumb into international pressure from IMF or World Bank and issue the directive just for the sake of issuing it.
- NRB has to facilitate Credit information Bureau so that all the commercial banks receive the updated list of the black listed borrowers as soon as possible. This helps to reduce the chance of creating bad quality assets in the bank's balance sheet.
- NRB should enhance the monitoring and supervision aspect of the directives and should timely publicize the reports.

- It is always wise and beneficial to comply the guidelines rather than pay heavy penalty for non – compliance.
- The banks need to have strong internal audit department in order to ensure that guidelines set by NRB are properly followed by the concerned department.
- Credit disbursement of the banks need to be very seriously dealt with mainly because of the classification of loans and corresponding provisions to be made. It is to be kept in mind that more the provision to be kept less profit to be obtained.
- Non – performing loan of the bank should be reduced to less than 5 % which ensures that provision are kept in certain check.

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ANNEXURE – I

Capital Adequacy Ratio

Capital	2061	2062	2063	2064
Core Capital				
Paid-up Capital				
Preference Share				
Capital Adjustment Fund				
Capital Reserve Fund				
Share Premium				
Debenture Redemption fund				
Proposed bonus share				
General Reserve				
Dividend Equalization Reserve				
Profit/Loss Account				
Excess Investment and SOL				
Goodwill				
Investment in associates				
Supplementary Capital				
General Loan Loss Provision				
Exchange Equalization Reserve				
Asset Revaluation Reserve				
Hybrid Capital Instrument				
Subordinate Term Debt				
Other Free Reserve				
Total Capital				
On Balance-sheet Assets				
Off balance transaction				
Total Risk Weighted Assets				
Total Capital to TRWA				
Core Capital to TRWA				
Reqd. Core Capital Ratio				
Reqd. Total Capital Ratio				
Surplus / Deficiency Core Capital				
Surplus / Deficiency Total Capital				

Source: Annual Report 2061/062 – 2064/065

ANNEXURE – II

Risk Weighted Assets

On-Balance-Sheet Assets	Weight	Previous Quarter		This Quarter	
		Amount	Risk Weighted Asset	Amount	Risk Weighted Asset
Cash Balance	0				
Gold	0				
Balance at NRB	0				
Investment on Government Bonds	0				
Investment on NRB Bonds	0				
FD Loan provided against the collateral security of own FD	0				
Loan provided against the collateral security of Government Bonds	0				
Accrued Interest Amount on Saving Bonds	0				
Balance with national banks and financial institutions	20				
FD Loan provided against the collateral security of FD of other banks and financial institutions	20				
Balance with Foreign Banks	20				
Money at Call	20				
Loan provided against the guarantee of Rated licensed foreign institutions	20				
Investment made in Rated licensed foreign institutions	20				
Investment in Shares, Debentures and Bonds	100				
Other investments	100				
Loans, Advances and Bills Purchase/Discount	100				
Fixed Assets	100				
Net Interest Amount Receivable (Total Interest Receivable-Interest from Saving Bonds-Interest Suspense)	100				
Other Assets (Other than Advance Tax Deposit)	100				
Total (A)					

Off-Balance-Sheet Items					
Bills Collection	0				
Forward Foreign Exchange Contract	10				
Guarantee having maturity period less than 6 months (Full Amount)	20				
Guarantee issued against Counter Guarantee of Rated Licensed Institutions	20				
Guarantee having maturity period of more than 6 months	50				
Bid Bond, Performance Bond and Underwriting related liabilities	50				
Advance Payment Guarantee	100				
Financial and Other Guarantee	100				
Irrevocable Loan Commitment	100				
Contingent Liability related to Income Tax	100				
All Other Contingent Liabilities including Acceptance	100				
Total (B)					
Total Risk Weighted Assets (A+B)					

Source: Annual Report 2061/062 – 2064/065

ANNEXURE – III

Calculation of Capital Adequacy Ratio

$$\text{Core Capital to RWA} = \frac{\text{Core Capital}}{\text{TRWA}} \times 100 \%$$

$$\text{Supplementary Capital to RWA} = \frac{\text{Supplementary Capital}}{\text{TRWA}} \times 100 \%$$

$$\text{CAR} = \frac{\text{Total Capital}}{\text{TRWA}} \times 100 \%$$

Calculation of loan loss to loan loss provision

Loan loss provision to Total loan and advances

$$\frac{\text{Loan Loss Provision}}{\text{Total loan and advances}}$$

Non – performing loan to Total loan and advances

$$\frac{\text{NPL}}{\text{Total loan and advances}}$$

Loan loss provision to NPL

$$\frac{\text{Loan Loss Provision}}{\text{NPL}}$$

ANNEXURE – IV A

Calculation of Correlation coefficient, coefficient of determination and Probable error

Nepal Investment Bank Ltd

Year	X	Y	$x=(X-\bar{X})$	$y=(Y-\bar{Y})$	xy	x^2	y^2
2061 / 062	10453	532	-6779.25	-296.5	2010047.63	45958230.56	87912.25
2062 / 063	13178	681	-4054.25	-147.5	598001.88	16436943.06	21756.25
2063 / 064	17769	899	536.75	70.5	37840.88	288100.56	4970.25
2064 / 065	27529	1202	10296.75	373.5	3845836.13	106023060.56	139502.25
	68929	3314			6491726.50	168706334.75	254141.00

$\Sigma X=68929$; $\Sigma Y=3314$; $\Sigma xy=6491726.50$; $\Sigma x^2=168706334.75$ and

$\Sigma y^2=254141.00$

$$\bar{x} = \frac{\Sigma X}{n} = \frac{68929}{4} = 17232.25$$

$$\bar{y} = \frac{\Sigma Y}{n} = \frac{3314}{4} = 828.5$$

Correlation Coefficient

$$(r) = \frac{\Sigma xy}{\sqrt{\Sigma x^2} \sqrt{\Sigma y^2}} = \frac{6491726.50}{\sqrt{168706334.75} \sqrt{254141}} = \frac{6491726.50}{12988.70 \times 504.12} = 0.9914$$

Coefficient of determination = $r^2 = (0.9914)^2 = 0.9829$

$$\text{Standard error} = \frac{1-r^2}{\sqrt{n}} = \frac{1-0.9829}{\sqrt{4}} = 0.0085$$

Probable error = $0.6745 \times \text{SE} = 0.6745 \times 0.0085 = 0.0058$

ANNEXURE – IV B

Himalayan Bank Ltd

Year	X	Y	$x=(X-\bar{X})$	$y=(Y-\bar{Y})$	xy	x^2	y^2
2061 / 062	13451	884	-3345	-118	394710	11189025	13924
2062 / 063	15761	977	-1035	-25	25875	1071225	625
2063 / 064	17793	1008	997	6	5982	994009	36
2064 / 065	20179	1139	3383	137	463471	11444689	18769
	67184	4008			890038	24698948	33354

$\Sigma X=67184$; $\Sigma Y=4008$; $\Sigma xy=890038$; $\Sigma x^2=24698948$ and $\Sigma y^2=33354$

$$\bar{x} = \frac{\Sigma X}{n} = \frac{67184}{4} = 16796$$

$$\bar{y} = \frac{\Sigma Y}{n} = \frac{3314}{4} = 1002$$

$$\text{Correlation Coefficient (r)} = \frac{\Sigma xy}{\sqrt{\Sigma x^2} \sqrt{\Sigma y^2}} = \frac{890038}{\sqrt{24698948} \sqrt{33354}} = \frac{890038}{4969.80 \times 182.63} = 0.9806$$

$$\text{Coefficient of determination} = r^2 = (0.9806)^2 = 0.9616$$

$$\text{Standard error} = \frac{1-r^2}{\sqrt{n}} = \frac{1-0.9616}{\sqrt{4}} = 0.0192$$

$$\text{Probable error} = 0.6745 \times \text{SE} = 0.6745 \times 0.0192 = 0.0129$$

ANNEXURE – IV C

Everest bank Ltd.

Year	X	Y	$x=(X-\bar{X})$	$y=(Y-\bar{Y})$	xy	x^2	y^2
2061 / 062	79000	419	-48388.25	-197	9532485.3	2341422738	38809
2062 / 063	101362	502	-26026.25	-114	2966992.5	677365689.1	12996
2063 / 064	140827	627	13438.75	11	147826.25	180600001.6	121
2064 / 065	188364	916	60975.75	300	18292725	3718042088	90000
	509553	2464			30940029	6917430517	141926

$\sum X=509553$; $\sum Y=2464$; $\sum xy=30940029$; $\sum x^2=6917430517$ and $\sum y^2=141926$

$$\bar{x} = \frac{\sum X}{n} = \frac{509553}{4} = 127388.25$$

$$\bar{y} = \frac{\sum Y}{n} = \frac{2464}{4} = 616$$

$$\text{Correlation Coefficient (r)} = \frac{\sum xy}{\sqrt{\sum x^2} \sqrt{\sum y^2}} = \frac{30940029}{\sqrt{6917430517} \times \sqrt{141926}} = \frac{30940029}{83171.09 \times 376.73} =$$

0.9875

Coefficient of determination = $r^2 = (0.9875)^2 = 0.9751$

$$\text{Standard error} = \frac{1-r^2}{\sqrt{n}} = \frac{1-0.9875}{\sqrt{4}} = 0.0124$$

Probable error = $0.6745 \times \text{SE} = 0.6745 \times 0.0124 = 0.0084$

ANNEXURE – IV D

Bank of Kathmandu

Year	X	Y	$x=(X-\bar{X})$	$y=(Y-\bar{Y})$	xy	x^2	y^2
2061 / 062	618045	365	-7019097	-102.25	717702643	49267719185860.60	10455.06
2062 / 063	7488700	409	-148441.8	-58.25	8646731.9	22034953143.06	3393.063
2063 / 064	9694101	479	2056959	11.75	24169271	4231081356160.56	138.0625
2064 / 065	12747721	616	5110579	148.75	760198663	26118020270530.60	22126.56
	30548567	1869			1510717309	79638855765694.70	36112.75

$\Sigma X=30548567$; $\Sigma Y=1869$; $\Sigma xy=1510717309$; $\Sigma x^2=79638855765694.70$ and

$\Sigma y^2=36112.75$

$$\bar{x} = \frac{\Sigma X}{n} = \frac{30548567}{4} = 7637141.75$$

$$\bar{y} = \frac{\Sigma Y}{n} = \frac{1869}{4} = 467.25$$

Correlation Coefficient (r)

$$r = \frac{\Sigma xy}{\sqrt{\Sigma x^2} \sqrt{\Sigma y^2}} = \frac{1510717309}{\sqrt{79638855765694.70} \sqrt{36112.75}} = \frac{1510717309}{8924060.49 \times 190.03} = 0.8908$$

Coefficient of determination = $r^2 = (0.8908)^2 = 0.7936$

$$\text{Standard error} = \frac{1-r^2}{\sqrt{n}} = \frac{1-0.7936}{\sqrt{4}} = 0.1032$$

Probable error = $0.6745 \times SE = 0.6745 \times 0.1032 = 0.0696$

ANNEXURE – V

Major Provision of NRB Directives

Directive no. 17: Deprived Sector Lending (Updated 2065 / 066)

- I Comments on the exceptions observed in the deprived sector lending
- II Whether the loan classified as deprived sector lending meet the stipulated pre – requisite conditions
- III Monitor mechanism for utilization of deprived sector lending on a half yearly basis
- IV Compliance with internal rules, regulations and guidelines

Base II framework under Capital Adequacy Ratio (Updated 2065 /066)

NRB has introduce Basel II framework during the Fiscal Year 2064 / 065. NRB approaches to implement this framework to all “A” class financial institutions. All banks within the scope of this framework should adopt the prescribed approaches by mid July 2008 (Fiscal Year 2065 / 066).

Minimum Capital Requirements

The minimum ratio has been set by Nepal Rastra Bank for an individual bank through a review process, every banks shall maintain at all times, the capital requirement set out below:

- a. A Tier 1 (core) capital of not less than 6 percent of total risk weighted exposure.
- b. A total capital fund of not less than 10 percent of its total risk weighted exposure.