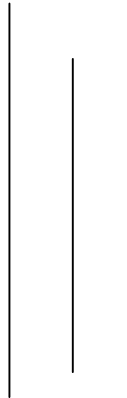


IMPACT OF NRB DIRECTIVIES ON NON - PERFORMING LOAN
AND LOAN LOSS PROVISION
(A CASE STUTY OF NEPAL INVESTMENT BANK LTD AND NABIL BANK LTD)

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Master of Business Study (MBS)

Kathmandu, Nepal
September, 2013

RECOMMENDATION

This is to certify that the Thesis

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Entitled:

Impact of NRB Directives on Non-Performing Loan and Loan Loss Provision (A Case Study of
Nepal Investment Bank Limited and Nabil Bank Limited)

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And found the thesis to be the original work of the student and written according to the prescribed format. We recommended the thesis to be accepted as partial fulfillment of the requirement for Master Degree of Business Studies (MBS)

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DECLARATION

I hereby declare that the work reported in this thesis entitled ‘Impact of NRB Directives on Non-Performing Loan and Loan Loss Provision (A Case Study of Nepal Investment Bank Ltd. and Nabil Bank Ltd.) submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Master Degree in Business Studies (MBS) under the supervision of Sneha Lata Kafle and Rashmee Rajkarnikar of Shanker Dev Campus T.U.

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Dipesh Kumar Adhikari
Researcher

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ABBREVIATIONS

NRB	:	Nepal Rastra Bank
CBS	:	Commercial Banks
CIB	:	Credit Information Bureau
CV	:	Coefficient of Variation
FY	:	Fiscal Year
Avg.	:	Average
JVB	:	Joint Venture Banks
LLP	:	Loan Loss Provision
Nabil	:	Nabil Bank Limited
NPA	:	Non-Performing Assets
NPL	:	Non-Performing Loan
NIBL	:	Nepal Investment Bank Limited
SD	:	Standard Deviation
TU	:	Tribhuvan University
No.	:	Number
r	:	Coefficient of Correlation
Rs	:	Rupees
www	:	World Wide Web
TU	:	Tribhuvan University
Ltd.	:	Limited
e.g.	:	Example
Fig.	:	Figure
i.e.	:	That is
P.E.	:	Probable Error
AM	:	Arithmetic Mean

CHAPTER - I

INTRODUCTION

1.1 Introduction

1.1.1 Background of the Study:

Since FY 1987 /1988 a significant step towards financial liberalization has been undertaken by Nepal Government with the view to accelerate the pace of economic development under structural adjustment programme. This gave birth to the liberalization in interest rate, strengthening of banking operation and shift to direct monetary control instruments.

As a result of liberalization policy of Nepal Government, foreign investors were attracted to invest in Nepal in joint venture especially in banking business. This initiated the establishment of Nepal Arab Bank Limited (NABIL) in 1984 A.D. as joint venture with Dubai Bank Limited. Following this, other banks in the same year were established. The increase in opening of the joint venture banks caught a dramatic way after the liberalization and market oriented economic policy.

1.1.2 Origin of Bank

The origin of word “bank” is linked to Latin word “Bancus”; Italian word “Banca” and a French word “banque; all of which means a bench. The early bankers, the Jews in Lombardy, transacted their business at benches in the market place. When they are unable to meet their liabilities, the depositors find mainly to make loans and buy securities. Banks operate as financial intermediaries between the ultimate lender (depositor) and ultimate borrower. Regarding the origin of bank in the world, the first bank named as The Bank of Venice, was established in Venice of Italy in 1157 A.D. Following this, “The Bank of Barcelona, Spain, established in 1401 A.D. was the second bank of the world. In addition, the first central bank, which was established in 1844 A.D., was “The Bank of England”. “I believe in that fact the banks are not merely purveyors of money, but also in an important.

According to the history of banking, it is found that the term bank was first used in Medieval Italy. According to the French Writer Revilpout, banking system and bank notes had come into existence in Babylon at around 543 A.D. In Jerusalem, the exchange of money used to be done at temple premises. Likewise in Greece temples used to accept deposits and lend out loans to the public. Banking system in early Rome was also developing in the similar manner like that in Greece. It has been found that the banking system in England started by the goldsmith. The goldsmith who in turn gave them deposit slip, which acted like a bank note, accepted the gold and silvers brought by the

citizen. The merchant were famous businesspersons who used to issue documents, which could be used as money at any place. On the other hand, moneylenders accepted goods and money to be deposited and lend money at certain interest rate.

1.1.3 Evaluation of Banking Industry in Nepal

The development of banking industry in Nepal has not long history as compared to other developed countries of the world. At ancient period, landlords, moneylenders, merchant, goldsmith etc were played the role of the bank. Though establishment of banking industry was very recent, some crude banking operations were in practice even in the ancient times. In the context of Nepal, Prime Minister Ranodip Singh established "Tejarath Adda" during the year 1880 A.D. which was the first step in institutional development of banking. Tejarath Adda did not collect deposit from public but granted loan to public against the collateral of bullions. Thus in the absence of saving mobilizing, "Adda" faced financial problems making it impossible to cater to the credit need of general population throughout the country. Consequently the major parts of, the country remain untouched from these limited banking activities. In addition, in 1934 AD, for the welfare of government staff, "Sainik Drabya Kosh" was established. The development of trade with India and other countries increase the necessity of the institutional banker, which can act more widely to enhance the trade and commerce and to touch the remote non- banking sector in the economy. Reviewing this situation, the "Udhyog Parishad"(Industrial Development Board) was constituted in 1936 A.D. year after its establishment, it formulated the, company Act., and, Nepal Bank Act" in 1937 A.D under which Nepal Bank limited was established in 1937 AD with Government sharing 51 percent and private sector sharing 49 percent. This was a mild stone in the foundation of modern banking system of Nepal.

Modern banking practices emerged with the establishment of Nepal Bank Limited .However the standard of Nepal Bank Limited alone in total monetary and financial sector was not sufficient and satisfactorily. Thus Nepal Rastra Bank was setup on 1956.04.26 A.D. as a central bank under Nepal Rastra Bank Act 1955 Similarly on 1966.01.23A.D. Rastriya Banijya Bank was established as fully government owned commercial banks. With the emergence of RBB, banking service spread to both the urban and rural areas but customers failed to have taste of quality/competitive service because of excessive political and bureaucratic interference. With the concept of industrial development of the nation, industrial Development Centre was set in 1956 A.D. which was converted to Nepal Industrial Development Corporation in 1959 A.D. Similarly, could be enhanced through introduction of modern agricultural techniques, Agricultural Development Bank (ADB) was established in 1968.01.21. As liberalization, privatization and Globalization have emerged as a new super power all over the world and Nepalese economy also adopted the same during the 1980s. as a result, Nabil Bank Limited (erstwhile Nepal Arab Bank Limited) was established I 1957.06.2, which opened the

door of opening commercial banks to the private sector. Nabil Bank Limited emerged as the first joint venture bank when the banking industry is totally dominated by Government and semi-government banks mainly to revitalize the economy by accelerating productivity in various sectors and to provide efficient customer service. Having observed the success on Nabil based on marketing concept and also because of liberal economic policy adopted by the successive government, many commercial banks have been established all over the kingdom. Following is the list of commercial banks that have been came into existence in Nepalese banking industry after liberalization policy adopted by the nation as 15 July 2004.

1.1.4 Meaning of Banking Institution

The ordinary meaning of bank is commercial bank. Commercial are those banks that pool together the saving of the community and arrange for their productive use. They supply the financial needs of modern business by various means. They accept deposits from the public on condition that they are repayable on demand or on short notice. In other words, a bank is a financial intermediary, a dealer in loans and in debts. It borrows from one set of people and lends to hiring money and hiring out again. Some banks draw their capital mainly from their shareholders, other's mainly from depositors. Some lend mainly to industry, others mainly to government, central and local. Some deal in short loans, borrowings and lending for short periods, others deal in long periods. However the business of individual bank may differ, their essential function is to gather saving together and lend out what they collect.

The primary economic function of the commercial bank is to hold demand deposits and to honor cheques drawn upon them. In short, to provide us, the economies, with the most important component of the money supply.

Commercial bank plays an important role in directing affairs of the economy in various ways. The operations of commercial banks record the economic pulse of the economy. The size and composition of their transaction mirror the economic happenings in the country. For instance, the mass failure of commercial banks during 1980 has reflected the phenomenon of several global depressions in the world. Commercial banks have played a vital role in giving direction financing the requirements of trade and industry in the country. In a planned economy, bank make the entire planned productive process possible by providing funds for all types of production incorporated in the plan, regardless of whether the production is in the public sector, joint sector or in the private

sector or whether the production is undertaken by one type of organization or another. They endeavor to promote enterprise development by investing in shares and debentures. Therefore, they support the country's overall economic development process by financing in various ways.

In the Nepalese context, the Nepal Commercial Bank Act 2031 B.S. defines a commercial bank as one, which exchanges money, deposits money, accepts deposits, grants loans and performs commercial banking functions.

As an outcome of, the economic liberalization policy, GoN has put its face in the international arena by which so many investment opportunities are evolved within the nation integrated and speedily development of the nation is possible, only when competitive banking services reach the nook sand corners of the nation. Commercial banks occupy an important place in the framework of every economy by providing required capital for the development of industry trade and business out of the saving collected as deposits, besides, commercial in view of facilitating the economic & social life. Banks are the essential part of the business activities, which are established to safeguard people's money and utilizing the money in making loans and investments. Concerning Nepal, there are several commercial banks operating in different places especially in the kingdom with foreign collaboration or joint investment.

1.1.5 Function of Banking Institution

The primary functions of Commercial bank in Nepal are concentrated on accepting deposit from general public and advancing loans to industrialist, businesspersons and others. Besides that, it also executes banking activities. All commercial banks are authorized to transact various businesses, which are considered as the main function of Commercial Bank. Commercial Bank has significant role in transferring idle money of General Public to industrialist or businessperson who generally use such amounts in productive sectors. This Major function of commercial bank plays a vital role in the overall development of economy and nation too. Despite that, Commercial bank provides wide range of agencies and other miscellaneous services by the means of branch expansion at different parts of the country, which can be listed as follows.

Accepting Deposits

Commercial bank accepts deposits in different types of account. The different types of deposits are:

• Saving Deposit

It is one of the deposits, generally collected from the people having low level of income. The bank usually pays a small rate of interest to the depositors against the deposit. The main purpose of this account is to increase saving habit of public. Under this account, the depositor has to maintain amount, as prescribed by the bank to open this accounts. The depositor is allowed to withdraw money by cheques up to the amount prescribed by bank. Amount collecting under this account should be invested in purchasing marketable securities and short- term investment.

• Current Deposit

Another account provided by commercial bank to deposit amount of traders and businesspersons is current deposit. The bank should payment on demand of the client therefore; it is called as demand deposit. There are no restrictions regarding the number of deposits and withdraws. The bank does not pay any interest on such amount.

• Fixed Deposit

A fixed deposit is such type of account where the customer is required to keep the amount the bank for long period. Those who do not need for stipulated time open such account. The bank, on such amount, provides a high rate of interest. The customers are not allowed to withdraw money before the matured period. In case of urgent need of money the customers are permitted to borrow money from the bank on the security of fixed deposit.

• Advancing loan

The major function of commercial bank is to invest and lend of its funds collected by means of different account into productive sectors. Enough consideration should be given in choosing the project that ensures the receiving of interest regularly and recoverable of loans after the matured period. Mainly loans are granted in four forms overdraft, cash credit, and direct loan and discounting of bills of exchange.

• Credit creation

Credit creation is one of the most important functions of commercial bank. Commercial bank's main objective is to earn profit. Bank creates credit by advancing loan in different sector. They do not provide hard cash but open an account on the loaner's name.

Bank creates credit by flowing or advancing loan in different productive sector. Commercial bank charges certain amount of money as interest. Sometimes commercial bank may advance loan beyond their capacity and they may feel difficulty. In such case central bank controls credit by changing the

cash reserve ratio (CRR), interest rate in loan or deposited and lending policy of commercial bank.

According to directive of central bank, i.e. Nepal Rastra and Commercial bank of Nepal should keep 20% of their profit as reserve, until it reaches double of its paid up capital. Similarly the spread rate should be between 4 - 5% in all commercial bank, this spread rate is not being practiced in bank of Nepal.

• **Financing foreign trade**

Foreign trade refers to trading activity with parties outside the country. This trade is done in foreign currencies, which are financed by banks. Some of the major products of foreign trade are Letter of Credit Guarantee, Advance payment, Draft and Collection.

In case of Nepal, when we say Letter of credit we normally refer to it with import because there is not much exporting in Nepal. In letter of credit also there is limited allocation according to the financial position of the firm or individual. Letter of credit is provided against collateral. Similarly, bank also finances foreign trade against 'Trust receipt'. Trust receipt is like an indemnity. Loan against 'Trust receipt' is normally provided for import of goods. When the importer cannot pay the exporter within a short period, the importer provides the bank with 'Trust Receipt' against which the bank provides a loan to the importer not exceeding 90% of the receipt. In addition, the importer is supposed to repay the bank within 120 —180 days with interest.

• **Agency functions**

A bank performs a number of services on behalf of its customer as an agent. Mainly commercial banks undertake the payment of subscriptions, insurance premium, rent collection of cheques, bills, salaries, pensions, dividends, remittance of money from one place to another etc on the behalf of customers. For these different services provided by commercial banks it charges a small amount of commission.

• **Miscellaneous Services**

Commercial banks provide other services to other customers provide lockers where important documents, gold and silver are kept for security and underwriting services shares issues, statistical information money market and business trend.

11.6 Nepal Rastra Bank as Center Bank

Banking system occupies an important place in a nation's economy. A banking institution is indispensable in a modern society. It plays a vital role in the development of economy of the country and forms the core of the money market in an advanced country. In the current background of the rapid expansion of the bank and financial institution network along with the financial sector liberalization, the implementation of this monetary policy will enhance the effectiveness of the NRB to undertake appropriate regulation, supervision and monitoring responsibilities for the qualitative development of the financial sector.

Nepal Rastra Bank (NRB) as a central bank of Nepal which was established in 26th April 1956 A.D (14th Bisakh 2013 B.S.) it controls all the commercial banks. It has to perform many functions. In one hand it acts as a bank of the government and on the other hand the monetary situations of the country, it is regarded as regulations for the banks and the banks need to follow them. So, it is also known as banker's. If the banks do not follow the rules and regulations issued by the central bank, the banks will be obliged to pay penalties. Generally, to bring uniformity and to amend the rules and regulations Nepal Rastra Bank used to issue directives to the bank. Directives are the guidelines issued by the central bank to the commercial bank for the operation of their daily activities. Nepal Rastra Bank issues directives to the commercial banks from time to time and amends them on 'need basis. The commercial banks have to modify their functions accordingly.

Nepal Rastra Bank has issued a set of 21 directives to the commercial banks so as to strengthen the commercial banking institutions, ensure corporate governance, consolidate their financial situation, improve the people's confidence in them and contribute to the overall health and stability of the financial system.

The banking institutions are often fragile and susceptible to failure because of poor management, partially financial management. Deposit collected by these financial institution are lend as loan and advances in various sectors in the form of investment, short term loan, long term loan etc. These loans are vital for profitability of bank and also proper utilization of resources of country as well as capital formation for investors. It is supposed that repayment of interest or principal shall have to be served without any implement but unfortunately some time these loan and advances borrowed by investors become unproductive because of risk underlying in the particular business. They become unable to repay loan. So such loan may be considered as doubtful and bad loan. This bad loan and doubtful loan is known as Non-performing assets or loan in short NPA\NPL it could have advance effect in bank's profitability both through loss of interest income and write off the principal loan

amount. Profitability is desire stage for any type of business enterprises so banks are not exceptional. However increasing non-performing assets have the direct on bank's profitability, as legally banks are not allowed to book income and such accounts and at the same since banks are forced to make provision on such assets.

1.1.7 Profile of the Sample Banks

a) NABIL Bank Limited

The arrival of NABIL Bank in Nepal on the 12th of July 1984 through a joint venture with Dubai Bank Ltd. under a Technical Service Agreement (TSA), marks a new dawn in the Nepalese banking industry. What is more admirable is with the opening of then Nepal Arab Bank Ltd, Customer Service or marketing took a U- turn. That in substance accelerated the evolution in banking products and services thereafter in Nepal. The bank commenced with a team of about 50 staff members and Rs. 28 million as capital. From the very inception in 1984 as the first joint venture bank to commence operations in Nepal, NABIL has been a leader in terms of bringing the very best international standard banking practices, products and services to the nation.

Today the bank's mission is to be the Bank of 1st Choice to all stakeholders. For the customers, the bank craves to be the first choice in meeting all financial requirements, for shareholders the bank wants to be the investment of choice, for Regulators to be an example of a model bank, and wants to be an outstanding corporate citizen in all the Communities and finally to be the first choice as an employer with whom to build a career.

Today NABIL Bank is a leader in the financial sector in Nepal with a network of large points of representation spread across the nation; complimented by a network of ATMs and now NABIL Net and NABIL Tele the ease of access of accounts and information for our customers has never been more convenient. NABIL is a full service bank providing an entire range of products and services, starting with deposit accounts in local and foreign currency, Visa and MasterCard denominated in rupees and dollars, Visa Electron debit cards, Personal Lending denominated in rupees and dollars, Visa Electron debit cards, Personal Lending products for Auto, Home and Personal loans, Trade Finance products, Treasury services and Corporate Financing. NABIL aims to be able to meet entire gamut of financial requirements that is why the banks prides itself in being 'Your Bank at Your Service.

b) Nepal Investment Bank Limited

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 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 15% of the Capital.
-) The remaining 20% being held by the General Public.

NIBL, which is managed by a team of experienced bankers and professionals having proven track record, offers what one is looking for. The bank ensures that one's choice of a bank will be guided among other things by its reliability and professionalism. The vision of the bank is to be „the most preferred provider of Financial Services in Nepal.

1.2 Focus of the Study

Increasing non-performing loan and loan loss provision is one of the emerging problems of Nepalese financial institution. Nepal Rastra Bank issues directives on various aspects to regulated and promote the financial institutions. NRB as a bank of the banks issues directives to ensure that banks are investing the public deposit in right way . This research study specifically focused on the directives issued by NRB on Non-Performing Loan and Loan Loss Provision and its impact over sampled Nepalese commercial banks namely Nepal Investment Bank and Nabil Bank Ltd. Moreover, this research study tries to attempt the relationship between Non-Performing Loan and Loan Loss Provision and total loan & advances.

1.3 Statement of the Problem:

Nepal is a least-developing country of the world. The economy of the country is at the primitive situation. The economic growth rate of the country is very poor. At present, commercial banks and

financial institutions are as the backbone of Nepalese economy. The establishment of joint venture banks in the kingdom has added more bricks in the up liftmen of Nepalese economy. The existence of the joint venture banks in Nepal was possible only when the 'Financial Sector Refoms' was introduced in 1980 A.D.

As outcome of the reforms in the year 1987-88, the Government allotted liberalization in interest rate structure directing only for interest spread. This led increment in commercial bank and financial institutions. Similarly, the responsibilities of the central bank, NRB also have been increased tremendously in the past decade. As banker's bank, NRB has to look after the commercial banks operating within the country. For the smooth operation of these CBS, NRB used to flow the necessity rules, regulation & especially directives time-to – time. However, every time the functioning of the activities does not goes well. Therefore, according to the requirement of the changing economic situation, market trend, the central bank has to circular new directives according to the necessity & suitability of the business & economic environment.

1.4 Objectives of the Study:

This study has been conducted to fulfill the following objectives:-

- i) To find out the effectiveness of directive of NRB.
- ii) To examine the implementation of NRB directives by commercial banks of Nepal.
- iii) To find out the impact of NRB directives on commercial banks.
- iv) To evaluate the proportion of non-performing loan and the level of NPAs in total deposit and total lending in the selected commercial banks.
- v) To evaluate the relationship between loan amount provided by commercial banks and loan loss provision in the commercial banks.
- vi) To analyze the impact of non-performing assets in the profit of commercial banks.
- vii) To present the trend line of the non-performing assets, loan and advances, loan loss provision of selected commercial banks.

1.5 Significance of the Study:

NPA is becoming prominent problem in commercial banks. Good investment policy of the bank has positive impact on economic development of the country and vice versa. But due to various reasons

investment policy of commercial banks are not effective and productive. Non – productive loan increase non-performing assets and non-performing loans. This increase loan loss provision according to the directive of Nepal Rastra Bank, Central Bank. The portfolio of loan provision and loan loss provision affect its overall financial strength of the banks. This research is conducted to highlight present issue regarding provision of NRB Directive for Nepalese Financial Institution and issue regarding non-performing and loan loss provision.

1.6 Limitation of the Study :

While preparing of the report the effort have been made to present & analyze the fact clearly, truly & within the boundary. However, reliability of tools, lack of research experience and lack of data are the primary limitation of the report.

The other limitations are as follows:-

-) The study is focused on only the few directives issued by the NRB time to time & non-performing loan and loan loss provision of the selective banks.
-) This study is based on direct interview & secondary data only received from NRB & the concerned commercial banks.
-) Only two commercial banks operating in Nepal are considered while study .
-) The period of the study is limited from fiscal year 2006/07 to 2010/011

1.7 Organization of the Study:

The Study is carried out on sequential order and has divided into five chapters. They are as follows:-

Chapter-I: Introduction

The first chapter introduction includes the overall background of the study subtitled General Background, Banking in Nepal, Nepal Rastra Bank Directives Impact to Nepalese Financial Institution, profile, Non-performing loan and Loan Loss Provision of the selected Banks for the study, statement of the problem, objective of the study, focus of the study and limitation of the study.

Chapter-II: Review of Literature

The second chapter Review of Literature enables the reviews of the previous studies with respect to the study. This is also devoted to the theoretical analysis and the brief reviews of the related journals, literature and articles.

Chapter-III: Research Mythology

Research design, Population and Sample, Nature & Sources of the data, Data collection & Analysis producers and Analytical tools used for the study have been include in this chapter.

Chapter – IV: Data Presentation and analysis

The data presentation and analysis chapter includes presentation and analysis of the relevant secondary data and information through a definite course of mythology .For the analysis of the collected data , appropriate mathematical , financial as well as statistical tools are used as per their necessity and findings of the study is included.

Chapter-V: Summary, Conclusion & Recommendations

The last chapter Summary, Findings, Conclusion & Recommendations will contain the Summary & Conclusion and necessary recommendations of the overall research study.

Besides these chapters bibliography and appendix are also presented at the end of the research.

CHAPTER - II

REVIEW OF LITERATURE

2 Introductions

Review of literature is an integral and mandatory process in any research work. It is the fundamental part of research work. The conceptual framework or regulatory system of NRB directives of commercial bank and financial institutions are presented in this chapter. The main motto of this chapter is to show how far and how much our present study is associated with different past researcher. Literature review is basically a “stock taking “ of available literature in the selected research topic. The literature review thus provides a useful knowledge of the status of the research topic. In this section, the researcher has tried to focus on the role of NRB in Financial system, Introduction to the Non-Performing Loan, Loan Loss Provision and reviews of the various related articles, journals and unpublished thesis.

A critical review of the literature helps the researcher to develop a thorough understanding and insight into previous research work that relates to the present study. It is also a way to avoid investigation problems that have already been definitely answered. Thus a literature review is the process of locating, obtaining, reading and evaluating the research literature in the area of the student's interest. The purpose of literature review is to find out what research studies have been conducted in one's chosen field of study and what remains to do. The primary purpose of literature review is to learn not to accumulate.

2.1 Conceptual Framework

Under this section we are discussing briefly about the theoretical and conceptual framework, which are closely related to the NRB directives on commercial bank and financial institution.

2.1.1 Supervision and Regulation of NRB

The NRB has responsibility for the supervision and control over commercial banks and financial institution. The bank's inspection and supervision department carry out this responsibility. In order to ensure the sound, healthy and efficient operation of the financial system, the inspection and supervision department is mandated to carry out both off-site and on-site supervision of banks and other institutions. Under off-site examination, the department is responsible for carrying out regular monitoring of the portfolio structure of the banks and financial institutions to ensure strict adherence to prudential guidelines and various sectoral targets set by the NRB. The bank is generally regarded

as having sought under –developed supervisory and regulatory capability .One of the key reasons for this appears to be the inability to retain trained staff who are attracted by considerable higher salaries offered by the private sector, financial institutions. This is particularly the case at senior levels, where staff has often had the benefit of foreign training and experience. Despite having available the necessary financial resources, the NRB is unable to effectively de-link the salary scale of its staff from the civil service pay scale.

The World Bank believes developing appropriate regulation which meets internationally acceptable norms with respect to exposure limits, provisioning policies, and capital adequacy and so on , is an urgent issue for the NRB . The subsequent development of both an on-site and off-site supervisory capacity is also extremely important. It is not only the development of these capacities ,but also the authority that the NRB subsequently has to deal with non-compliance with the central bank directives, which will be critical according to World Bank , 1999(Financial Sector Nepal, World Bank,1999 as cited in sheathe , 2009).

Central bank has power and full authority to supervise and regulate the banking sector. A central bank makes rules, issues instructions from time to time. For this NRB established banking operations 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 industrials loans department were merged and department was renamed as a banking operation and loan 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 functions of the BFIRD include steering the financial sector reform, providing license to banks and financial institution re-financing 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 sector.

2.1.2 Review of NRB Directives

NRB is authorized bank to regulate, control and develop the banking system; it gives permission for the setting up of new commercial bank and financial institutions and lastly, serves as a lender of last resort to commercial bank and financial institutions. The NRB's mandate incorporates the supervision, regulation and monitoring of all commercial banks and financial institutions. NRB has the effective functioning of commercial banks; they should be issued some guidelines of 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 creditability towards it.

The financial sector reform of Nepal was initiated in mid 1980s and from the onward NRB, has been playing pioneer role by issuing directives to commercial bank is an attempt to maintain their level at part to the international standard.

The number of guidelines issued by NRB to commercial banks and financial institutions are as follows:

1. Provisions of Capital Adequacy
2. Provisions of Classification of Loans/advances and Loan Losses
3. Provisions of Single Borrower and Limitation of the Sectoral Credit and Facilities
4. Provisions of Accounting Policies and Format of Financial Statements
5. Provisions of Mitigation of Risks in Transactions of Licensed Institutions
6. Provisions of Good Corporate Governance
7. Provisions of Timeframe for Implementation of Regulatory Directives Issued in connection with Inspection and Supervision
8. Provisions of Investment
9. Provisions of Filing of Statistical Returns by Licensed Institutions to Nepal Rastra Bank
10. Provisions of Transfer or Sale of Promoters Shares of licensed institutions
11. Provisions of Consortium Financing
12. Provisions of Credit Information and Blacklisting
13. Provisions of Compulsory Reserve/Statutory Liquidity
14. Provisions of Opening of Branch/Offices
15. Provisions of Interest Rates 389
16. Provisions of Collection of Financial Resources
17. Provisions of Lending to Deprived Sector
18. Provisions of Amalgamation, Merger and Upgrading
19. Provisions of now Your Customers
20. Provisions of Subsidiary Companies
21. Miscellaneous Provisions

2.1.3 Loan and advances

The major function of banks and financial institution is to collect deposits from people, business group, and society and lend to those who stand a need of money. Almost all banks have the loan and advances as their prime assets and interest earning from loan and advances are the major sources of income. These assets constitute primary sources of income to banks. Loans and advances dominated the assets side of the balance sheet of any bank. Similarly, earning from such loan and advances occupy a major space in income statement of the bank. They are also the least liquid of the bank's entire assets. Loans and advances may take different forms and are allowed against various types of securities. Loans, overdrafts, discounting of bills of exchange etc are some of the forms of bank lending. Granting loans and advances always carries a certain degree of risk. Loans and advances are regarded as the risky assets of the banks.

2.1.4 Performing Assets/ Loans

Performing loans are those loans, which repay principal and interest timely to the bank from the cash flow it generates. In other word, performing loan are the productive assets that generate some profits. Loans have the certain period to returns its principle with its interest. If anyone repays loan with its interest on time is known as the performing loan. It is the most profitable assets of bank. Its help in repaid growth of banking sector in this fast pace competitive age. Better performing loan are the symbol of success of bank. It ultimately helps in economic growth and development. So such loans are necessary for overall development and prosperity of country. However, many banks are suffering from the non-repayment of loan amount

2.1.5 Non-Performing Loan / Assets (NPL / NPA)

Loan becomes non-performing when it cannot be recovered within certain stipulated time that is governed by some respective laws. So, non-performing loan is defined for the institutional point of view, generally from the lending institutions side. Loan may also be non-performing if it is used in different way than that for which it has been taken. This is the user's point of view. But, here we will confine the definition to the institutional point of view. In this case, loan becomes non-performing when it is classified as bad and loss.

Non-performing Loan (NPL) can be defined as the non – productive assets of the banks. An asset is known as non – performing assets (NPAs) . In other word, it is the loan or bad debt and doubtful debt that does not repay timely. Generally the loan does not repay within three months is known as non-performing loan. The loan amount that does not covered by collateral after selling is known as non-

banking assets (NBA) or non – performing assets (NPA), Non-performing assets also includes the suspend interest. It is the interest, which becomes receivable. Unutilized assts and those investments which do not generate any cash or incomes to the bank are also non-performing assts. The proper management of those assets to generate income is known as management of non-performing sets. According to current banking act, the banks have to make provision for bad and doubtful debts. After deducting the bad and doubtful debts from the non-performing assets, net non-performing can be achieved. According to the NRB, central banks NPAs are classified loans and advances according to their nature of overdue timing. NRB has directed to maintain loan loss provision according to aging basis for risk mitigation. The loan provision is to be maintained by debiting profit account .Thus as the quality of loan degrades the ratio of loan loss provision is increased affecting the profitability of the banks.

2.1.6 Effect of NPLs/ NPAs

Its direct effect is on the profitability of commercial banks. In future, it affects overall performance of banks. It also affects liquidity and competitive functioning of public and private sector banks and finally the psychology of the bankers in respect to their disposition towards credit delivery and credit expansion .Increasing of Non-performing loans has the direct effects to banks, investors and customers. It has negative impact to the economic health and business of country. Banks and financial institution cannot mobilize the non-performing loans to increase profitability. They also have to make provision for doubtful debts from their profits and other resources. That’s why the profit of banks decreased and may occure losses. As a result, share capital also becomes capital erosion and capital inadequacy. The central bank can take action on those banks, which have low capital or capital adequacy ratio. When the non-performing loans increase, the banks have to increase the amount of provision for doubtful debts and when the loan is repaid, the profit treated as profit . If the provision for doubtful debts crosses 5 % of the total loan amount, the bank have to pay income tax as profit. So, it has direct effects to the cash flow of bank’s. As a result, the employment of human resources and profit of the bank has also affected.

2.1.7 Causes of Occurring NPLs/ NPAs

There are various causes to increase the NPL / NPAs. It can increase due to :

-) Reduced attention to borrowers (Hawthorne effect)
-) Moving along the risk curve (Petroski effect)

-) Increasing loan size increase risk (Inverted pyramid effect)
-) Lenders lack plans to deal with risk (Pollyanna effect)
-) Borrower probe a credit operation's weakness (Jurassic park effect)
-) Rent-seekers capture the credit program
-) Lenders and project designers have low expectation
-) The lender is unwilling to collect
-) Lack of good models (High default culture effect)
-) Loan sanctioned by corruption
-) Donors give loans to dominate
-) Weak follow up weaken the system

2.1.8 Ways to Turn Non-Performing Loan into a Performing Loan

Recovery is not a problem, just the end of non process that fed into the next process .This is our self –developed problem due to our lack of knowledge, negligence, inefficiency and lack of commitment. As this is the social devil we should avoid this. Some points are presented below as a ways to control recovery crisis.

-) Law and order situation
-) Risk assessment
-) Motivation
-) Recovery agency
-) Less relaxation
-) Collateral management
-) Developing situation specific models
-) Real time training
-) Trade-offs
-) Monitoring

2.1.9 Loan Loss Provision

Loan loss provision is the accumulated fund that is provided as a safeguard to cover possible losses upon classification of risk inherited by individual loan. There is a risk inherent in every loan. Hence provisioning is made as cushion against possible losses and to reflect the true picture of bank's assets. There is risk associated in every loan and banks should be recognized as being impaired and

necessary provision should be made, if it is likely that the bank will not be able to collect all the amounts due i.e. principle and interest. To minimize the risk from possible losses from loan banks have to allocate some fund as loan loss provision.

Loan loss provision is an arrangement made in order to safeguard from the bankruptcy if loaned amount is not recover or if debtors default on repayment of loan. It provides buffer against future unexpected losses. Loan loss provision is thus a method that banks used to recognize a reduction in the realizable value of their loans. Banks are expected to evaluate credit losses from their loan portfolios on the basis of available information a process that involves a great deal of judgment and is subject to opposing information. Banks are directed to make a provision as per the classification of the loans into four categories.

a) Pass Loan :

Loans and advances whose principal amounts are not past due and past due for a period up to 3 months shall be included in this category . These are classified and defined as performing loans.

b) Sub-Standard Loan:

All loans and advances that are past due for a period of 3 months to 6 months shall be included in this category.

c) Doubtful Loan :

All loans and advances, which are past due for a period of 6 months to 1 year shall be included in this category.

d) Loss :

All loans and advances which are past due for a period of more than 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 .

Loans and advances falling in this category of Sub-standard, Doubtful and loss are classified and defined as Non-performing loan. Bank and Financial institutions should provision the loan and advances as per the following system.

Provision for Loan Loss

Loan Classification	Time Period	Loan Loss Provision
Pass Loan	Less than 3 months	1 %
Sub-Standard Loan	3 months to 6 months	25 %
Doubtful Loan	6 months to 1 year	50 %
Loss Loan	More than 1 year	100 %

Provisions made for the performing loan i.e. pass loan is considered as general loan loss provision and the provision made for the non-performing loan is considered as specific loan loss provision

Additional Arrangement in respect of “ Loss Loan ”

- i. Insufficient security / collateral.
- ii. The borrower has been declared bankrupt
- iii. The borrower is absconding or cannot be fund.
- iv. Purchase or discounted bills are not realized within 90 days from the due date.
- v. Misuse of loan, i.e. credit not been used for the purpose originally intended.
- vi. Owing to non-recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation.
- vii. Loans provided to the borrowers included in the blacklist and where the Credit Information Bureau blacklists the borrower.
- viii. If project / business is non-operative condition or closed.
- ix. Credit card loan not write off within 90 days from its expiry date.

2.1.10 Principals of Lending Loan and Advances

The precautions to be taken by a banker, and the principles to be taken care of , While granting loan and advances . Some of the principles are as follows while lending loan and advances.

- I. Liquidity
- II. Profitability
- III. Safety and Security
- IV. Purpose
- V. Social Responsibility

2.2 Review of related Articles, Journals and Books

On the way to prepare this research work some books, journals and publications have been studied to formulate ideas about the subject matter. Although, the specific books reading the NPA could not be found, however some banking related books have been consulted.

An article Published on the occasion of 54th anniversary of Nepal Rastra Bank by Numanath Poudel about high non-performing loan and many problematic Financial Institutions. This was the best indicator of the health of the banking industry in a country is its level of NPL. Given this fact, Nepalese bank and financial institutions seem to be placed in a vulnerable to the high credit risk than they were in the past. Credit forms major source of income and its share of gross credit in total earning asset of all commercial bank is above 54 percent. However, average NPL level of banking industry was at 6.08 percent, which is higher as compared to internationally accepted from of 5 percent. Such higher level of NPL required banks to provided for such provision which consumed earning and deteriorated the capital in case of few commercial banks.

Dhungana B.R. Non-Performing Loan in the Nepalese Financial System and the Role of NRB and judiciary System in Resolving the Problem: in this article in the 42nd Souvenir of Rastriya Banijya Bank has stated that- A lot of defaulters in the loan portfolio indicates poor and weak health of the institution. If there are such types of weak banks and financial institutions, they will not be able to finance the resources as needed by the private e sectors to boost up the economy. Therefore, the system should be managed in the disciplined way and the players of the system should maintain and exhibit financial discipline in each and every aspect. If the financial discipline is weak in the system, there will be lapses either lending or recovery and there will be a reflection fo it in the form of weak portfolio, i.e. high level of NPL in the system is an indicator of financial institutions themselves. Recovery of distress loan is challenging task for the banks and financial institutions. This is disposal; sale or acquiring of borrower's assets and legal proceeding is likely to happen in most of cases. In the banking experience, almost in all the big loans of the banks, borrowers are appealing in the court to restrain the recovery process. Therefore, to materialize the recovery process for banks and financial institutions, the role judiciary has been extremely important in Nepal. This is because the stay over can restrain the recovery process and vacant of stay orders can facilitate banks to recover the loan.

H.D.Cross says in 1963 , In this regard lending is the essence of commercial banking, consequently the formulation and implementation of sound policies are among the most important responsibilities of bank directors and management . Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit creating function effectively and minimize the risk inherent in any extension of credit.

If we analyze further, we can find that poor corporate governance and poor risk management practices as the major reason for high NPL and causes of negative capital in problematic banks. Other external causes of high NPL are economic slowdown, legal hurdles for recovery, defaulting attitude of borrower and deficiency in enforcement of supervisory authority by central bank. Management practices in banks with higher NPL are still very weak in areas of credit analysis, credit administration, risk management and internal control system. Other reason for increase in NPL is multiple banking, non-existing of system for registration of hypothecated current assets, poor credit information and lack of disclosure by borrower.

2.3 Review of Related Studies

Pandey (2003), has carried out study on “ Nepal Rastra Bank Directives their Implementation and Impact on the Commercial Bank – A Case study of HBL with the objectives to find out the impact of changes in NRB directives on the performance of the commercial banks and find out whether the directives were implemented or not .

The directives is not properly addressed have potential to wreck the financial system of the country as they are the only tool of the NRB to supervise and monitor the financial institutions . The directives in themselves are not that the commercial banks. In case commercial banks are making such huge profit with full compliance of NRB directives, then the commercial banks would deserve votes of praise because they would then be instrumental in the economic development of the country. All the changes in NRB directives made impact on the bank and the result are the followings:

-) Increase in operational procedures of the bank will increase the operational cost of the bank.
-) Short term decreases in profitability which result to lesser dividends to shareholders are lesser bonus to employees.
-) Reduction in the loan exposure of the bank, which decreases the interest income but increase the protection of the depositor’s money.
-) Increase demand for shareholder’s contribution in the bank by foregoing dividends for loan loss provisions and various other reserves to increase the core capital.

All the aforesaid result leads to one direction; the bank will financially healthy and stronger in the future. HBL will be able to withstand tougher economic situation in the future with adequate capital and precision for losses. The tough time through which the bank is undergoing at present will prevail

only for a couple of years but in the long run, it will be strong enough to attract more deposit and expose itself to more risk with capital cushion behind it. The quality of the assets of the banks will become better as banks will be careful before creating credit. Ultimately, it changes in the depositors, the employees and economy of the country as a whole.

Shrestha (2004), has conducted a research on “ A Study on Non-Performing Loan and Loan Loss Provision of Commercial bank ” with reference to NBL, NABIL and SCBNL. Main objectives of her study are to find out the proportions of non-performing loan, relationship between loan loss provision and profitability, factors that affect to accumulate the non-performing loans in selected banks.

She has pointed out the problems of commercial banks / financial institutions in Nepal have been facing several problems like lack of smooth functioning of economy, different policies and guidelines of NRB, political instability security problem, poor information, over liquidity caused by lack of good lending opportunities, increasing non-performing assets etc. In the present context, where Nepalese banks are facing the problem of increasing NPAs more amounts have to be allocated for loan loss provision .

She has concluded ineffective credit policy, political pressure to lend to uncreditworthy borrowers, over valuation of collateral are the major causes of mounting non-performing assets in government owned banks like NBL. Other factors leading to accumulation of NPAs are weak loan sanctioning process. Ineffective credit control review and classification of loans enables banks to monitor quality of their loan portfolios and to take remedial action counter deterioration in credit quality. In addition to these , establishing recovery cell, hiring asset Management Company are also measure to resolve the problem on NPL. She has been found the NBL has very high portion of non-performing loan resulting to higher provision in comparison to NABIL and SCBNL. Even the NBL has highest investment in the most income generation assets i.e. Loans and advances, it is in loss. Even the private sector bank, NABIL, has also higher non-performing loan and provision which is higher than acceptable during the study period.

She recommended that the factor which leads to non-performing loan are improper credit appraisal system, ineffective credit monitoring and supervision system etc. Besides that negligence in taking information from Credit Information Bureau may also lead to bad debts. Hence all the three banks are recommended to be more caution and realistic while granting loans and advances. After advancing loan there should be regular supervision and follow up for proper utilization of loan . She also recommended the banks to initiate training and development program for the employees to make

them efficient and professional in credit appraisal, monitoring and proper risk management. The regulation regarding loan classification and provisioning is stringent and tighter than the previous. Hence, NRB should not only impose directives but also create supportive environment for the commercial banks. NRB is recommended to strength Credit Information Bureau so that banks can get required credit information about the borrowers on time. This help in reducing NPL

Maharjan (2006), in his study “NRB Directive, Their Implementation and Impact on Commercial Banks: A Case Study of Himalayan Bank Limited ” with the main objectives are : to examine loan loss provision in commercial banks, to evaluation the proposition of non-performing loan and the level of NPAs in total assets, total deposits and total lending in the Nepalese commercial banks, to analyze the impact of non-performing assets in the performance of commercial banks and to evaluate the relationship between loan and loan loss provision in commercial banks. He has observed that the changes in NRB Directives have made the impact on the commercial banks. Because of new Directives, banks have to increase the operation cost and dividends to shareholders and bonus to the employees are scaled down due to decrease in profit of bank. He has also observed about the protection of deposits of public because of reduction in the loan exposure. He further states that due to new directives, its foresight results lead to banks financially healthy and stronger in future. Finally, he laid down about the changes in directives will bring prosperity to the shareholders, depositors, employees and the economy of the country as a whole. He suggested, in his thesis, to NRB that the NRB should issue directives after being proper homework. NRB must strengthen the functioning of its Credit Information Bureau. NRB should be piratical and should issue directives to be applicable in the context of Nepal, not only to meet the international standard. Otherwise, complaints from commercial banks may arise. However, in the present context, the commercial banks have to comply such directives and maintain its policies and NRB has directed commercial banks to obey such rules and regulations, otherwise NRB will take action as per RB Act, 2058 B.S.

Presently, NRB has issued directives relating to banking regulations and prudential comprises then directives. The findings of above study may indicate the certain impact of the new directives to the commercial banks.

Barahi, Mila (2008), entitled’ A Comparative Study on NRB Directives & its implementation in Nepalese Commercial Bank ’’ (A case study of Everest Bank Limited, Nepal Bangladesh Bank and Lumbini Bank Limited) revealed that Everest Bank had risky averse attitude of the management or they have policy of investing low in the risky assts i.e. loan and advances as compared to NBBL and

LBL because the loan and advances to total asset ratio of LBL, NBBL and EBL during the study period was appeared to be 52.3% 47 % and 29.34 % respectively . The EBL has higher proportion of the investment in risk free or nominally risky assets like treasury bills, National saving bonds. Similarly, the loans and advances to total deposit ratio of NBBL, LBL and EBL during the study period was found to be 57.63% , 56.35% and 35.94 % respectively . It indicates that EBL has the most consistent and variability during the study period where as the NBBL has the higher consistent and variability as comparison to other two banks. LBL has the moderate level of consistent and variability.

Total loan of NBBL, LBL and EBL was found to be performing loan .Not only the public sector bank, even private sector bank like NBBL has higher proportion of non-performing loan. However, in recent years NBBL has shown significant decrement in non – performing assets, which are the result of effective bank credit management and its efforts of recovering bad debts through the recovery of establishment of recovery cell.

Luitel (2009), has conducted a study on “Analysis of Non-Performing assets and loan loss provision of Commercial Banks; with special reference to SCBNL, BOK & EBL” with the main objective of examining and studying of non-performing assets and loan loss provision of commercial banks. The specific objectives of the study were;

-) To find out the level of non-performing assets in selected commercial bank.
-) To find out the loan loss provision maintained by the bank.
-) To measure the relationship between NPA with total deposit and net profit.

The major findings of the study were;

-) The non-performing assets covered 0.79% of the total assets of SCBNL, 2.40 % of the total assets of BOK and 0.80 % of the total assets of EBL, thus implying more risky assets in BOK compared to SCBNL and EBL.
-) Likewise, the non-performing assets to total deposit of SCBNL is 0.89 % and that of BOK is 2.80 % and EBL is 0.93 % , which has indicated better loan management in SCBNL than in BOK and EBL.
-) In average, SCBNL has kept 2.89 % of total loans as loan loss provision and BOK has kept 3.71 % as loan loss provision. Similarly, the loan loss provision represented 141.99 % and 106.40 % and 288.06 % of non-performing assets in SCBNL, BOK and EBL respectively.

Amatya, Prakash (2010), entitled “NRB Directives Impact & Implementation of NRB on Commercial Banks in respect to SBL, EBL and RBB”. In his study report tried to find out the effects of the prudential directives issued by NRB to the CB's and their implementation. He has concluded both the negative and positive facts of NRB directives. He concludes that, NRB directives are successful in making the financial system healthy and stronger in the long run. These directives have been able to protect the banking sector from bankruptcy. As well NRB directives are not only bringing prosperity to the banks but also to its shareholders, depositors, employees and also to the economy of the country as a whole. The regional economic integration, adaptation of international standards in the banking industry will make it efficient & competitive with the international banks.

Besides all these positive facts, the NRB prudential directives have some negative aspects also. Since Nepal is a developing country and has small market where banking history is not so old, adaptation of the international standards is not suitable and will be hard for compliance of international level norms. Strict disbursement of loan will reduce credit and as a result interest income will be affected. As well higher the portion of loan & advances results higher the level of loan loss provision which would lead to get less return. As well increase in the operational procedures of the bank will increase the operational cost of the bank. Revision and frequent changes in directives leads to inefficient management.

He concludes, since for every topic there is always positive and negative aspects, one should adopt its positive aspect and well negative aspect should be considered and focused on how to take more benefit from it and for this we have to concentrate on implementation part.

Paudel, Smriti (2011), “A study on Non Performing Loan and Loan Loss Provisioning of Commercial Banks with reference to ADB, RBB, SCBNL and EBL”. Main objectives of her study are to find out the proportions of non-performing loan, relationship between loan & loan loss provisioning and loan loss provisioning & profitability, factors that affects to accumulate the non-performing loans in selected banks. A brief problem and conclusion with recommendations made in her thesis are as follows:

She has pointed out the problems of commercial banks as "Commercial Banks /financial institutions in Nepal have been facing several policies and guidelines of NRB, political instability, security

problem, poor information system, over liquidity caused by the lack of good lending opportunities, increasing non-performing loan etc. In the present Nepalese banks are facing problem of increasing NPA, more amount have to be allocated for loan loss provisioning". She further states, "Ineffective credit policies, political pressure to lend to uncreditworthy borrowers, overvaluation of collateral are the major causes of mounting non-performing assets in government owned banks."

She suggest that resolve the NPAs problems immediate remedial action for the recovering bad debts and hiring Assets Management Company, exploring the new areas of investment, more caution to taken while granting loans, efficient and professional credit appraisal, strictly follow the NRB directives and effective & efficient stringent of NRB and Credit Information Bureau (CIB).

2.4 Research Gap

From the review of previous research and study it has been found that increasing no-performing loan and loan loss provision is one of the most challenging problems faced by existing commercial banks in the current scenario. Some researchers have studied on implementation aspects on NRB directives by commercial banks while some other studied non-performing loan and loan loss provisioning of commercial bank. No research has been found on the impact of non-performing loan and loan loss provision on the performance of commercial banks, required profitability and capital adequacy of commercial banks as per Nepal Rastra Bank Directives. Likewise no research has been found of sufficient to discover whether NRB directives do have positive or negative impact on commercial banking. It is equally important to check whether the issued directives are being followed properly or not. If despite of following the directives, commercial banks are not able to enhance their situation or their situation worsens instead of enhancing, we can conclude that the directives are not user friendly. It is necessary to include other sectors of the directives in order to know whether the directives do have positive impact on banks or whether the directives are actually being followed by the banks. Therefore, this research is made to fulfill research gap by taking the reference of Nepal Investment Bank Limited and Nabil Bank Limited. This research will be able to deliver some of the present issues, latest information and data regarding loan classification, non-performing loan and loan loss provisioning and their ratios, data and real picture of loan advances of Nepalese Commercial Banks with reference to Nepal Investment Bank Limited and Nabil Bank Limited.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Introduction

Advanced learner's Dictionary of Current English defined research as "a careful investigation or inquiry especially through search for new facts in any branch of knowledge" Research is a systematic inquiry of any particular topic and methodology is the method of doing research in well manner. Thus research methodology is a way to solve the problem systematically. It is understood as a science of studying how research is doing scientifically. It is analysis of specific topic by a proper method. "Research may be defines as the systemic method of discovering new facts or verifying old facts, their sequences, interrelationship causal explanation and the natural laws which govern them . Research methodology refers to the various sequential steps to be adopted by the researcher while the studying a problem with certain object in view. Its focus is made on the application of the technique and procedure to analysis the relevant variables to see the basic relationship between relevant topics. It is 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 conclusion to determine whether they fit the formulated hypothesis. To sum up research is the process of a systematic and in – depth study or research of any particular topic, subject or area of investigation backed by the collection, compilation, presentation and interpretation of relevant details or data. This chapter looks in to the research design, population and sample, sources of data, data collection Techniques, Period of study, and method of data analysis.

3.2 Research Design

Research design is the overall framework of the activities to be undertaken for the course of research study. It is a strategy for the research work. It guides about the collection and analysis of data, the research instruments to be employ and the sampling plan to be followed. The research design describes about the general work plan for collection, interpretation, analysis and the evaluation of collected data. It is the core integrated system that is employed for overall research work.

This research is aimed at studying of NRB Directives impact to Nepalese Banking & Financial Institution and non-performing loan and loan loss provisioning of commercial banks in Nepal and provide valuable recommendation. This research will follow analytical, descriptive and exploratory research design and it also analysis the compositions of trend of non-performing assets, loan recovery

and profitability condition of commercial banks. The design for this research is made by collection of information from different sources by using various financial and statistical tools.

3.3 Population & Sample

The term population for research means all the members or any well defined class of people, event or object. It means that the entire group of people, events or things of interest that a researcher wishes to investigate. A sample is a collection of items or elements from population or universe. Hence, a sample is only a portion or subset of the universe or population. It comprises some observations selected from the population. Sampling may be defined as the selection of some part of an aggregate or totality on the basis of which judgment or inference about the aggregate or totality is made.

As this study is about non-performing loans and loan loss provisioning of commercial banks, all 32 commercial banks of Nepal is taken into account as population and out of the total population two following commercial banks are selected as sample for this study.

1. Nabil Bank Limited
2. Nepal Investment Bank Limited

3.4 Sources of Data

Basically, there are two types of data one is primary and second is secondary data. These data are classified on the basis of the nature of collection. Primary data: Primary data is collected for the first time and it is original in its form. On the basis of research questions information are directly gathered from the informant is known as primary data. These data are collected from the informant directly. These data are first hand information.

Secondary Data: Secondary data are reused data. Those data already collected by various individuals and organizations in the form of primary data and secondary data are known as secondary data.

This research is based upon secondary data. Secondary data collected from various sources are used to find out various research problems. The study is mainly based upon secondary data. Sources for these secondary data are taken from financial statements of banks. Besides this all relevant information from various sources are referred. Hence for the purpose of research various plans, structure and strategies are designed. To achieve the objective of the study, descriptive and analytical research design

has been proposed. Some financial tools and statistical tools may come in use. This study has been conducted on the basis of secondary data. The data related to the research purpose like deposit, investment, loan and advances etc. are obtained from banks, central bank and various publications. The supplementary data are obtained from various institutions and regulatory bodies like Nepal Rastra Bank, Security Exchange Board, Ministry of Finance and National Planning etc. All the secondary data are compiled processed and tabulated in the time series as per the need and objectives' both statistical and financial tools are used in this study. The analysis of data will be done according to pattern of data available. Because of limited time and sources, simple analytical statistical tools such as graph, percentage, Karl Pearson's co-efficient of correlation and the method of least square are adopted in this study. Similarly some strong accounting tools such as ratio analysis

And trend analysis have also been used for financial analysis. The various calculated results obtained through financial, accounting and statistical tools tabulated under different headings. Then they are compared with each other to interpret the results.

3.5 Data Collection Techniques

The required information is collected by conducting visits to each banks, consulting library, surfing the internet and related text books. The annual reports of each bank for the study period are obtained from the official websites of each bank. NRB regulatory directives, statistics of commercial banks of Nepal and other related publications is also obtained from the official websites. Existing literature on the subject matter is collected from various research papers placed in central library. Likewise the review of working papers conducted by various international scholars on the related matters is done through internet surfing to various websites. For the primary data collection, a questionnaire containing 12 questions have been prepared and distributed to the 10 employees of each sample bank, asking them to fill up the questionnaire and return it.

3.6 Period of the Research Study

This study is done with the collection, analysis & evaluation of the five consecutive year's data of Two commercial banks viz. Nabil Bank Limited and Nepal Investment Bank Limited. Meaning that, this study covers its findings from 2006 July to 2011 July.

3.7 Method of Data Analysis

The necessary data collected from the different sources are presented and analyzed systematically. Data are presented simply and understood able pattern through different charts, diagrams, graphs & tables. For the purpose of analysis of collected data, appropriate mathematical, financial as well as statistical tools have been used where necessary. Data are analyzed through Ratio Analysis: Credit Deposit Ratio, Non-performing loan to total loans & advances, Provision held to non-performing loan, Loan loss provision to total loan & advances. Statistical Analysis: Correlation Analysis, Probable Error, Coefficient of Determination.

3.7.1 Financial Tools

Financial analysis is the process of identifying the financial strength and weakness of a firm by properly establishing relationship between the items of the financial statements. To evaluate the financial condition and performance of the bank, a financial analyst needs some yardsticks. The yardsticks frequently used are the ratios and index relating two pieces of financial data. Analysis and the interpretation of the various ratios should give experienced, skilled analyst and a better understanding of the financial condition and performance of the firm than they would obtain from the analysis of the financial data alone.

3.7.1.1 Credit Deposit Ratio (C.D.Ratio)

The deposited money of customers is provided security as well increase the profitability of the bank. Credit Deposit Ratio (CDR) is the parameter that reflects the efficiency of bank in term of mobilization of available deposit effectively. Mathematically, Credit Deposit ratio is calculated by dividing total loans and advances by total deposit figure. Greater the CD ratio implies the greater utilization of total deposits and better earning and vice-versa.

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

3.7.1.2 Capital Deposit Raito

A bank carries out its transaction through the medium of ownership & borrowed capital. Naturally, the function of a bank requires a lot of capital it is known based on deposit in the bank, whether a bank has an adequate ownership capital or not. If there is 8-10% ownership capital of the total deposit of the bank, it is considered good. However, the ratio is to change according to the movement of the economy.

3.7.1.3 Cash Reserve Ratio (CRR)

It is the proportion of the deposit liabilities that commercial banks are required to keep as a cash deposit with the NRB. The level of CRR influences the commercial banks' credit creation capacity. If there is a higher rate of CRR, then the CBs need to keep the higher portion of deposits for CRR purpose with the central bank. As such, they have less deposit for lending purpose. Hence, the higher CRR squeezes the money expansion in the economy. Conversely, the low CRR rate means CBs need to keep less of the deposits so that they can lend more, resulting in the expansion of money supply in the economy. Moreover, CRR also serves as a measure for smoothing payment system as a prudential measure by avoiding sudden liquidity crunch in the banking system.

3.7.1.4 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 total risk weighted assets of the bank.

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

To measure the Adequacy of Capital Fund

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

Where,

Total Capital Fund = Core Capital + Supplementary Capital

4.7.1.5 NPL to Total Loan & advances Ratio

This ratio shows the quality of debts or assets in the form of loan & advances. The NPL to total loan & advances ratio is the mathematical proportion of NPL to the total loan & advances. Hence lower the ratio is preferred. In real, there is not any standard about this ratio but as per the international standard 5 % is allowed. In the context of Nepal, 10% is acceptable.

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

3.7.1.6 Provision Held to NPL Ratio

Provision held to NPL is the proportion of volume held for the NPL of the bank. Provision for the NPL means the cushioned amount by the bank to safeguard the possible losses in future. Meaning that higher the portion signifies that the banks are safeguards against future contingencies and in another side it may reduce the efficiency of operation as well profit of the bank. Although higher the ratio refers better the financial strength of the bank.

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

3.7.1.7 Loan Loss Provision to Total Loan and Advance Ratio

Loan loss provision indicates the cushion against the future risk created by the defaulters in the payments of loan & advances. Indirectly, this ratio describes the quality of assets in the form of Total Loan & Advances that a bank is holding. Since, as per the directives issued by NRB high provision should made for the NPL, the higher volume of provisioned amount implies increasing Non-Performing Loan. Similarly, lower the provisioned amount implies lower amount of NPL and accordingly good quality of loan & advances. So, lower ratio is preferred.

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

3.7.2 Statistical Tools

The statistical tool is essential to measure the relationship of two or more variable. It is the mathematical technique used to facilitate the analysis and interpretation of the performances of the organizations. It also helps to present the data, show the relation and deviations or differences of variables of organizations. In this study, the following statistical tools are used:

3.7.2.1 Arithmetic Mean (A.M.)

The mean is the figure we get when the total of all the values in a distribution is divided by the number of values in the distribution. The arithmetic mean is also known as the average. It should, however, be remembered that the mean can only be calculated for numerical data. The mean is an appropriate term than saying average. The mean of data is based toward extreme values. The mean is suitable when the scores are distributed symmetrically about the center of the distribution. This is calculated by using following formulae:

$$\text{Mean } (\bar{X}) = \frac{\sum X}{N}$$

Where,

$\sum X$ = Sum of the variable 'x'

N = No. of observation

This tool is used to find out mean of Total Deposit, total loan and advances Non- Performing asset, Loan Loss Provision.

3.7.2.2 Standard Deviation (S.D.)

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

$$\text{Standard Deviation } (s) = \sqrt{\frac{\sum (x - \bar{x})^2}{N}}$$

3.7.2.3 Correlation Coefficient

Correlation coefficient refers to the degree of relationship existing between the two variables. The value of correlation coefficient determines the associations between the dependent and independent variables. It is the geometric mean of the two regression coefficients. When the change in the value of one variable is accompanied by the change in another variable, then the variables are said to be correlated. Meaning that, increase and decrease in one variable cause increase or decrease in another variable, then such variables are said to be correlated. The value of correlation coefficient is denoted by 'r'. The value of 'r' describes only the degree of relationship but it does not explain about the cause and effects of the relationship.

There are various techniques of calculating the value of correlation coefficient. Among the different techniques, Karl Pearson's coefficient of correlation is widely used. Following types of correlation coefficient are calculated for this study applying the Karl Pearson's techniques.

*Correlation coefficient between the Total Loan & Advances and Non- Performing Loan.

* Correlation coefficient between the NPL and Total Loan & Advances.

* Correlation coefficient between Loan Loss Provision and Total NPL.

$$\text{Correlation Coefficient (r)} = \frac{n \sum xy - \sum x \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

3.7.2.4 Probable Error

Probable error is the mathematical expression that helps to judge the reliability and significance of the value of coefficient of correlation. It is denoted by P. Er. If the value of correlation is greater than six times of the value of the Probable Error, then the obtained correlation coefficient is significant. If it is not, then it is said to be insignificant and there is chance of correlation.

$$\text{Probable Error} = 0.6745 \times \frac{1-r^2}{n}$$

3.7.3 Diagrammatic and Graphical Presentation

Collected data are presented through different charts and diagrams. These are the visual aids that give a bird eye view of a given sets of numerical data. Diagrams and charts are presented here so that the collected data could be read in a simple and readily manner. Lots of Bar Diagrams, Histograms, and Trend Liners are used for the presentation and analysis of the data.

CHAPTER – IV

DATA PRESENTATION AND ANALYSIS

This chapter deals with the analysis and interpretation of the data into the understandable format that are collected for the purpose of the study. The data were tabulated and kept in sequential order according to the purpose of the study. Data collected are analyzed on the basis of financial and statistical tools supported by the diagrams and graphs. Findings, conclusions and the necessary recommendations obtained from the analysis are presented in the next chapter.

4.1 Financial Analysis

Financial analysis is the process of identifying the financial strength and weakness of a firm by properly establishing relationship between the items of the financial statements. Analysis and the interpretation of the various ratios should give experienced, skilled analyst and a better understanding of the financial condition and performance of the firm than they would obtain from the analysis of the financial data alone.

4.1.1 Loan and advance to Total Deposit Ratio (Credit Deposit Ratio)

Loan and Advance is major function of commercial banks. Its circulation plays vital role in the profit of company and its overall performance of company. Banks must be able to use its fund and assets as loan and advances.

Same way deposit collection is major function of commercial banks. These deposit demands interest. Collected deposits in the form of saving and fixed deposits are to be paid certain interest. So, if banks are unable to mobilize these deposits in the form of loan and advances they may not be able to pay any interest. Finally and gradually they may go bankrupt. Hence it is always necessary to mobilize funds of commercial banks in the form of loan and advances.

The ratio of Loan and Advances to Total Deposit reveals the loan and advance situation of commercial banks. It shows how much of their deposit is utilized in the form of loan and advances. While disbursing deposit as loan and advance banks must act prudently. Banks deals with many people known as its clients in the form of depositor, creditor and other stake holders. These clients have their own problem and demands. They approach banks with different demands and problems.

Banks have to disburse money to lenders and borrowers. So bank must have certain money to meet the needs of borrowers and lenders. Banks cannot use all deposits as loan and advance. Meantime bank cannot preserve deposit without using as loan and advances because they are obliged to meet the interest of deposit. The ratio is calculated by dividing Total Loan and Advances by total deposit as follow:

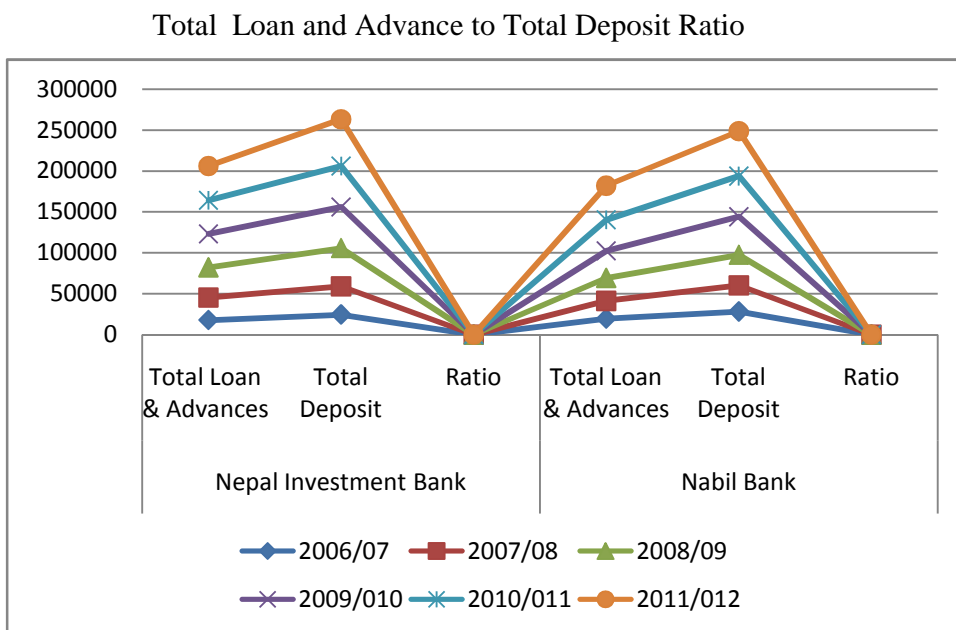
$$\text{Loan and Advances to Total Deposit Ratio} = \frac{\text{Total Loan and Advances}}{\text{Total Deposit}}$$

Table 4.1
Total Loan and Advances to Total Deposit Ratio

Name	Nepal Investment Bank			Nabil Bank			
Year	Total Loan & Advances	Total Deposit	Ratio	Total Loan & Advances	Total Deposit	Ratio	Remark
2006/07	17769	24489	0.72	19478	28214	0.69	
2007/08	27529	34452	0.74	21759	31915	0.68	
2008/09	36827	46698	0.79	27990	37348	0.75	
2009/010	40948	50094	0.82	33031	46410	0.71	
2010/011	41095	50138	0.82	38034	49696	0.77	
2011/012	41637	57010	0.73	41605	55023	0.76	

Source: Website of Investment Bank & Nabil Bank

Figure 4.1



The above table reveals the ratio of Total Loan and Advances to the Total Deposit of the bank. The ratio is dispersed between 0.72 and 0.82 for Nepal Investment Bank. The highest ratio is 0.82 and the lowest ratio is 0.72 of NIBL. The ratio is fluctuating.

It means the ratio of Loan and Advances to the total Deposit ratio is fluctuating. Thus ratio is important indicator of the performance of bank because it reveals the competence of the bank to disburse its deposit fund as loan and advance to the various sectors. This is also important for the overall economy of the country. Loan and advance goes to entrepreneurs who will help in economic growth and economic development.

Same way the ratio of NABIL Bank is dispersed between 0.68 to 0.77. The highest ratio is 0.77 and lowest ratio is 0.68. The ratio is gradually increasing from 2006 to 2011. The maximum ratio 0.77 has reached in 2010 but in 2011 it has again declined to 0.76. Average loan and advances of Nabil bank is lower than NIBL as well as the average deposit collection of NIBL is higher than Nabil Bank. So the inverse condition reflects the attitude of management in these two banks.

4.1.2 Non-Performing Loan to Total Loan and Advance Ratio

Non-performing assets, also called non-performing loans. As per the directives issued by the NRB, commercial banks should classify their loan in terms of pass loan, substandard loan, doubtful loan and loss loan. Hence, the loans falling in the category of substandard, doubtful and the loss loan are considered as non-performing loan. Increase in the NPL results higher volume of loan loss provision and of course deduction in the banks profit. That's why, NPL could not only affect the banking operation but also it has serious implication in the economic performance of the country. This ratio NPL to total loan & advances implies the proportion of the NPL in the bank's loan portfolio. Meaning that, higher the ratio represents higher portion of NPL and vice-versa. Hence, lower the ratio preferred the best.

It is calculated as follow
$$\frac{\text{Non- Performing Loan}}{\text{Total Loan and Advances}}$$

Table 4.2

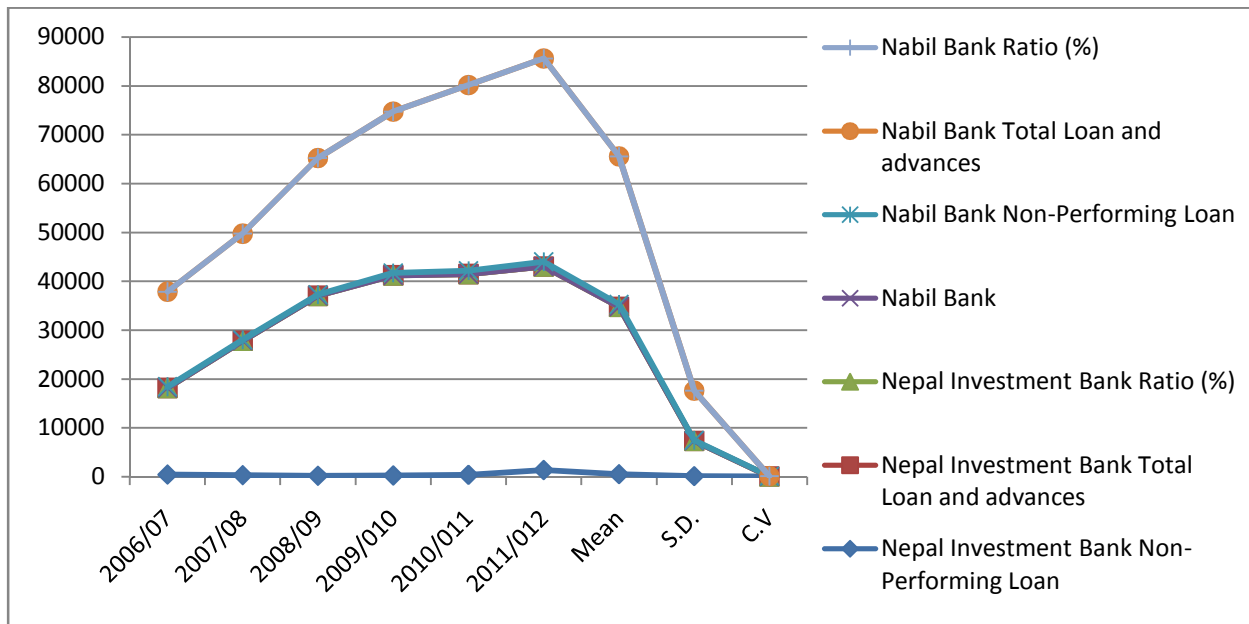
Non-Performing Loan to Total Loan and Advance Ratio

Year	Nepal Investment Bank			Nabil Bank		
	Non-Performing Loan	Total Loan and advances	Ratio (%)	Non-Performing Loan	Total Loan and advances	Ratio (%)
2006/07	421.13	17769	2.37	218.15	19478	1.12
2007/08	308.32	27529	1.12	161.02	21759	0.74
2008/09	213.60	36827	0.58	223.92	27990	0.80
2009/010	274.35	40948	0.67	488.86	33031	1.48
2010/011	386.29	41095	0.94	673.20	38034	1.77
2011/012	1,382.35	41637	3.32	969.40	41605	2.33
Mean	497.67	34300.83		455.76	30316.17	
S.D.	137.09	7221.22		74.22	10207.46	
C.V	48.04	46.11		23.27	35.56	

Source: Researcher Calculation

Figure 4.2

Non-Performing Loan to Total Loan and Advance Ratio



Above table shows the ratio of Non- performing loan to the total Loan and Advances. Average non-performing loan of the bank within the study period Rs.497.67 million and SD is Rs 1370.9 million and CV is 48.04% of NIBL. Same way average loan and advances bank has disbursed within study period Rs 34300.83 million and SD is Rs 7221.22 and CV is 46.11 % of NIBL.

The ratio is fluctuating. In the year 2006/07 the ratio was 2.37 like as in the year 2009/010 ratio was 0.67 and in the year 2011/012 it was 3.32%. Every year within the study period it is just fluctuated. It means bank management is conscious and cautious about the affects of NPL so it trying to reduce it every year in big chunk.

In other hand Nabil Banks average NPL is Rs 455.76 million and SD is Rs 74.22 million and CV is 23.27%. Banks average loan and advance disbursement is Rs30316.17million and SD of Loan and Advances is Rs.10207.46 million and CV is 35.56%.

The ratio of NPL to Total Loan and advances in this bank is fluctuating. In the year 2006/07 NPL was Rs 218.15 million but it has increased by about 2.25 times in the year 2009/010 to RS 488.86 million. The ratio of NPL was gradually increasing up to 2011/012. The ratio also increasing sharply from 0.74 to 2.33. This indicated the management's should conscious towards NPL. But from the figure we can see the Bank is trying to reduce the NPL amount.

4.1.3 Loan Loss Provision to Loan & Advances Ratio

This ratio is often known as loan Loss Ratio. Loan loss provision is the amount cushioned against the future contingencies created by the default of the borrowers in the payment of loans and ensures continual solvency of the banks. As per the directives issued by the NRB, commercial banks should create loan loss provision according to their category to offset the possible future losses. Hence, this ratio implies the portion of the LLP in terms of total loans & advances. Since high provision has to be made for the NPL, higher the ration reflects increasing level of NPL in the total loan portfolio and lower the ratio implies the good quality of loans & advances. Loan loss provision to total loan and advance ratio express the loan loss provision to total loan and advances. Higher the ratio implies that much of the fund of bank remained unproductive as reserve. The ratio is calculated using following formula .

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

Table 4.3

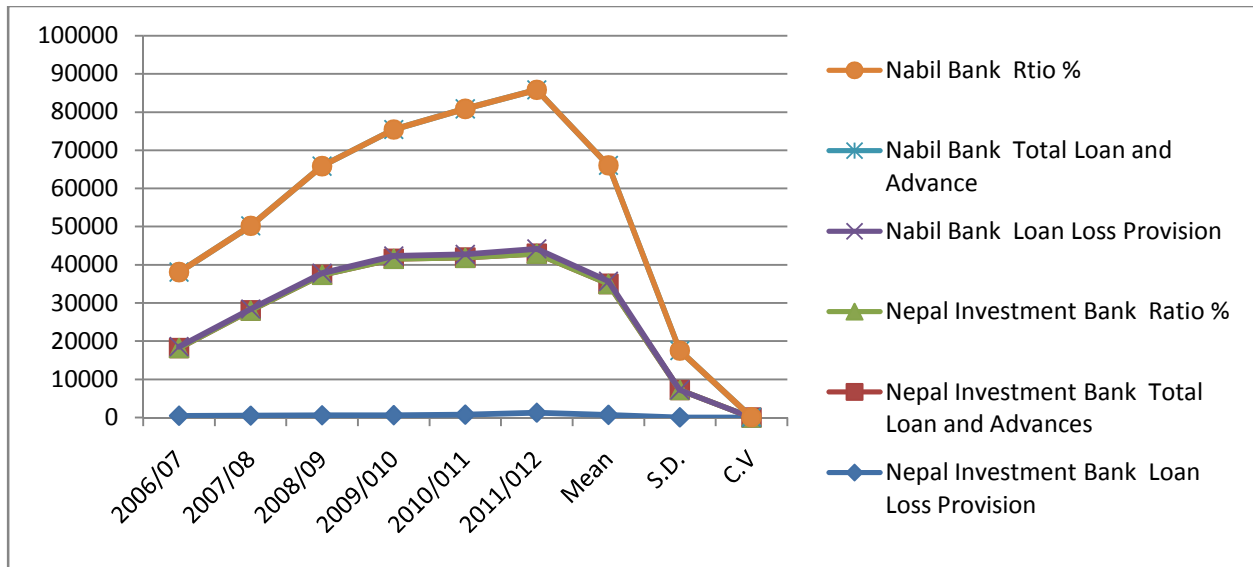
Loan Loss Provision to Loan & Advances Ratio

Name	Nepal Investment Bank			Nabil Bank		
Year	Loan Loss Provision	Total Loan and Advances	Ratio %	Loan Loss Provision	Total Loan and Advance	Rtio %
2006/07	472	17769	2.66	354	19478	1.82
2007/08	527	27529	1.91	390	21759	1.79
2008/09	581	36827	1.58	406	27990	1.45
2009/010	628	40948	1.53	762	33031	2.31
2010/011	790	41095	1.92	871	38034	2.29
2011/012	1266	41637	3.04	1261	41605	3.03
Mean	710.67	34300.83		674	30316.17	
S.D.	47.57	7221.22		38.07	10207.46	
C.V	23.41	46.11		19.66	35.56	

Source: Researcher Calculation

Figure 4.3

Loan Loss Provision to Loan & Advances Ratio



Above table shows the ratio of Loan Loss Provision to the Total Loan and Advances. If the provision increases it will retain fund of the bank as non- productive resource. The provision held is for the security of non-performing loan and advances as stipulated by central bank’s directive. In the above table the ratio is fluctuating. In the year 2006/07 it was 2.66% but it has declined 1.53% in the year 2009/010 as well as the ratio is 3.04 in the year 2011/012 of *NIBL*. . It implies bank management of *NIBL* is conscious and cautious about the affects of the provision in the overall performance of the

bank so it has made efforts to decline it gradually.

In case of NABIL Bank also the ratio is tapering continuously. In 2006/07 it was 1.82% but it has reduced to 1.45% in the year 2008/09 but in the year 2011/012 the ratio was 3.03% So it has fluctuating in the study period. It also reveals the attitude of management towards the consequences of LLP.

Within the study period average LLP of NIBL is higher than Nabil Bank. Average LLP of NIBL is Rs 710.67 million but the average LLP of Nabil Bank is Rs. 674 million. The CV of LLP of NIBL is 23.41% where as Nabil Bank has 19.66%. It means management of Nabil is guardedly tapering the LLP so that the effect of LLP can be reduced as far as possible

4.1.4 Non-Performing Loan to Total Deposit Ratio

Commercial banks' major function is to collect deposit and disburse it in the form of loan and advances. When loan and advances are lent there is risk. Some lenders may be able to pay because of bankrupt or some may turn cheat. According to the directive to NRB commercial banks has to categorize loan and advances based upon the repayment time into productive or non productive loan. Productive loan help to enhance performance of bank and also help in boosting economic situation of country. But non-productive loan known as non-performing loan erodes not only the performance of the bank but also economy of country. So collected deposit must be used wisely. The ratio of NPL to Total Deposit indicated the relationship between NPL and Total Deposit. It is calculated as follows formula:

$$\text{Non-Performing Loan to Total Deposit} = \frac{\text{Non-Performing Loan}}{\text{Total Deposit}}$$

Table 4.4

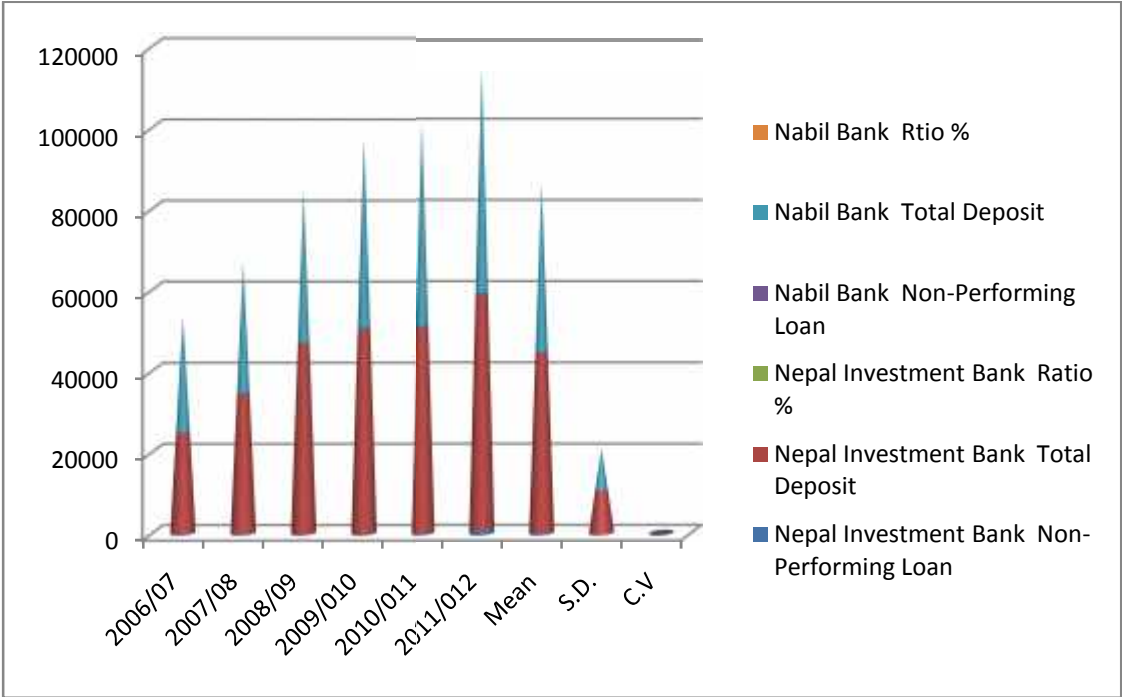
Non-Performing Loan to Total Deposit Ratio

Name	Nepal Investment Bank			Nabil Bank		
	Non-Performing Loan	Total Deposit	Ratio %	Non-Performing Loan	Total Deposit	Ratio %
2006/07	421.13	24489	1.72	218.15	28214	0.77
2007/08	308.32	34452	0.89	161.02	31915	0.50
2008/09	213.60	46698	0.46	223.92	37348	0.60
2009/010	274.35	50094	0.55	488.86	46410	1.05
2010/011	386.29	50138	0.77	673.20	49696	1.35

2011/012	1,382.35	57010	2.42	969.40	55023	1.76
Mean	497.67	43813.50		455.76	41434.33	
S.D.	137.09	10539.07		74.22	9990.09	
C.V	48.04	43.02		23.27	46.02	

Source: Researcher Calculation

Figure 4.4
Non-Performing Loan to Total Deposit Ratio



In the table ratio of the NPL to Total Deposit of NIBL is fluctuating declining. In year 2006/07, 2007/08, 2008/09, 2009/010, 2010/011 and 2011/012 the ratio is 1.72, 0.89, 0.46, 0.55, 0.77 and 2.42 respectively. In case of Nabil bank also the ratio is in fluctuating mode. In year 2006/07 it was 0.77 where as in the year 2008/09 it was 0.60 and in the year 2011/012 it was 1.76. In the Both banks are trying to reduce the proportion of NPL to total deposit.

4.1.5 Loan Loss Provision to Non-Performing Loan

Loan loss provision is reserve created to save individual and households savings. Commercial banks have to maintain certain percentage as loan loss provision on the basis of the nature of loan. Higher the NPA higher the Loan loss Provision. If Loan loss provision is higher, it may curtail the performance of bank. If NPA is higher, it has to create higher loan loss provision. Higher loan loss provision is trained from its available funds which otherwise can be used as productive fund. The

ratio of loan loss provision to NPA shows the relationship between them. What is its trend? Is it increasing or decreasing? The ratio is calculated using following formula:

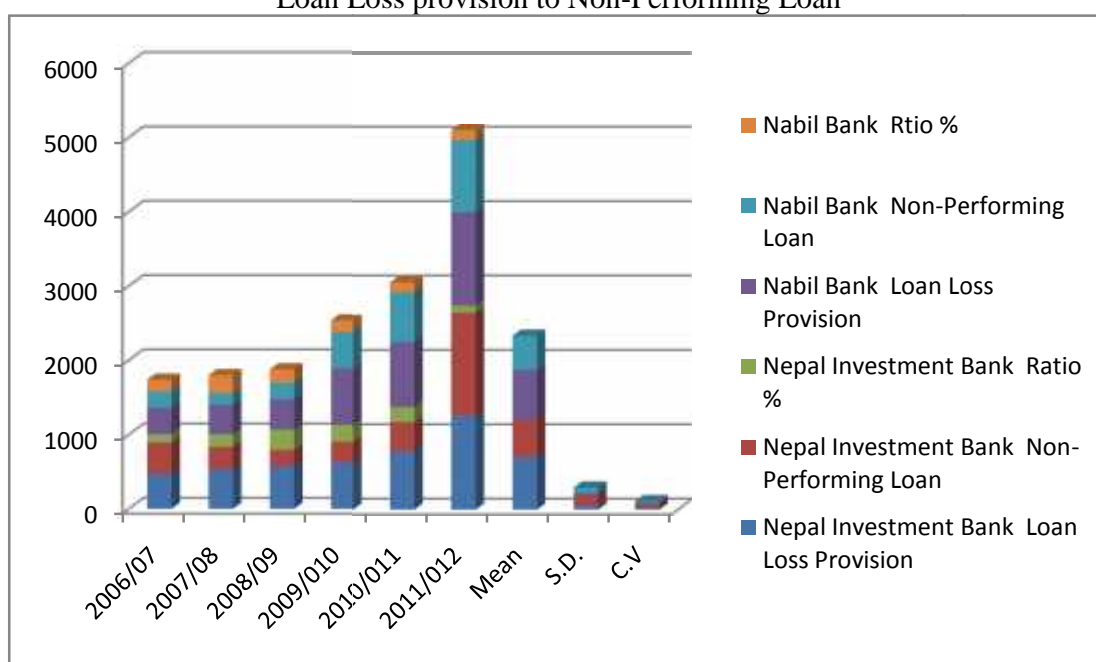
$$\text{Loan Loss provision to Non-Performing Loan} = \frac{\text{Loan Loss Provision}}{\text{Non-Performing Loan}}$$

Table 4.5
Loan Loss provision to Non-Performing Loan

Name	Nepal Investment Bank			Nabil Bank		
	Loan Loss Provision	Non-Performing Loan	Ratio %	Loan Loss Provision	Non-Performing Loan	Rtio %
2006/07	472	421.13	1.12	354	218.15	1.62
2007/08	527	308.32	1.71	390	161.02	2.42
2008/09	581	213.60	2.72	406	223.92	1.81
2009/010	628	274.35	2.29	762	488.86	1.56
2010/011	790	386.29	2.05	871	673.20	1.29
2011/012	1266	1,382.35	0.92	1261	969.40	1.30
Mean	710.67	497.67		674	455.76	
S.D.	47.57	137.09		38.07	74.22	
C.V	23.41	48.04		19.66	23.27	

Source: Researcher Calculation

Figure 4.5
Loan Loss provision to Non-Performing Loan



The table shows the ratio of loan loss provision to non-performing loan. The ratio is in fluctuation that means the ratio is increasing some time and decreasing next time. In the years 2005/06 the ratio was 112.08 likewise in 2009/2010 it was 228.90 and in year 2011/012 ratio is 91.58 of NIBL. The average loan loss provision in the study period is Rs 710.67 million. The standard deviation of the loan loss provision is Rs.47.57 million. There is less variation in loan loss provision because CV is only 23.41%. Average Non- performing loan within the study period is Rs. 497.67 million. Its SD is Rs 137.09 million and CV is 48.04%.

The ratio of loan loss provision to the Non-performing loan is fluctuating. Loan loss provision to the Non-performing loan is directly related. As the NPL increases LLP also increases. Although the ratio is fluctuating, it remained somewhat near 0.91 That means bank is trying to maintain the ratio constant at minimum. In case of Nabil bank the ratio is also in fluctuating mode. The ratio is highest in year 2007/08 that is 242.21% which is lowest in year 2010/011 and 2009/010 that is 155.87%. But in year 2011/012 it has reduces to 130.08%.

4.1.6. Net Profit to Total Loan and Advances

Net Profit reveals the performance of bank. It shows efficiency of management. It shows the capacity of management has been able to utilize deposits. Net profit increment plays vital role of the bank. The ratio of net profit to total loan and advances reveals profit in comparison to total loan and advance disbursed.

It is calculated using following formula =

$$\frac{\text{Net -Profit}}{\text{Total Loan and Advances}}$$

Table 4.6

Net Profit to Total Loan and Advances

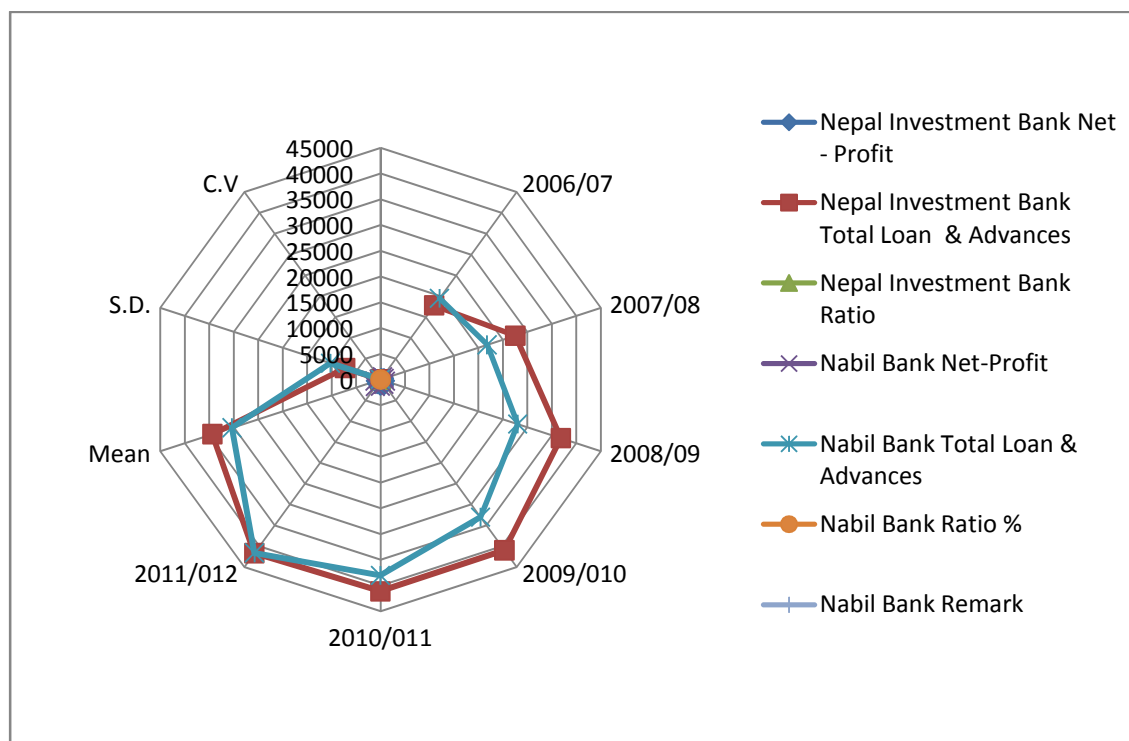
Name	Nepal Investment Bank			Nabil Bank			Remark
	Year	Net - Profit	Total Loan & Advances	Ratio %	Net-Profit	Total Loan & Advances	
2006/07	350	17769	1.97	673	19478	3.46	
2007/08	697	27529	2.53	746	21759	3.43	
2008/09	901	36827	2.45	1031	27990	3.68	
2009/010	1265	40948	3.09	1138	33031	3.45	
2010/011	1176	41095	2.86	1344	38034	3.53	
2011/012	1039	41637	2.5	1700	41605	4.09	

Mean	904.67	34300.83		1105.53	30316.17		
S.D.	200	7221.22		242.85	10207.46		
C.V	27.6	46.11		33.10	35.56		

Source: Researcher Calculation

Figure 4.6

Net Profit to Total Loan and Advances



The given table reveals the ratio of Net profit to Total Loan and Advances. The ratio of NIBL is 1.97, 2.53, 2.45, 3.09, 2.86 and 2.5 in the years 2006/07, 2007/08, 2008/09, 2009/10, 2010/11 and 2011/12 respectively. The average Net profit within the study period is Rs 904.67 million and its SD is Rs 200 million and CV 27.6%. Same way average loan and advances within the study period is Rs 34300.83 million and SD is 7221.22 and CV 46.11%. Net profit is gradually increasing during the period in comparison to the loan and advances. In case of NABIL Bank the ratio is 3.46, 3.43, 3.68, 3.45, 3.53 and 4.09 in the years 2006/07, 2007/08, 2008/09, 2009/10, 2010/11 and 2011/12 respectively. The average net profit within the study period is Rs 1105.53 million and SD is 242.85 million and CV is 33.10% same way average loan and advances within the study period is Rs. 30316.17 million, SD is Rs.10207.46 million and CV is 35.56 %. The ratio is gradually fluctuating in during the study period. It means bank is unable to harp more profit from its loan and advances.

4.2 Statistical Tools

4.2.1 Correlation

The correlation between variables varies from -1 to 0 to +1. If two variables are inversely correlated then they have negative correlation, whereas if they are highly correlated or proportionately correlated then they have positive value. If value is between 0.7 and 1, then they are highly correlated.

For the purpose of decision-making interpretation of the result is based upon following conditions:

When $r = 1$, there is perfect positive correlation

When $r = -1$, there is perfect negative correlation

When $r = 0$, there is no correlation

When r lies from 0.7 to 0.999 (-0.7 to -0.999), there is a high degree of positive (or negative) correlation.

When r lies from 0.5 to 0.6999, there is moderate degree of correlation. When r is less than 0.5, there is low degree of correlation.

4.2.1.1 Correlation between the Loan Loss Provision and Loan & advances .

The co-efficient shows the degree of relationship between Loan loss Provision and Loan and Advances. Here, Total loan and advance is considered as independent variable (x) and loan loss provision is dependent variable (y). The below table describes the total relationship between Loan Loss provision and Loan and Advances, during the study period.

Table 4.7(a)

Correlation Co-efficient Between Loan Loss Provision and Loan and Advances for Nepal Investment Bank Limited (NIBL)

r	P.E.(r)	6P.E.(r)
-0.56	0.27	1.39

Source: Annex 1

Table 4.7(b)

Correlation Co-efficient Between Loan Loss Provision and Loan and Advances for Nabil bank

r	P.E.(r)	6P.E.(r)
-0.066	-0.2007	1.804

Source: Annex 2

The table 4.7 (a) reveals that the coefficient of correlation between Loan loss Provision and Loan and Advance of Nepal Investment Bank Limited, the value is negative 0.56(-0.56). It means there is negative moderate degree of correlation between Loan loss Provision and Total Loan and Advances. The value of P.E. (r) is 0.27 and the value of 6P.E. (r) is 1.39. So value of r is less than 6 P.E. so the value of correlation is insignificant. It implies there is no significant relationship between loan loss provision and the total loan and advances disbursed. On the other hand table 4.7(b) reveals the coefficient of correlation between LLP and Loan and advances of Nabil bank is negative 0.066 (-0.066). It means there is very low negative correlation between LLP and Loan and Advances in case of Nabil bank. The value of P.E. (r) is 0.2007 and 6P.E. (r) is 1.804. Value of r is less than the value of 6P.E. (r). It means there is insignificant relation between LLP and Loan and Advance.

4.2.1.2 Correlation between Loan Loss Provision and Non-Performing Loan

To measure and evaluate the co-efficient of correlation between these two variables i.e. loan loss provision (LLP) and non-performing loan (NPL). In this analysis, LLP (y) is taken as dependent variable and NPL is taken as independent justify whether LLP and NPL are highly significant or not. The following table describes the relationship between LLP and NPL within study period.

Table 4.8(a)

Correlation Co-efficient between LLP and NPL of Nepal Investment Bank(NIBL)

r	P.E.(r)	6P.E.(r)
0.786	0.187	0.875

Source: Annex 3

Table 4.8(b)

Correlation Co-efficient between LLP and NPL of Nabil Bank

r	P.E.(r)	6P.E.(r)
0.536	0.469	1.884

Source: Annex 4

From the table 4.8(a) it is revealed that the correlation co-efficient between LLP and NPL of the NIBL is positive correlation between two variables. In another word, as NPL increase LLP also increases but at very low rate. The value of P.E. is 0.187 and 6P.E is 0.875. The value of r is less than 6 P.E. that means there is significant relation between LLP and NPL. It implies that increment in

LLP is not the result of increment of NPL.

In table 4.8(b) the correlation coefficient between LLP and NPL of Nabil bank is positive 0.536 (+0.536), it means that there is high degree of positive correlation between these two variables. In another word, as NPL increases LLP also increases significantly. The value of P.E. (r) is 0.264 and the value of 6P.E. (r) is 1.884 The value of r is less than the value of 6P.E. (r). It implies that the relationship between NPL and LLP in Nabil bank is insignificant.

4.2.1.3 Correlation between Total Loan & Advances and Total Deposit

The calculation was conducted to find out the relationship between loan and advances and total deposit. The table given below shows the correlation between loan and advances and deposit within the study period.

Table 4.9(a)

Correlation Co-efficient between Loan & Advance and total Deposit of NIBL

r	P.E.(r)	6P.E.(r)
0.972	0.442	0.279

Source: Annex 5

Table 4.9(b)

Correlation Co-efficient between LLP and NPL of Nabil Bank

r	P.E.(r)	6P.E.(r)
0.998	0.007	0.05

Source: Annex 6

The table 4.9(a) shows the value of r is positive 0.972(+0.972) which is highly positive in case of NIBL. And again P.E is equal to 0.0442 and 6P.E. is 0.279. The positive value of r means that when deposit increases loan and advances also increases. So one has influence upon another in the positive form. The value of 6P.E. is less than r, i.e. the value of coefficient of correlation is higher than 6P.E. this implies that there is significant relationship between deposit collected and loan and advances disbursed.

The table 4.9(b) shows the value of r is positive 0.998 (+0.998) which is highly positive in case of Nabil Bank. The value of P.E. (r) is 0.007 and 6P.E. (r) is 0.05. The value of r indicates that there is highly positive correlation between Loan and Advances and Total Deposit. If total Deposit increases Loan and advances also increases. The value of 6P.E. (r) is less than the value of r. It means there is significant relationship between two variables.

4.3 Trend Analysis

Trend analysis is done to predict the future scenario. This analysis is very important for business. Business environment is more complex and dynamic than ever before so firms want to know will- be scenario. This scenario helps to build strategies and tune to the unseen changes in the economy. So this statistical tool helps businessmen to estimate future. The estimation is based upon past data or information

Among various methods of estimating trend the least square method is used in this research. In this method trend line is fitted to the data satisfying following two conditions:

$$y = na + b x$$
$$xy = a x + b x^2$$

4.3.1 Trend analysis of Loan and Advances

In the calculation time is taken as independent variable (x) and loan and advance is taken as dependent variables(y). The calculation is made to estimate trend of loan and advance from 2013 to 2017. The trend of loan and advances is forecasted from the year 2013 to 2017 based upon the past data.

Table 4.10(a)
Trend of Loan and Advances for NIBL

(Rs in Millions)

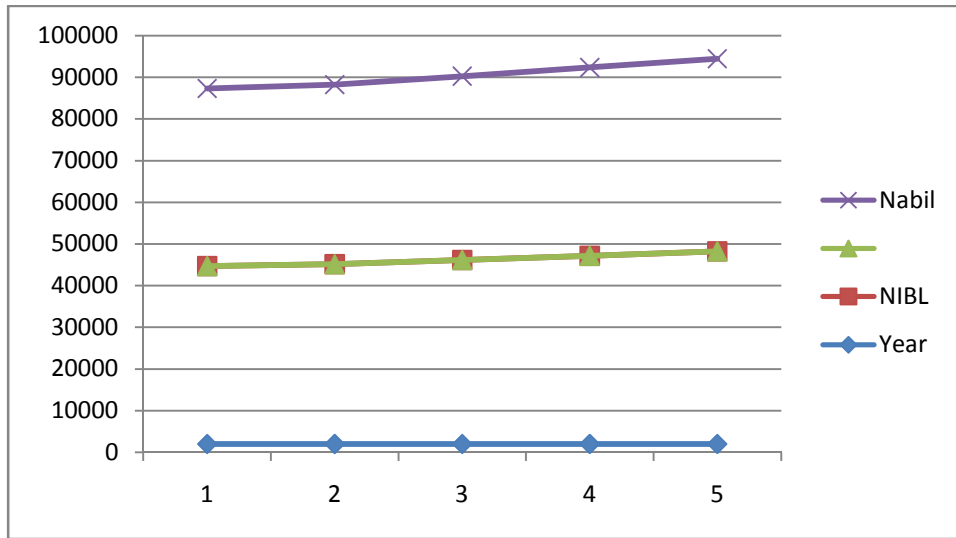
Year	2013	2014	2015	2016	2017
Estimation of Loan and Advances	42677	43135	44138	45176	46217

Table 4.10(b)
Trend of Loan and Advances for Nabil

(Rs in Millions)

Year	2013	2014	2015	2016	2017
Estimation of Loan and Advances	42645	43102	44101	45141	46181

Figure 4.7
Trend of Loan and Advances



As shown in the table 4.10(a) loan and advance is in increasing trend. If the business environment remains same the NIBL will be able to disburse Rs 46217 Million in year 2017. This is the highest amount of loan and advance it will be able to disburse.

In table 4.10(b) it shows the loan and advance in future years of Nabil Bank. It also shows that loan and advances is increasing. The maximum loan and advances will be in year 2017, which will amount to Rs. 46181 million.

4.3.2 Trend Analysis of Loan Loss Provision

Loan loss provision is unproductive fund from the view of bank management. Bank has to allocate fund in the form of loan loss provision. As the directive of central bank, Nepal Rastra Bank is mandatory for any commercial banks operating in the land they have to allocate fund as loan loss provision. Loan loss provision is allocated on the basis of nature of loan. Nature of loan categorized on the basis of time of repayment. Trend of loan loss provision is calculated below:

Table 4.11(a)
Trend of Loan Loss Provision for NIBL

(Rs in Millions)

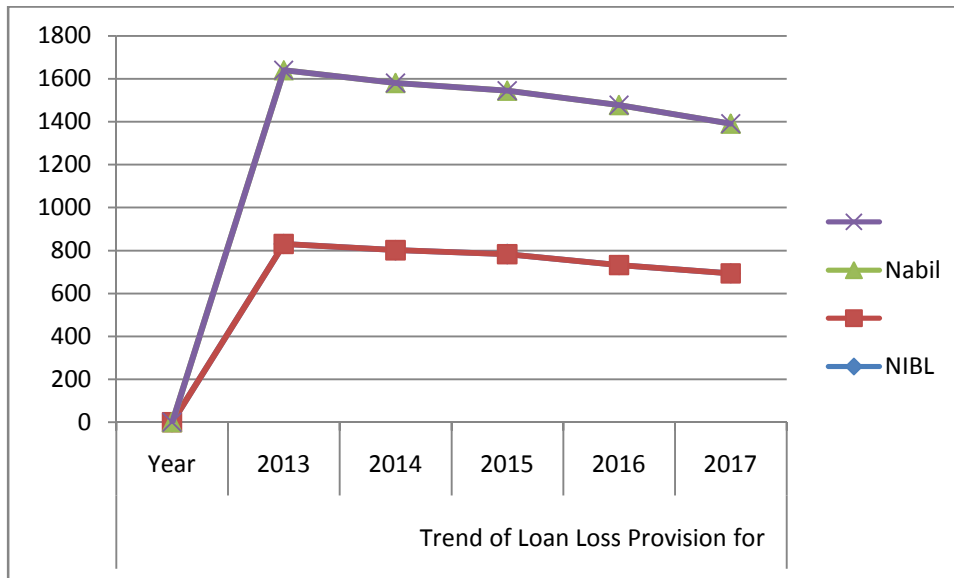
Year	2013	2014	2015	2016	2017
Estimation of Loan Loss Provision	830	801	783	732	693

Table 4.11(b)
Trend of Loan Loss Provision for Nabil

(Rs in Millions)

Year	2013	2014	2015	2016	2017
Estimation of Loan Loss Provision	810	780	762	746	698

Figure 4.8
Trend of Loan Loss Provision



Above table 4.11(a) reveals the trend of Loan loss provision from year 2013 to 2017 of NIBL. The trend is decreasing. In the year 2013 it is Rs 830 million but in 2017 it will be Rs 693 million. The trend is calculated based upon the past information. From year 2013 to 2017 the trend of Loan loss

provision is estimated based on the historical data. So within the estimated period if the business environment remains same trend of Loan loss provision will gradually decline. Gradual declination of LLP means it can use the unproductive fund in some productive fund and increase its net profit Also in table 4.11(b) trend of LLP in Nabil Bank is revealed. The bank will have 810 Millions as LLP in 2013but it will be reduced to Rs.698 Million in 2017. This is based upon the historical data and assumption of status quo.

4.3.3 Trend Analysis of Non-performing Loan

NPL reduces and hinders the performance of bank. It also reduces the credibility of bank. So banks have to reduce NPL to increase productivity and profitability. Trend of NPL of banks is estimated below:

Table 4.12(a)
Trend of Non-Performing Loan for NIBL

(Rs in Millions)

Year	2013	2014	2015	2016	2017
Estimated NPL	480	306	252	201	116

Table 4.12(b)
Trend of Non-Performing Loan for Nabil

(Rs in Millions)

Year	2013	2014	2015	2016	2017
Estimated NPL	430	280	205	181	107

Figure 4.9
Trend of Non-Performing Loan

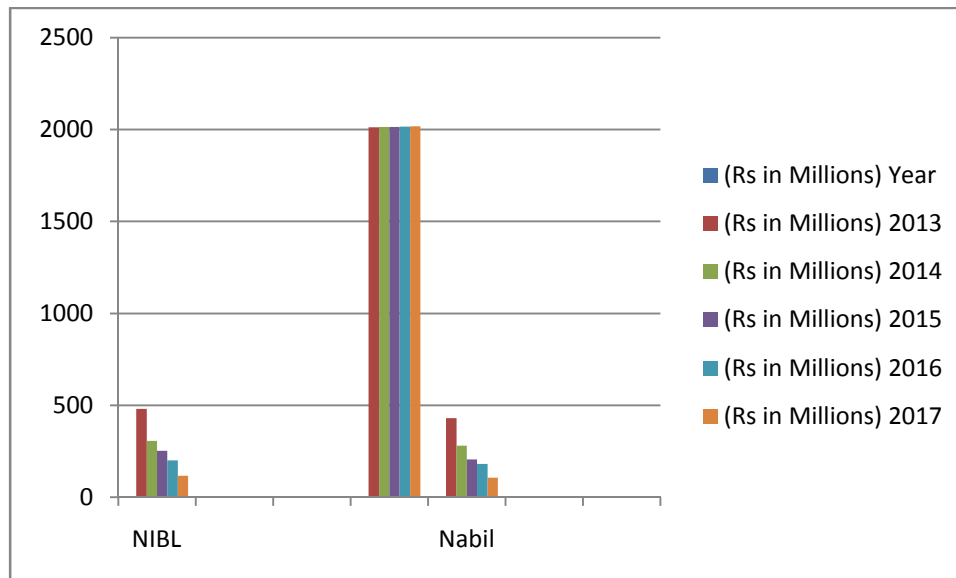


Table 4.12(a) shows that the Trend of Non-performing loan is gradually declining. It has reached to Rs 116 million in 2017 from the year 2013. There will lowest NPL of the NIBL in year 2017. So it is decreasing sharply. This trend is good for the bank. Bank is able to utilize resources in productive sources. So bank will decrease its Non- performing loan in coming days if the economic environment remains same as the past performances were occurred

In the table 4.12(b) also shows the trend of NPL is gradually declining. In the year 2013 it is Rs. 430 million and in the year 2017 it will be Rs107 million. So bank will continuously decrease its non-performing loan in the coming year if the economic condition remains same as the past performances occurred.

4.3.4 Trend Analysis of Net-Profit

Net profit is the major objectives of any business. It attracts to invest more in the industry. It encourages entrepreneur to introduce new technology, new product. It also shows the competence of management to operate in the given business environment. It also shows the health of the firm or company. Trend analysis is conducted to predict future net profit. The trend is as follows:

Table 4.13(a)
Trend of Net-Profit for NIBL

(Rs in Millions)

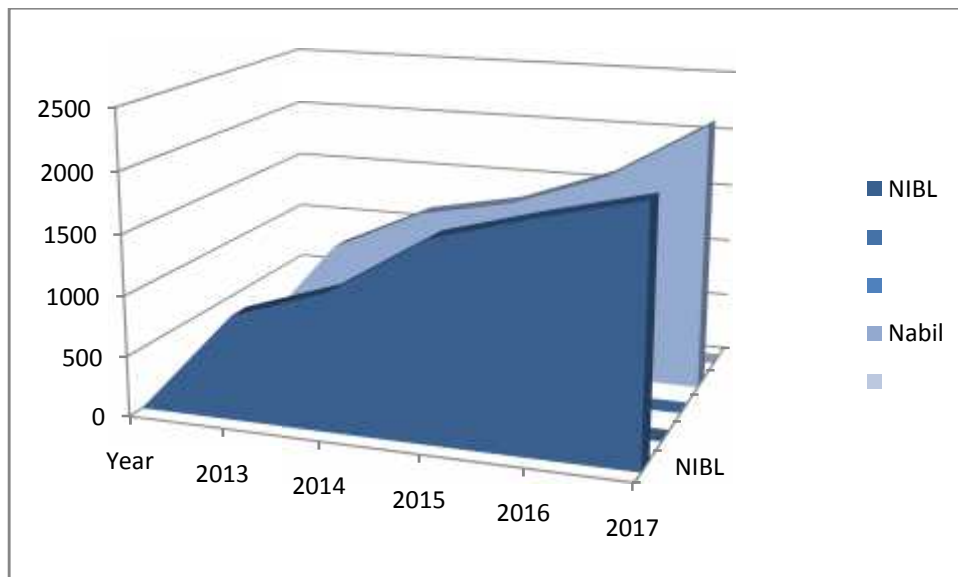
Year	2013	2014	2015	2016	2017
Estimated Net Profit	1255	1550	1731	19852	2150

Table 4.13(b)
Trend of Net-Profit for Nabil

(Rs in Millions)

Year	2013	2014	2015	2016	2017
Estimated Net Profit	1125	1356	1622	1788	2227

Figure 4.10
Trend of Net Profit



In the above table 4.13 (a) trend of net-profit is increasing. It is Rs 1255 million in year 2013 and it will increase to Rs 2150 million in the 2017, if the business environment remains constant. From the

year 2013 to 2017 the prediction has been made based upon the historical data

In the table 14.3 (b) trend of Net profit is increasing if the business environment remain status quo. In the year 2013 estimated net profit is Rs. 1125 million and in 2014 it will increase to Rs. 227.

4.4 Theoretical Analysis the Impact of NRB Directives

4.4.1 Implementation & Impact Part of the NRB Directives

As stated earlier, in order to streamline the Banking sector, NRB as a central bank of Nepal issues different regulatory and advisory guidelines and directives to the financial institutions in Nepal. These directives, especially issued in favor of banking industry are playing vital role for the development of the sustainable financial market. NRB issues effective new directives and amends the olds timely as per the necessity of financial environment. Amongst the directives issued for the regulation on the loan and advances especially Non Performing Loans has helped to make the strong financial culture in the banking industry. Here, we are trying to record some implementary facts of the sample banks regarding Non Performing Loans related directives.

As per the new directives issued by the NRB for the banks in commercial banks, Banks should categories their loans and advances portfolio in four categories viz. Pass, Substandard, Doubtful and Loss. Loans and Advances due for 0-3 months- Pass, 3-6 months-Substandard, 6-12 months- Doubtful and 12 months and above- Loss. Also, in addition the overdue basis, loans and advances to be classified on Loss loans on the basis of CIB Blacklisting, Collateral Value, and Misuse of funded loan and Bankruptcy of the Borrower. As well, banks should formulate necessary loan loss provision to avoid the possible losses in future as 1% for Pass, 25% for Substandard, 50% for Doubtful and 100% for Loss Loans.

Particular	Basis of Classification	Loan Category & LLP	Overdue Period
Banks should categories their Loans and Advances in four categories	Classification to be made on the basis of ageing of past dues as: Pass Substandard	Loans to be classified into four categories and necessary LLP to be formulated as: Pass = 1%	The period of the overdue of each category of loan in shorted will be : Pass= 0 – 6 months Substandard= 3 – 6 months

	Doubtful Loss	Substandard = 25% Doubtful = 50% Loss = 100%	Doubtful = 9 – 12 months Loss = 1 year and above
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Talking on the subject regarding the implementation of NRB directive, all the sample banks has been found satisfactorily implemented the directive as per the table presented above. Simultaneously, all the banks have been created necessary loan loss provisions for the possible losses against the loans. Looking on the financial part of the both sample Banks are trying to reduce the non-performing loan each year, even though we can see in the specific period of the Banks non-performing loan fluctuating . Sometimes it is increasing and sometimes it is decreasing , that may be causes of increasing proportion of the loan during the study period which can be regarded as the best part of the directive. Hence this can be concluded that due to the NRB regulatory efforts, not only the Non-Performing Loans of the banks has decreased, their income level has also been increased. This is because of the effect of that higher volume of NPL requires higher portion of LLP and lesser NPL requires lesser the amount of LLP and the LLP deducted in the net profit of the bank.

Non-Performing Loan not only deducts the interest earning of the bank but also creation of loan loss provision pushes to decrease the profit of the bank. As a reason the operating status of the banks NIBL & Nabil has been badly affected. At this point, we can say that NRB regulatory forces have helped to increase the profit level of the financial institutions as well. At the present context of Nepal where the banking sector has severely affected by the increasing level of Non- Performing Loan, tightening the policies and provisions is essential to safeguard the banks from the banking crisis and to ensure the banks remain liquid even in the economic downturns.

As mentioned earlier, loan loss provision should be deducted from the net profit of the bank. That means net profit of the bank will come down due to the creation of LLP. However, the impact of the LLP on profitability of the bank is short term. After few periods, when banks have enough provision for loss loans, the profitability of bank will be tuned to pick up. Hence, in long run banks will enjoy the greater cushion against loan disbursed and improves their financial strength leading to increase their profitability. And keeping this in mind, the sample banks have clearly implemented the NRB directives regarding NPL and as a reason banking sector has been flourished even in the failure of the economic condition of the country. In summary, NRB’s rules and regulations has been safeguarded the banking from the economic and financial failure.

4.4.2 Analysis of the Collected Primary Information

During the study period, various questionnaires have been developed and asked with the concerned officials of NRB and commercial Banks randomly. Details of the reply of the respondents have been presented here. Referring to the NRB officials, their monitoring and inspection role is effective and is working properly so far. As per the view, there is no need to make any changes considering the un-adjustability to banks in their monitoring and inspection role. Regarding the effectiveness of the NRB directives, all the respondents replied that directives to keep the financial institutions healthy and safe. Respondents also replied banks must carry on their business complying meeting the NRB standards, first to make the financing position better and safeguard the risk, second to play the co-operative role with the NRB in making the overall banking sector smarter. This is encouraging part which helps banks and financial institutions strong always.

Regarding to the implementation part of the directives most of the player of commercial banking sector are complying with the NRB norms and standards. Some who are not implementing the regulatory guidelines will automatically show their inefficiency in very short span of time and NRB makes regulatory force to stop them doing so. Hence, in overall the implementation part is satisfactory. And regarding the necessity of NRB directives, NRB official replied it is the proudest matter even in the slowdown economy and presence of financially corrupted different industries, banking sector is safeguarding their business. The major credit of this goes to the NRB making the appropriate standards, regulatory guidelines and effective directives to safe the financial industry.

Similarly, responding to the officials of different commercial banks, most of the banks are satisfied with the NRB guidelines. Regarding to the effectiveness of monitoring and supervision of NRB, all the respondents have replied better. The commercial banks are happy to comply the NRB standards and monitoring & inspection activity. Regarding to the necessity of NRB directives, the directives are much more necessary to protect the depositors deposit, interest and investments, safety of the loan and advances, for the fair and healthy competitive environment and to protect the financial institutions. Replying to the impact of the NRB directives in short run, NRB directives are deducting the profit standards and business but in the long run they are found very effective for the sustainable market of the player. That's why NRB directives are very essential to protect the life of financial institutions.

Answering to the revision of the NRB directives, most of the respondents replied that NRB should

revise its policy and standards as per the market structure and changing business environment but to be kept in mind that the negative impact should not be come on. Means revision to be done on the basis of the changing banking environment and necessity faced by the banking organization. All the respondents replied, however the supervision and controlling of NRB looks some tighter, in long run the policies, standards and supervision are very effective to secure the banks, economy and the nations interest.

4.4.3Gist of the Primary Information

Complying with the NRB norms, the banking sector is financially healthy, stronger and safer in long run. The best part of the directive is they are successful in securing the public deposit and interest, minimizing the credit risk through loan loss provision, protecting the bank from bankruptcy, and maintaining the friendlier healthy competitive environment. NRB directives are not only bringing prosperity to the banking institutions but also to all its stakeholders like shareholders, depositors, employees and overall the economy of the country. They are also helping the bankers in adopting the international standards and making efficient and competitive with the international banks.

4.5 Major Findings of the Study

Ratio

The ratio of Total Loan and Advances to Total Deposit of NIBL is higher than the ratio of Nabil Bank Ltd. The ratio of NIBL is dispersed between 0.72 and 0.82 so the range of dispersed is 0.10 but in case of Nabil it is dispersed between 0.68 and 0.76 and the range is 0.08. It implies NIBL bank is willing to lend loan and advances than Nabil Bank of the deposit it has collected. Within the study period NIBL has been able to disburse more average loan and advances than the Nabil Bank despite of Low average Deposit collection. This also shows the attitude towards risk. Comparatively, if loan and advance truly express the attitude towards risk, NIBL is risk averse and Nabil Bank is risk seeker. Since CV coefficient of loan and advances of both banks are nearly equivalent there is consistency in disbursement of loan of banks. In case of deposit collection NIBL has been able to collect more amount than the Nabil bank. The coefficient of CV of total deposit of NIBL is higher than the NABIL bank.

Both banks are trying hard to decrease the ratio to the lowest level as far as possible. In the specified years both banks have loan loss provision ratio less than 3.5% respectively. It reveals the

consequences of Loan Loss Provision in the bank's performance. Within the study period average LLP of the Nabil bank is less than the NIBL bank. Same way CV coefficient reveals that there are fewer consistencies in the LLP of NIBL than Nabil bank.

The ratio NPL to Total Loan and Advances of both banks is defining but the rate of increasing same ratio Nabil bank and NIBL. Within the study period, initially in 2007 the ratio of NIBL is higher than the Nabil bank. The ratio is 2.37 of NIBL bank but it 1.12 of Nabil Bank in 2007. But in final year 2012 the ratio of NIBL bank is also higher than that of Nabil Bank. In 2012 the ratio is 3.32% of NIBL and 2.33 of Nabil bank. This clearly indicated that the management of Nabil bank has been able to reduce NPL sharply than NIBL even though the average loan and advances of NIBL is higher than Nabil Bank. Average NPL of NIBL is higher than the Nabil it may be due to the higher Loan and advances.

This NPL to Total Deposit ratio is also in fluctuating mode but the ratio of NIBL is higher than the ratio of Nabil. Average deposit collection of NIBL is higher than of Nabil and the average NPL of NIBL is also higher than Nabil.. In 2007 the ratio of NIBL is 1.72 whereas that of Nabil is 0.77. In 2012 the ratio of NIBL is 2.42 and Nabil is 1.76 . Even between the lowest values NIBL has higher one. It indicated that the collected deposit is gradually turning to productive loan. In another word Loan and advances disbursed from the collection of ordinary people as total deposit is having a fruitful consequence in the economy.

The LLP to Total NPL ratio of both banks is fluctuating. That means it is increasing some year and decreasing next year. In 2007 the first year within study period, the ratio of NIBL is 1.12 but Nabil bank's is 1.62 only. In 2012 the ratio of NIBL bank has 0.92 in the same year Nabil has 1.30. In case of NIBL the ratio is increasing from 2007 to 2009 for Nabil within same period it has on decreasing trend. The greater fluctuation is seen in NIBL than Nabil. The range of NIBL is between 0.92 to 2.72 but the range for Nabil is 1.30 to 2.42 .

The major portion of net profit of commercial banks is contributed by interest earned from the disbursed loan and advances. It means that the net profit indicates the performance of loan and advance. The ratio of Net Profit to Total Loan and advances of the NIBL is lower than the Nabil bank. The ratio of both banks is fluctuating. Although the disbursement of average loan and advance

of NIBL is higher than the Nabil Bank and average net profit of NIBL is lower than the Nabil bank's. The average net profit of NIBL is Rs904.67 million and the average net profit of Nabil bank is Rs. 1105.53 million. The ratio of NIBL range between 1.97 to 3.09 but in case of Nabil it range between 3.43 to 4.09 . The highest ratio of NIBL is still lower than the lower ratio of Nabil. It means NIBL has been unable to maintain net profit with the increment of total loan and advances.

Correlation

The value of correlation between LLP and Total Loan and Advances, r of NIBL is negative 0.56 (-0.56) and the Nabil is negative 0.066 (-0.066). That means there is negative correlation between LLP and Total Loan and advances. In another word, if Loan and advances increases LLP decrease and vice versa. But the value of r of NIBL is more negative than Nabil. It means in NIBL loan and advance and LLP has more negative correlation than Nabil. Since both banks have r less than 6P.E. (r) there is significant relation between LLP and loan and advances.

The value of correlation between LLP and NPL, r in both banks is positive. It means there is positive relation between LLP and NPL. As NPL rises LLP also rises. But the value of NIBL is higher than Nabil. The value of r of NIBL is 0.786 and Nabil is 0.536. The higher value of NIBL means there is higher degree of positive correlation between LLP and NPL. That means if NPL increases LLP also increase in NIBL. But in Nabil increment of NPL and LLP is less positively correlated. Same way value of 6P.E. (r) of Nabil is higher than the value of r . That means there is no significant relation between LLP and NPL in Nabil bank. Similarly the value of 6P.E. (r) is greater than the value of r in case of NIBL it means there is no significant relation between LLP and NPL.

The correlation between Loan and Advances and Total Deposit, r of both banks are positive and their values are higher than 0.75. It means there is higher degree of correlation between total Deposit and Total loan and advances. In another word higher the deposit higher will be loan and advances. In both cases the value of 6P.E. (r) is less than the value of r ; it also signifies that there is significant relation between Total Loan and Advances.

Trend Analysis

Trend analysis of Loan and advances of both banks shows the increasing trend of loan and advances. But the ratio of increment of NIBL is higher than the Nabil. In 2014 NIBL will have Rs.46217million and Nabil will have Rs. 46181million as loan and advance. So NIBL bank has to act

prudently to cope with various problems due to loan and advances.

The trend analysis of LLP of both banks is gradually declining. The rate of declining is higher in case of NIBL than Nabil. In the end of estimated period 2017, the LLP of NIBL will be Rs. 693 million only whereas the Nabil will have Rs. 698 million. The trend indicated positive aspect of bank.

The trend analysis of NPL of both banks is also declining. In this case also Nabil rate of reduction is lower than NIBL. According to trend from 2013 onwards NIBL will have lower NPL in 2017 ie. Rs.107 Million but NIBL will have Rs. 116 Million in the year 2017.

Trend of Net profit is increasing in both banks. The rate of increment of NIBL is higher than the Nabil. In 2013 the net profit of NIBL is Rs.1255 million and that of Nabil is Rs. 1125 million. In year 2017 the net profit of NIBL is Rs. 2150 million and Rs. 2227 million of Nabil. Profit of NIBL bank will overcome the profit of Nabil Bank in future if the economic environment remains same.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMMENDATION

This research attempts to analyze the NRB Directives impact to Nepales Commercial Bank and NPL & Loan Loss Provision on their effects in the performance of bank. This chapter is final chapter. It includes summary, conclusion and recommendation. Summary and conclusion of the study is presented in the first section. The second section has been design for the recommendation.

5.1 Summary

Financial sector of have major role to play in the development of the country. Banks are the financial regulator, which collects funds and invest them in productive sectors. There is not so long history of commercial bank in Nepal. Nepal Bank Limited is the first commercial bank established on 1994 Kartik 30. But now there are 31 commercial bank as per NRB banking and financial statistics published in mid July 2013 extending their series in different part of the country. The successful working of the bank depends on ability of the management to distribute the funds among the various kind of investment known as loans and advances. Loan and advances are the most profitable assets of a bank. These assets constitute primary sources of income to the bank. As being a business institution, a bank aims at making huge profit. Since loans and advances are more profitable than any other assets of the banks, it is willing to lend as much as its funds as possible but banks have to be careful about the repayment of loan interest before giving loan.

This study is aimed at studying the non-performing loan and loan loss provisioning of commercial banks. For this purpose, descriptive cum analytical research design was adopted. Out of the total population the Thirty Two commercial banks, only two banks, Nepal Investment BankL and Nabil banks are taken as sample using judgmental sampling method. Secondary data are collected from annual reports and other publication of respective banks. The data collected from various sources are recorded systematically and presented in appropriate mathematical, statistical, financial, graphical tools have been applied to analyze the data. The data of six consecutive years of the two selected banks have been analyzed to analyze to meet the objective of the study.

Nepal Rastra Bank has set up the directives/ regulations regarding the loan loss provisioning of the Nepalese commercial banks. According to the this provision a bank has to maintain 1%, 25%, 50% and 100% loan loss provision for its pass , substandard, doubtful and bad loan respectively. It is

found that sampled banks maintained higher than requirement for one type of loan where are lower for another class of loan category. They should make provision perfectly neither more nor less. The reason may be over provision create inadequacy of capital which reduce the profit and less provision create legal hassle to the bank. The loan loss provision made by Nabil bank and NIBL found satisfactory not serious matter only little attention is needed to manage LLP of each loan category. Likewise role of NRB is essential, regular supervision and control over the Nepalese commercial banks by NRB, whether they are implementing NRB's directive perfectly or not is very important.

Basically, research methodologies here signifies the research design, sources of data, data collection technique, data collection methods and tools and techniques employed etc. for this purpose descriptive cum analytical research design was adopted. Out of total population of Thirty Two commercial banks, two banks are taken as sample using judgmental sampling method. Here two major banks NIBL and Nabil bank is selected from private sector banks. Annual reports and other publications from the basis of secondary data are used. Besides this newspaper, relevant thesis, journals, articles, related websites etc are also used for this research. The data collected from various sources are recorded systematically and presented in the appropriate forms of the tables, charts and appropriate mathematical, statistical, financial, graphical tools have been applied to analyze the data. The data of the six consecutive years of selected banks have analyzed to meet the objectives of the study.

5.2 Conclusion

From the study of various variables like NPL, LLP, Total Loan and Advances, Total Deposit, Net profit and their relation with each other in the form of ratio, correlation and trend has shown satisfactory performance of two banks.

From the ratio analysis and trend analysis NIBL's performance is better than Nabil Bank. NPL level to total loan and advances and total deposit of NIBL is increasing sharply than Nabil Bank, even though average Total Loan and advances of Nabil is higher than NIBL's.

Trend also reveals higher performance of NIB than Nabil. The trend of net profit is increasing in higher ratio of NIBL than Nabil's. The trend of NPL of NIBL is virtually there will be low NPL from 2013 onwards. But the trend of Nabil is higher than NIBL even till 2017.

Borrowing deposit from individuals in the form of various accounts and lending in the form of loan and advances is major function of commercial banks. Besides this role of commercial bank is increasing as the globalization has increased. While disbursing loan and advance to lenders banks have to face various risks. Some lenders may go bankrupt and some may not pay with ill intention. So bank has to face both situations. Because of any reason NPL of Bank will increase. This also increases LLP. According to the categorized as Pass Loan, Doubtful loan and Bad Loan

Both the private banks under study, NIBL and Nabil, are trying hard to reduce the amount of NPL and LLP. Increase in NPL has two way adverse effects in the performance of bank. First of all Banks have to deposit LLP as compensation and guarantee. This reduces the fund of bank for investment in some profitable sector. In second case it reduces the credibility and accountability of management which could have long term adverse consequences to the bank. The summary can be divided in three different chapter to explain more about it.

5.3 Recommendation

On the basis of findings and analysis following recommendation are proposed to both banks to perform better:

-) NPL erodes the performance of commercial banks. It reduces profitability because of LLP. This LLP will reduce banks fund for productive sector. NPL of both are declining so banks have to make every effort to continue this trend.
-) Lending loan and advance to various lenders is major function of commercial banks. But Nabil has not lent its deposit as loan and advances in compare to NIBL. Nabil can increase the lending proportion so that the profit of the bank may increase.
-) The of higher Loan and Advances of NIBL than Nabil, the average Net profit is also higher than Nabil. So Nabil has to increase net profit by maintaining with the increment with the Loan and Advances.
-) The main factors which lead to NPL and improper credit appraisal system, ineffective credit monitoring and supervision system etc. besides that negligence in taking information from Credit Information Bureau may also lead to bad debts. Hence all banks are recommended to

be more careful and realistic while granting loan and advances. After advancing loan there should be regular supervision and follow up for proper utilization of loan.

-) Trend analysis shows that the Loan and Advance amount of both banks will increase in future so bank has to train its employee to make efficient and professional in credit appraisal, monitoring and proper risk management.

-) Banks have to adhere to the guideline of central bank to reduce the amount of NPL and also to increase accountability and credibility of bank.

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ANNEXURE

Annex – 1

Correlation between Loan Loss Provision and Total Loan and Advances of Nepal Investment Bank (NIBL)

LLP(X)	Loan and Advances (Y)	XY	X ²	Y ²
472.00	17769	8386968	222784	315737361
527.00	27529	14507783	277729	757845841
581.00	36827	21396487	337561	1356227929
628.00	40948	25715344	394384	1676738704
790.00	41095	32465050	624100	1688799025
1266	41367	52712442	1602756	1733639769
x = 4264	y = 205805	xy = 155184074	x ² = 3459314	y ² = 7528988629

$$\text{Correlation coefficient (r)} = \frac{n \sum xy - \sum x \cdot \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

$$\text{Correlation coefficient (r)} = \frac{6 \times 155184074 - 4264 \times 205805}{\sqrt{6 \times 3459314 - (4264)^2} \sqrt{6 \times 7528988629 - (205805)^2}}$$

$$r = 0.63$$

$$\text{P.E.}(r) = 0.6745 \times \frac{1-r^2}{n}$$

$$\text{P.E.} = 0.17$$

$$\text{And } 6\text{P.E.}(r) = 1.02$$

Annex – 2

Correlation between Loan Loss Provision and Total Loan and Advances of Nabil Bank Limited
(Nabil)

LLP(X)	Loan and Advances (Y)	XY	X ²	Y ²
354	19478	6895212	125316	379392484
390	21759	8486010	152100	473454081
406	27990	11363940	164836	783440100
762	33031	25169622	580644	1091046961
871	38034	33127614	758641	1446585156
1261	41605	52463905	1590121	1730976025
x = 4044	y = 181897	xy = 137506303	x ² = 3371658	y ² = 5904894807

$$\text{Correlation coefficient (r)} = \frac{n \sum xy - \sum x \cdot \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

$$\text{Correlation coefficient (r)} = \frac{6 \times 137506303 - 4044 \times 181897}{\sqrt{6 \times 3371658 - (4044)^2} \sqrt{6 \times 5904894807 - (181897)^2}}$$

$$r = 0.94$$

$$\text{P.E.}(r) = 0.6745 \times \frac{1-r^2}{n}$$

$$\text{P.E.} = 0.03$$

$$\text{And } 6\text{P.E.}(r) = 0.19$$

Annex – 3

Correlation between Loan Loss Provision and Non-Performing Loan of Nepal Investment Bank
(NIBL)

LLP(X)	NPL (Y)	XY	X ²	Y ²
472.00	421.13	198773.36	222784	177350.48
527.00	308.32	162484.64	277729	95061.2
581.00	213.60	124101.60	337561	45624.96
628.00	247.35	172291.80	394384	75267.92
790.00	386.29	305169.10	624100	149219.96
1266	1382.35	1750055.10	1602756	1910891.52
x = 4264	y = 2986.04	xy = 2712875.6	x ² = 3459314	y ² = 2453416.07

$$\text{Correlation coefficient (r)} = \frac{n \sum xy - \sum x \cdot \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

$$\text{Correlation coefficient (r)} = \frac{6 \times 2712875.6 - 4264 \times 2986.04}{\sqrt{6 \times 3459314 - (4264)^2} \sqrt{6 \times 2453416.07 - (2986.04)^2}}$$

$$r = 0.92$$

$$\text{P.E.}(r) = 0.6745 \times \frac{1-r^2}{n}$$

$$\text{P.E.} = 0.04$$

$$\text{And } 6\text{P.E.}(r) = 0.26$$

Annex – 4

Correlation between Loan Loss Provision and Non-Performing Loan of Nabil Bank Limited (Nabil)

LLP(X)	NPL (Y)	XY	X ²	Y ²
354	218.15	77225.10	125316	47589.42
390	161.02	62797.80	152100	25927.44
406	223.92	90911.52	164836	50140.17
762	488.86	372511.32	580644	238984.10
871	673.20	586357.20	758641	453198.24
1261	969.40	1222413.40	1590121	939736.36
x = 4044	y = 2734.55	xy = 412216.34	x ² = 3371658	y ² = 1755575.73

$$\text{Correlation coefficient (r)} = \frac{n \sum xy - \sum x \cdot \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

$$\text{Correlation coefficient (r)} = \frac{6 \times 412216.34 - 4044 \times 2734.55}{\sqrt{6 \times 3371658 - (4044)^2} \sqrt{6 \times 1755575.73 - (2734.55)^2}}$$

$$r = 0.99$$

$$\text{P.E.}(r) = 0.6745 \times \frac{1-r^2}{n}$$

$$\text{P.E.} = 0.0043$$

$$\text{And } 6\text{P.E.}(r) = 0.03$$

Annex – 5

Correlation between Total Loan and Advances and Total Deposit of Nepal Investment Bank (NIBL)

Loan and Advances (X)	Total Deposit (Y)	XY	X ²	Y ²
17769	24489	435145041	315737361	599711121
27529	34452	948429108	757845841	1186940304
36827	46698	1719747246	1356227929	2180703204
40948	50094	2051249112	1676738704	2509408836
41095	50138	2060421110	1688799025	2513819044
41367	57010	2373725370	1733639769	3250140100
x = 205805	y = 262881	xy = 9588716987	x ² = 7528988629	y ² = 12240722609

$$\text{Correlation coefficient (r)} = \frac{n \sum xy - \sum x \cdot \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

$$\text{Correlation coefficient (r)} = \frac{6 \times 9588716987 - 205805 \times 262881}{\sqrt{6 \times 7528988629 - (205805)^2} \sqrt{6 \times 12240722609 - (262881)^2}}$$

$$r = 0.98$$

$$\text{P.E.}(r) = 0.6745 \times \frac{1-r^2}{n}$$

$$\text{P.E.} = 0.01$$

$$\text{And } 6\text{P.E.}(r) = 0.06$$

Annex – 6

Correlation between Loan Loss Provision and Total Loan and Advances of Nabil Bank Limited (Nabil)

Loan and Advances (X)	Loan and Advances (Y)	XY	X ²	Y ²
19478	28214	549552292	379392484	796029796
21759	31915	694438485	473454081	1018657225
27990	37348	1045370520	783440100	1394873104
33031	46410	1532968710	1091046961	2153888100
38034	49696	1890137664	1446585156	2469692416
41605	55023	2289231915	1730976025	3027530529
x = 181897	y = 248606	xy = 8001699586	x ² = 5904894807	y ² = 10860581170

$$\text{Correlation coefficient (r)} = \frac{n \sum xy - \sum x \cdot \sum y}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

$$\text{Correlation coefficient (r)} = \frac{6 \times 8001699586 - 181897 \times 248606}{\sqrt{6 \times 5904894807 - (181897)^2} \sqrt{6 \times 10860581170 - (248606)^2}}$$

$$r = 0.99$$

$$\text{P.E.}(r) = 0.6745 \times \frac{1-r^2}{n}$$

$$\text{P.E.} = 0.00307$$

$$\text{And } 6\text{P.E.}(r) = 0.02$$

Annex – 7

Trend of Total Loan Loss Provision of NIBL

Year X	Loan Loss Provision (Y)	X ₂	Y ₂
1	472	1	222784
2	527	4	277729
3	581	9	337561
4	628	16	394384
5	790	25	624100
6	1266	36	1602756
X=21	Y =4264	X ₂ =91	Y ₂ = 3459314

Here,

$$Y = na + b \times \dots\dots\dots 2$$

$$XY = a \sum X + b \sum X^2 \dots\dots\dots 3$$

$$A = 90.79$$

$$B = 7.37$$

Year	Estimated Loan Loss Provision
2013	830
2014	801
2015	783
2016	732
2017	693

Annex – 8

Trend of Total Loan Loss Provision of Nabil

Year X	Loan Loss Provision (Y)	X ₂	Y ₂
1	354	1	125316
2	390	4	152100
3	406	9	164836
4	762	16	580644
5	871	25	758641
6	1261	36	1590121
X=21	Y =4404	X ₂ =91	Y ₂ = 3371658

Here,

$$Y = na + b \times \dots\dots\dots 2$$

$$XY = a \sum X + b \sum X^2 \dots\dots\dots 3$$

$$A = 78.25$$

$$B = 5.69$$

Year	Estimated Loan Loss Provision
2013	810
2014	780
2015	762
2016	746
2017	698

Annex – 9

Trend of Non-Performing Loan of NIBL

Year X	NPL (Y)	X ₂	Y ₂
1	421.13	1	177350.48
2	308.32	4	95061.22
3	213.60	9	45624.96
4	274.35	16	75267.92
5	386.29	25	149219.96
6	1382.35	36	1910891.52
X=21	Y =2986.04	X ₂ =91	Y ₂ = 2453416.07

Here,

$$Y = na + b \cdot x \dots\dots\dots 2$$

$$XY = a \cdot X + b \cdot X^2 \dots\dots\dots 3$$

$$A = 529.14$$

$$B = 21.05$$

Year	Estimated NPL
2013	480
2014	306
2015	252
2016	201
2017	116

Annex – 10

Trend of Non-Performing Loan of Nabil

Year X	NPL (Y)	X ₂	Y ₂
1	218.15	1	47589.42
2	161.02	4	25927.44
3	223.92	9	50140.17
4	488.86	16	238984.10
5	673.20	25	453198.24
6	969.40	36	939736.36
X=21	Y =2734.55	X ₂ =91	Y ₂ = 1755575.73

Here,

$$Y = na + b \times x \dots\dots\dots 2$$

$$XY = a \sum X + b \sum X^2 \dots\dots\dots 3$$

$$A = 768.21$$

$$B = 36.08$$

Year	Estimated NPL
2013	430
2014	280
2015	205
2016	181
2017	107

Annex –11

Trend Analysis of Net-Profit of NIBL

Year X	Net-Profit (Y)	X ₂	Y ₂
1	350	1	122500
2	697	4	485809
3	901	9	811801
4	1265	16	1600225
5	1176	25	1382976
6	1039	36	1079521
X=21	Y =5428	X ₂ =91	Y ₂ = 5482832

Here,

$$Y = na + b \times \dots\dots\dots 2$$

$$\sum XY = a \sum X + b \sum X^2 \dots\dots\dots 3$$

$$A = 588.91$$

$$B = 165.56$$

Year	Estimated Net Profit
2013	1255
2014	1550
2015	1731
2016	19852
2017	2150

Annex –12

Trend Analysis of Net-Profit of Nabil

Year X	Net-Profit (Y)	X ₂	Y ₂
1	673	1	452929
2	746	4	556516
3	1031	9	1062961
4	1138	16	129504
5	1344	25	1806336
6	1700	36	2890000
X=21	Y =6632	X ₂ =91	Y ₂ = 8063786

Here,

$$Y = na + b \times \dots\dots\dots 2$$

$$XY = a \sum X + b \sum X^2 \dots\dots\dots 3$$

$$A = 753.23$$

$$B = 191.05$$

Year	Estimated Net Profit
2013	1125
2014	1356
2015	1622
2016	1788
2017	2227

Annex –13

Trend Analysis of Total Loan and Advance of NIBL

Year X	Net-Profit (Y)	X ₂	Y ₂
1	17769	1	315737361
2	27529	4	757845841
3	36827	9	1356227929
4	40948	16	1676738704
5	41095	25	1688799025
6	41637	36	1733639769
X=21	Y =205805	X ₂ =91	Y ₂ = 7528988629

Here,

$$Y = na + b \times \dots\dots\dots 2$$

$$\sum XY = a \sum X + b \sum X^2 \dots\dots\dots 3$$

$$A = 23445.24$$

$$B = 5905.25$$

Year	Estimated Total Loan & Advances
2013	42677
2014	43135
2015	44138
2016	45176
2017	46217

Annex -14

Trend Analysis of Total Loan and Advance of Nabil

Year X	Net-Profit (Y)	X ₂	Y ₂
1	19478	1	379392484
2	21759	4	473454081
3	27990	9	783440100
4	33031	16	1091046961
5	38034	25	1446585156
6	41605	36	1730976025
X=21	Y =181879	X ₂ =91	Y ₂ = 5904894807

Here,

$$Y = na + b \times \dots\dots\dots 2$$

$$XY = a \sum X + b \sum X^2 \dots\dots\dots 3$$

$$A = 17035.56$$

$$B = 7446.74$$

Year	Estimated Total Loan & Advances
2013	42645
2014	43102
2015	44101
2016	45141
2017	46181