

**NON PERFORMING ASSETS OF NEPALESE
COMMERCIAL BANKS
(With Reference to HBL, EBL & BOK)**

Submitted by:

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has been prepared as approved by this department in the prescribed format of faculty of management. This thesis is forwarded for evaluation.

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VIVA-VOCE SHEET

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I hereby proclaim that the thesis work entitled ‘Non-Performing Assets of Nepalese Commercial Banks (With reference to HBL, EBL & BOK)’ submitted to Birendra Multiple Campus, faculty of Management, Tribhuvan University is my original work for the partial fulfillment of the requirement for the Master’s Degree of Business studies (MBS) under the supervision of Baikuntha Pd. Bhusal lecturer (Chairperson Research Committee) of Birendra Multiple Campus, Bharatpur, Chitwan.

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LIST OF ABBREVIATIONS

| | | |
|------|---|-------------------------------|
| BOK | : | Bank of Kathmandu |
| C.V. | : | Coefficient of Variance |
| DL | : | Doubtful Loan |
| EBL | : | Everest Bank Limited |
| HBL | : | Himalayan Bank Limited |
| IS | : | Interest Suspense |
| LA | : | Loan and Advances |
| LL | : | Loan Loss |
| NBA | : | Non Banking Assets |
| NP | : | Net Profit |
| NPA | : | Non Performing Assets |
| NPL | : | Non Performing Loan |
| P.E. | : | Probable Error |
| r | : | Correlation Coefficient |
| RNPL | : | Remaining Non Performing Loan |
| S.D. | : | Standard Deviation |
| SSL | : | Sub Standard Loan |
| TA | : | Total Assets |
| TD | : | Total Deposit |
| TL | : | Total Loan |
| UA | : | Unutilized Assets |

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Non Performing Asset means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by NRB. (*Dahal & Dahal; 2011: 15*)

NPAs have a different meaning that varies from country to country. In some countries, it means that the loan is impaired. In some countries, it means that the payment are due but there are significant different among countries how many days a payment should be in arrears before past due status is triggered. (*Shrestha; 2008: 14*)

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 assets can be achieved. (*Regmi; 2009: 75*)

Non-Performing loan (NPL) can be defined as the non-productive assets of the banks. In other words, it is the loan or bad and doubtful debts that doesn't repay timely. Generally the loan, which doesn't repay within three months, is known as non-performing loan. The loan amount that doesn't covered by the collateral after selling is known as non-banking assets (NBA). Non-performing assets also includes the suspend interest. It is the interest, which become receivable unutilized assets and those investments which don't generate any cash or incomes to the bank are also non-performing assets (NPAS). The proper management of those assets to generate income is known as management of non-performing assets.” (*Rahdaswami & Vasudevan; 2004: 49*)

In the distant past, banks had to deal with only few cases of bad-loans. So, they used to take legal actions against chronic defaulters of bank-loans. For the last ten/twelve years, banks are suffering from a large chunk of non-performing loans (assets) as a consequence of economic as well as non-economic factors in the country. By international parameter, non-performing assets of a bank should not exceed ten percent.

Recovery of bad loans by banks and financial institutions has turned into a big issue in the financial sector of Nepal. This has greatly caused negative impact upon Banks' profit, government revenue and the overall financial sector of the country. This calls for an effective system and mechanisms that ease the early recovery of debts of Banks and also of bank-like institutions as specified by Nepal Rastra Bank-the Monetary Authority.

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

1.2 Statement of the Problem

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

caused by lack of good lending opportunity, increasing NPAs etc., in the present context where Nepalese commercial banks are facing the problem of increasing NPAs, more amount has to be allocated for loan loss provision. As earlier mentioned, the provision amount is taken out by deducting from the profit of the bank; the profit of the bank might come down.

The main research problem of this study is to examine non-performing assets of Nepalese commercial banks. It has been conducted to find out the solution of following research questions:

- a. What is the proportion of non performing assets in fixed assets in the selected commercial banks?
- b. What is the level of non-performing assets in selected commercial bank?
- c. What is the impact of loan loss provision on the profitability of the commercial banks?
- d. What conditions makes to risky assets in the total assets portfolio of the commercial banks?
- e. What is the relationship between loan and loan loss provision in the selected commercial bank?

1.3 Objective of the Study

The main objective of this research was to examine and study of non performing assets of commercial banks, especially of Himalayan Bank Limited, Everest Bank Limited and Bank of Kathmandu Limited. The specific objectives are:

- a. To determine the proportion of non performing asset in the selected commercial banks.

- b. To analyze the level of non-performing assets in selected commercial bank.
- c. To examine the impact of non-performing assets on the profitability of the commercial bank.
- d. To analyze the portion of risky assets in the total assets of the commercial banks.
- e. To examine the relationship between non-performing assets with total deposit and net profit.

1.4 Significance of the Study

It is well known fact that the financial institution and bank in Nepal has been facing the problem of increasing non-performing assets and issue becomes more and more critical. Unfortunately nowadays banks have been becoming victims of high level of non-performing assets. Non-performing assets are those loans, which neither pay interest nor repay the principal. So, non- performing assets have been becoming subject of headache to the banking sector. Likewise Nepalese banking sectors cannot escape from such truth.

Concerning to the central library of Tribhuvan University, it has been found that there are a few research regarding non- performing assets and loan loss provision. This research will be able to deliver some of the present issues, latest information and data regarding non- performing assets and loan loss provision. Hence this study will be significant to bankers, shareholders, depositors and further researcher, students etc.

1.5 Limitations of the Study

The research is conducted to fulfill the academic requirement of Master of Business degree. It is focused on the study of non performing asset of HBL, EBL and BOK based of the audited financial annual reports of

condition of each bank during the period 2007/08 to 2011/12. This research is tried to cover all the aspects of the non- performing assets. However the present research has the following limitation:

- a. This research is concerned only with the non- performing assets of commercial bank. It doesn't consider other aspects of banks.
- b. This research is focused on the Nepalese commercial bank and only three commercial banks, namely HBL, EBL and BOK, have been selected as sample for the study.
- c. The period of the study is limited for fiscal year 2007/08 to 2011/12.
- d. The accuracy of secondary data mainly relies on the annual reports of the banks and the accuracy of the primary data totally relies on the responses of the respondents.

1.6 Organization of the Study

This research work has been divided into five chapters:

Chapter – I: Introduction

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

Chapter – II: Review of the Literature

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

Chapter – III: Research Methodology

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

Chapter – IV: Presentation and Analysis of Data

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

Chapter – V: Summary, Conclusion and Recommendations

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

Besides these chapters, Bibliography and Appendix are also presented at the end of the research.

CHAPTER TWO

REVIEW OF LITERATURE

Under this section, the concept related to the non performing assets, and the journals and articles, thesis that have been conducted in the past have been reviewed.

2.1 Conceptual Framework

2.1.1 Non-Performing Assets

One of the most emerging problems of the commercial banks is to the management of non-performing assets. Due to the effects of non-analysis of Non-performing Assets of Nepalese Commercial Banks performing assets, many banks have already suffered from financial problems. In this fast paced competitive age, the bank should have to operate taking in consideration that thing.

If any advances or credit facilities granted by bank to a borrower becomes non-performing, then the bank will have to treat all the advance/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may be still exist certain advance/credit facilities having performing status. (*Pandey; 2009: 167*)

$$NPA = (NPL+NBA+RNPL+SI+UA)$$

Where;

NPA = Non-Performing Assets

NPL = Non-Performing Loan

NBA = Non-Banking Assets

RNPL = Remaining non performing loan

SI = Suspend Interest

UA = Unutilized Assets

2.1.2 Factors for Rise in NPA

The banking sector has been facing the serious problems of the rising NPA. But the problem of NPA is more in public sector banks when compared to private sector banks and foreign banks. The NPA in CBs are growing due to external as well as internal factors.

A) External Factors

The external factors that cause the non-performing assets are;

a. Ineffective Recovery Tribunal

“The Govt. has set of numbers of recovery tribunals, which works for recovery of loans and advances. Due to their negligence and ineffectiveness in their work the bank suffers the consequence of non-recover, their by reducing their profitability and liquidity.” (*Zacharias & Ramamurthy; 2008: 13*)

b. Willful Defaults

“There are borrowers who are able to payback loans but are intentionally withdrawing it. These groups of people should be identified and proper measures should be taken in order to get back the money extended to them as advances and loans.” (*Zacharias & Ramamurthy; 2008: 13*)

c. Natural Calamities

“This is the measure factor, which is creating alarming rise in NPAs of the CBs. The major natural calamities make the borrowers unable to pay back their loans. Thus the bank has to make large amount of provisions in order to compensate those loans, hence end up the fiscal with a reduced profit. For instance, the farmers depends on rain fall for cropping. Due to

irregularities of rain fall the farmers are not to achieve the production level thus they are not repaying the loans.” (*Zacharias & Ramamurthy; 2008: 14*)

d. Industrial Sickness

“Improper project handling, ineffective management, lack of adequate resource, lack of advance technology, day to day changing govt. policies give birth to industrial sickness. Hence the banks that finance those industries ultimately end up with a low recovery of their loans reducing their profit and liquidity.” (*Zacharias & Ramamurthy; 2008: 15*)

e. Lack of Demand

“Entrepreneurs in developing countries could not foresee their product demand and starts production which ultimately piles up their product thus making them unable to pay back the money they borrow to operate these activities. The banks recover the amount by selling of their assets, which covers a minimum level. Thus the banks record the non-recovered part as NPAs and has to make provision for it.” (*Zacharias & Ramamurthy; 2008: 15*)

f. Change on Government Policies

“With every new govt. banking sector gets new policies for its operation. Thus it has to cope with the changing principles and policies for the regulation of the rising of NPAs.” (*Zacharias & Ramamurthy; 2008: 15*)

B) Internal Factors

The internal factors that raise the non performing assets are;

a. Defective Lending Process

“Defective lending process invites doubt in loan recovery safety. By safety it means that the borrower is in a position to repay the loan both

principal and interest. The repayment of loan depends upon the borrowers:

- i) Capacity to pay
- ii) Willingness to pay

Capacity to pay depends upon:

- i) Tangible assets
- ii) Success in business

Willingness to pay depends on:

- i) Character
- ii) Honest
- iii) Reputation of borrower

The banker should therefore take utmost care in ensuring that the enterprise or business for which a loan is sought is a sound one and the borrower is capable of carrying it out successfully. The borrower should be a person of integrity and good character.” (*Zacharias & Ramamurthy; 2008: 16-18*)

b. Inappropriate Technology

“Due to inappropriate technology and management information system, market driven decisions on real time basis can not be taken. Proper MIS and financial accounting system is not implemented in the banks, which leads to poor credit collection, thus NPA. All the branches of the bank should be computerized.” (*Iyengar; 2007: 38*)

c. Improper SWOT Analysis

“The improper strength, weakness, opportunity and threat analysis is another reason for rise in NPAs. While providing unsecured advances the

banks depend more on the honesty, integrity, and financial soundness and credit worthiness of the borrower.

d. Poor Credit Appraisal System

“Poor credit appraisal is another factor for the rise in NPAs. Due to poor credit appraisal the bank gives advances to those who are not able to repay it back. They should use good credit appraisal to decrease the NPAs.” (*Iyengar; 2007: 39*)

e. Managerial Deficiencies

“The banker should always select the borrower very carefully and should take tangible assets as security to safe guard its interests. When accepting securities banks should consider the:

- a. Marketability
- b. Acceptability
- c. Safety
- d. Transferability.

The banker should follow the principle of diversification of risk based on the famous maxim “do not keep all the eggs in one basket”; it means that the banker should not grant advances to a few big farms only or to concentrate them in few industries or in a few cities. If a new big customer meets misfortune or certain traders or industries affected adversely, the overall position of the bank will not be affected.” (*Iyengar; 2007: 40*)

f. Absence of regular industrial visit

“The irregularities in spot visit also increases the NPAs. Absence of regularly visit of bank officials to the customer point decreases the collection of interest and principals on the loan. The NPAs due to willful

defaulters can be collected by regular visits.” (Reddy, Appannaiah & Satyaprasad; 2008: 65)

2.1.3 Problems due to NPA

“The three letters strike terror in banking sector and business circle today. NPA is short form of “Non Performing Asset”. The dreaded NPA rule says simply this: when interest or other due to a bank remains unpaid for more than 90 days, the entire bank loan automatically turns a non performing asset. The recovery of loan has always been problem for banks and financial institution. To come out of these first we need to think is it possible to avoid NPA. The following are the major problems caused by NPA;

- a. Owners do not receive a market return on their capital. In the worst case, if the bank fail, owners loose their assets. In modern times this may affect a broad pool of shareholders.
- b. Depositors do not receive a market return on saving. In the worst case if the bank fails, depositors loose their assets or uninsured balance.
- c. Banks redistribute losses to other borrowers by charging higher interest rates, lower deposit rates and higher lending rates repress saving and financial market, which hamper economic growth.
- d. Non performing loans epitomize bad investment. They misallocate credit from good projects, which do not receive funding, to failed projects.

Non performing asset may spill over the banking system and contract the money stock, which may lead to economic contraction. This spill over effect can channelize through liquidity or bank insolvency:

- a. When many borrowers fail to pay interest, banks may experience liquidity shortage. This can jam payment across the country,
- b. Illiquidity constraints bank in paying depositors ,
- c. Undercapitalized banks exceed the banks capital base.” (*Reddy, Appannaiah & Satyaprasad; 2008: 70-73*)

2.1.4 Impact of NPA

The impact of NPA is wide in range. However, the major impacts are listed below;

a. Profitability

“NPA means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the prodigality of bank decreases not only by the amount of NPA but NPA lead to opportunity cost also as that much of profit invested in some return earning project/asset. So NPA doesn’t affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity. Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.” (*Shekher & Shekher; 2008: 52*)

b. Liquidity

Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for short period of time which lead to additional cost to the company. Difficulty in operating the functions of bank is another cause of NPA due to lack of money in routine payments and dues. (*Shekher & Shekher; 2008: 52*)

c. Involvement of management

“Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which

would have given good returns. Now day's banks have special employees to deal and handle NPAs, which is additional cost to the bank.” (*Wild, Subramanyam & Haskey; 2003: 31*)

d. Credit loss

“Bank is facing problem of NPA then it adversely affect the value of bank in terms of market credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting their money in the banks.” (*Shekher & Shekher; 2008: 53*)

2.1.4.1 Bank Growth Vs NPAs

“Following were identified as major impacts of NPAs on Banks’ Growth;

a) Deterioration of Profits

When an advance become NPA Interest due for last 3 month and future accruals are required to transfer in to interest in suspense.

b) Increase in Provisions

When a loan or overdraft falls in to substandard category it is required to provide capital provisioning.

c) Drop in Reserves

When a facility is not recoverable capital will be write off at last. This will have an impact on Profits.

d) Increasing Overhead Costs

It is costly to maintain non performing advances, since it doesn't generate an income. (Ex: follow up costs, staff costs, legal costs)

e) Increasing Market Borrowings

When advances are not recoverable there fill be a liquidity issue in meeting payments and granting further credit. In order to finance banks tend to borrow from the market at high rate.

f) Drop in Share Value

When it is known a bank is having a high Gross NPA ratio and Net NPA ratio share value will be dropped.

g) Negative Image

In the long run bank will have a negative image due to NPAs.” (Wild, Subramanyam & Haskey; 2003: 44)

2.1.4.2 NPAs impact on Economy

“Not only NPA affects the sound system of Bank, but also affects the whole economy.

a) High Interest rates

In order to compensate the loss of interest in NPAs banks have to charged high interest rate from other borrowers. This will have an indirect impact on inflation.

b) Negative Impact on Development

When funds to lend become scare due to NPAs, country’s development will get effected.

c) Unemployment

Businesses ceased to exist due to inability to meet its repayment obligations. This will create unemployment.

d) Instability in the Banking System

Due to high NPA position if liquidity crisis arises and bail out is required, this has huge impact on whole banking sector.” (Wild, Subramanyam & Haskey; 2003: 48)

2.1.5 Early Symptoms of NPA

“Early symptoms by which one can recognize a performing asset turning into Non-performing asset can be mainly categorized in four sections;” (Bidani; 2003: 71)

A) Financial

- i. Non-payment of the very first installment in case of term loan.
- ii. Bouncing of cheque due to insufficient balance in the accounts.
- iii. Irregularity in installment.
- iv. Irregularity of operations in the accounts.

- v. Unpaid over due bills.
- vi. Declining Current Ratio.
- vii. Payment which does not cover the interest and principal amount of that installment.
- viii. While monitoring the accounts it is found that partial amount is diverted to sister concern or parent company.

B) Operational and Physical

- i. If information is received that the borrower has either initiated the process of winding up or are not doing the business.
- ii. Overdue receivables.
- iii. Stock statement not submitted on time.
- iv. External non-controllable factor like natural calamities in the city where borrower conduct his business.
- v. Frequent changes in plan.
- vi. Non payment of wages.

C) Attitudinal Changes

- i. Use for personal comfort, stocks and shares by borrower.
- ii. Avoidance of contact with bank.
- iii. Problem between partners.

D) Others

- i. Changes in Government policies.
- ii. Death of borrower.
- iii. Competition in the market.

2.1.6 Preventive Measurement for NPA

The preventive measurement that can lessen the chances of occurring NPA are as follows;

a. Early Recognition of the Problem

“Invariably, by the time banks start their efforts to get involved in a revival process, it’s too late to retrieve the situation- both in terms of

rehabilitation of the project and recovery of bank's dues. Identification of weakness in the very beginning that is: when the account starts showing first signs of weakness regardless of the fact that it may not have become NPA, is imperative. Assessment of the potential of revival may be done on the basis of a techno-economic viability study. Restructuring should be attempted where, after an objective assessment of the promoter's intention, banks are convinced of a turnaround within a scheduled timeframe. In respect of totally unviable units as decided by the bank, it is better to facilitate winding up/ selling of the unit earlier, so as to recover whatever is possible through legal means before the security position becomes worse." (*Bidani; 2003: 75*)

b. Identifying Borrowers with Genuine Intent

"Identifying borrowers with genuine intent from those who are non-serious with no commitment or stake in revival is a challenge confronting bankers. Here the role of frontline officials at the branch level is paramount as they are the ones who has intelligent inputs with regard to promoters' sincerity, and capability to achieve turnaround. Based on this objective assessment, banks should decide as quickly as possible whether it would be worthwhile to commit additional finance." (*Bidani; 2003: 76*)

In this regard banks may consider having "Special Investigation" of all financial transaction or business transaction, books of account in order to ascertain real factors that contributed to sickness of the borrower. Banks may have penal of technical experts with proven expertise and track record of preparing techno-economic study of the project of the borrowers.

Borrowers having genuine problems due to temporary mismatch in fund flow or sudden requirement of additional fund may be entertained at branch level, and for this purpose a special limit to such type of cases should be decided. This will obviate the need to route the additional

funding through the controlling offices in deserving cases, and help avert many accounts slipping into NPA category.

c. Timeliness and Adequacy of response

“Longer the delay in response, grater the injury to the account and the asset. Time is a crucial element in any restructuring or rehabilitation activity. The response decided on the basis of techno-economic study and promoter’s commitment, has to be adequate in terms of extend of additional funding and relaxations etc. under the restructuring exercise. The package of assistance may be flexible and bank may look at the exit option.” (*Bidani; 2003: 78*)

d. Focus on Cash Flows

“While financing, at the time of restructuring the banks may not be guided by the conventional fund flow analysis only, which could yield a potentially misleading picture. Appraisal for fresh credit requirements may be done by analyzing funds flow in conjunction with the Cash Flow rather than only on the basis of Funds Flow.” (*Bidani; 2003: 78*)

e. Management Effectiveness

“The general perception among borrower is that it is lack of finance that leads to sickness and NPAs. But this may not be the case all the time. Management effectiveness in tackling adverse business conditions is a very important aspect that affects a borrowing unit’s fortunes. A bank may commit additional finance to analyze unit only after basic viability of the enterprise also in the context of quality of management is examined and confirmed. Where the default is due to deeper malady, viability study or investigative audit should be done – it will be useful to have consultant appointed as early as possible to examine this aspect. A proper techno-economic viability study must thus become the basis on which any future action can be considered.” (*Bidani; 2003: 79*)

2.1.7 Practical Approach to Manage NPAs

“The practical approaches that can enhance in managing the NPAs are as follows;” (*Rahdaswami & Vasudevan; 2004: 62-70*)

a. Improving the Appraisal system

Emphasis should be given to appraisal process to ensure proper evaluation done to establish the credit worthiness of the customer. It should be noted at the appraisal level all required information to submit in order for the approving authorities to take a credit decision.

b. Continuous Monitoring Supervision and Follow Up

Monitoring supervision and Follow-up should not be a task to be implemented when an advance turn in to loss category. Early warning signals should be identified and preventive measures should be implemented.

c. Availability of Historical Data

Availability of historical data is paramount of important in preparation of a credit proposal. So banks should have historical data base to extract past records as and when required.

d. Market Intelligence System

MIS information should be available for various reasons when taking credit decisions. (Ex: To rate a customer, to extract performance ratios)

e. Speedy Legal Actions

When all possible attempts for recovery is failed only option is to proceed with legal action and this should be speedy otherwise this will be costly.

f. Integrity

Staff integrity is also vital factors. No member in the approval cycle should take a decision based on financial rewards.

g. Rewarding Staff

Introducing a staff rewarding/incentive scheme will also support in reducing NPAs. It should be noted rewarding staff will be less costly rather than spending.

2.2 Review of NRB Directives Relating to NPA

1. Classifications of Loan and Advances: Effective from FY 2058/59 (2001/02) banks shall classify outstanding principal amount of loan and advances on the basis of aging. As per the directives issued by NRB, all loans and advances shall be classified into the following four categories:

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

2. Additional Arrangement in Respect of Pass Loan: Loan and advances fully secured by gold, silver, fixed deposit receipts, credit cards and government securities shall be include under “pass” category. Loans against fixed deposit receipts of other banks shall also qualify for inclusion under pass loan. However, where collateral of fixed deposit receipt or government securities or NRB bonds is placed as extra security, such loan has to be classified on the basis of clause 1 to clause 7. While renewing working capital loan having maturity period up to one year can be classified as pass loan. If the interest of working capital nature loans and advance is not regular, such loan and advances should be classified on the basis of interest outstanding period.

3. Additional Arrangement in Respect of loss Loan: Even if the loan is not past due, loans having any or all of the following discrepancies shall be classified as “loss”.

- a. Security is not sufficient,
- b. The borrower has been declared bankrupt,
- c. The borrower is absconding or cannot be found,
- d. Purchased or discounted bills are not realized within 90 days from the due date and non fund based letter of credit and guarantees etc are not realized with in 90 days from the date of conversion into fund based are not realized within 90 days,
- e. The credit has not been used for the purpose originally intended,
- f. Owing to non-recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation,
- g. Loan provided to the borrowers included in the blacklist of credit information center (CIC),
- h. Project or business is not in operative conditions, project or business is not in operation,
- i. Credit Card Loan is not written off within 90 days from past due date.

4. Additional Arrangements in Respects of Term Loan:

In respect of term loans, the classification shall be made against the entire outstanding loan on the basis of the past due period of overdue installment.

5. Prohibition to Recover Principal and Interest by Overdrawing the Current Account and Exceeding the Overdraft Limit:

Principal and interest on loans and advance shall not be recovered by overdrawing the borrower’s current account or where overdraft facility has been extended, by overdrawing such limit. However, this

arrangement shall not be constructed as prohibitive for recovering the principal and interest by debiting the customers' account. Where a system in the bank exists as to recovery of principal and interest by debiting the customers' account, and recovery is made as such resulting in overdraft, which is not settled within one month, such overdrawn principal amount shall also be liable to be include under the outstanding loan and such loan shall be downgraded by one step from its current classification. In respects if recognition of interest, the same shall be as per the clause relating to income recognition mentioned in directives no 4.

6. Letter of Credit and Guarantees:

If letter of credit and guarantees and other contingent liabilities converted into fund based liabilities and have to be paid, in such condition such loan shall be classified as pass loan within 90 days from the date of conversion into fund based. After 90 days such loan shall be classified as loss loan.

7. Rescheduling and Restructuring of the Loan:

If the bank is confident on the following bases of written plan of action submitted by borrower, it may reschedule or restructure the loans and advances. Clear bases of rescheduling or restructuring should be attached with loan files.

- a. If there is proof of adequate documents and collateral security relating to loan.
- b. If the bank is confident in recovery of restructured or rescheduled loans and advances.

In addition to written plan of action for rescheduling or restructuring of loan, payment of at least 25 percent of total accrued interest up to the date of rescheduling of restructuring should have been collected.

8. Loan Loss Provisioning:

The loan loss provisioning, on the basis of the outstanding loans and advances and bills purchases classified as per this directives, shall be provided as follows:

| <u>Classification of Loan</u> | <u>Loan Loss Provision</u> |
|-------------------------------|----------------------------|
| Pass loan | 1% |
| Sub-standard loan | 25% |
| Doubtful loan | 50% |
| Loss | 100% |

2.3 Review of Journals and Articles

Pasha and Khemraj (2005), in their article, “*The Determinants of Non-Performing Loan: An Econometric Case Study of Guyana*”, have stated that macro-factors, such as, the real effective exchange rate and growth in real GDP impacts significantly on the level of NPLs. In particular, we found that the real effective exchange rate has a strong positive association with the levels of NPLs reported by commercial banks suggesting that whenever there is a deterioration in the international competitiveness of the domestic economy (as reflected by an appreciation in the real effective exchange rate) this translates into higher NPLs. We also find evidence of a significant inverse relationship between GDP and non-performing loans. This means that strong performance in the real economy results in lower non-performing loans. Our results show that the impact of growth in real GDP on NPLs is instantaneous. The empirical results, however, reveals that inflation is not an important determinant of NPLs in the Guyanese banking system.

Wu, Chang and Selvili (2007), in their article, “*Banking System, Real State Market and Non Performing Loan*”, have stated that the risky lending behavior of banks and the recessive real estate sector can cause increasing levels of nonperforming loans. In turn, a high percentage of

nonperforming loans can push banks to adopt more restrictive real estate lending policies, causing the real estate market to slump.

The nonperforming loan ratio can indeed have an effect on bank profitability. The converse is also true: bank profitability has an impact on the nonperforming loan ratio. Further the bank profitability and the housing price have causal relationships. The nonperforming loan ratio can be explained by the GDP growth rate, the change in housing price, the relative cost of real estate borrowing, and the ratio of corporate to individual real estate loans. All but the change in housing price are important determinants of the nonperforming loan ratio. In addition, the banking profitability by including the GDP growth rate, the spread between the lending rate and the deposit rate, the total amount of loans, and the nonperforming loan ratio. The results suggested that the nonperforming loan ratio affects banking profitability negatively, as expected.

Inaba, Kozi and Sekine (2009), in their article, *“Non Performing Loans and the Real Economy; Japan’s Experience”*, have explained that the deterioration in firms’ balance sheets due to the collapse of land prices was responsible for the increase in NPLs. Cyclical downturns seemed to be also responsible, albeit indirectly, in that they increased quasi-NPLs. The increase in NPLs, in its turn, distorted real economic performance via malfunctioning in the banking sector. Both a “credit crunch” and “forbearance lending” took place, and these caused a decline, through the banking sector, in the efficiency of its resource allocation.

In tandem with the government, the Bank of Japan has endeavoured to restore bank health through bank supervision. Recent measures include its advocacy of the discounted cash flow methodology for provisioning, as well as the purchases of equities from the banking sector aimed at reducing banks’ equity exposure and keeping it down at the level of their

Tier 1 capital. The Bank has also made efforts to strengthen the monetary transmission mechanism. As part of its efforts in this direction, the Bank decided to purchase asset-backed securities. The fall in land prices was responsible for the increase in NPLs that ended up suppressing the real growth of Japan's economy. Although the fall in land prices is generally thought to have reflected the bursting of the bubble as well as ongoing structural changes (eg rapid ageing, hollowing out, etc), there is uncertainty in quantitative sense of the extent of each factor's contribution. Further, more work is needed on banks' profitability, since bank health cannot be restored unless banks become reasonably profitable.

Schafer (2010), in her article, "*Non Performing Assets- An Established Assets Class*", has stated that the sale of distressed loan portfolios has become one of the standard instruments of bank risk management. Conversely, distressed loans now constitute an established asset class for investors in the capital market. They provide market participants with additional options and thereby improve the economic allocation of risk and capital.

After years of rapid growth, the market has entered a phase of consolidation and differentiation. Important legal points have been clarified and all those involved are standardizing their processes. While the number of billion-Euro transactions is falling, smaller institutions, offering volumes in the two-digit million bracket, are more and more increasing the number of vendors. A large number of service providers are ready to advise banks interested in selling and to take over the management of their problem loans. The type of loans traded is also changing. Whereas at the beginning mainly real estate loans were sold in the portfolios, now individual corporate loans are increasingly coming onto the market. This qualitative change in the market will play its part in

better accommodating the requirements of the market participants. All direct participants as well as the overall economy will continue to gain considerably from trading in loan portfolios.

2.4 Review of Thesis

Shrestha (2005), in her study “*A Study on Non-Performing Loan and Loan Loss Provisioning of Commercial Banks; with reference to Nepal Bank Ltd, NABIL Bank Ltd. and Standard Chartered Bank Nepal Ltd.*”, has main objective to analyze the various aspects of non-performing loan in the commercial banks. The specific objectives of the study are; to find out the proportion of non-performing loan, to examine the factors leading to accumulation of non-performing loan, to analyze the relationship between loan and loan loss provision and to find out the impact of loan loss provision on profitability of the commercial bank.

The study has found that increasing non-performing loan is the serious problem of the banking sector in Nepal. A further, non-performing asset directly affects the income flow of the bank. Moreover, NBL has very high portion of non-performing loan resulting to higher portion. Hence, even the bank has the highest investment in the most income generating assets i.e. loan and advances, it is in loss. Even the private sector bank like NABIL has higher non-performing loan and according higher provision. NABIL's average proportion on non-performing loan during the study period is higher than the acceptable. However in recent two year NABIL's non-performing loan has shown significant decrement and according provision has also decreased. Eventually, among the three banks SCBNL has the least non-performing loan and thus the least loan loss provision. From these indicators it can be said that SCBNL is the best among the three banks. However SCBNL seems less oriented towards lending. Hence, the lower percentage of NPL and provisioning

of SCBNL is not only due to proper lending function but also due to relatively lower investment in loans and advances.

Khadka (2007), in his study, “*Non-Performing Assets of Nepalese Commercial Banks*”, has the main objective to examine the non-performing assets of the selected banks. The specific objectives of the study are; to analyze the level of NPAs in total assets, total deposit and total lending of Nepalese commercial banks, to examine the loan loss provision of the commercial banks, and to analyze the effects of non-performing assets on Return on Assets and Return on Equity of Nepalese commercial banks.

The study has found that escalating level of NPAs has been becoming great problem in banking business in the world. In this context, Nepal can't be run off from such situation. Also, the level of NPAs in Nepalese banking business is very alarming. It is well known fact the problem of swelling non-performing assets (NPAs) and the issue is becoming more and more unmanageable day by day. Moreover, the total NPA in Nepalese banking system is about 35 billion, while it is very worse in case of two largest commercial banks Rastriya Banijya Bank (RBB) and Nepal Bank Ltd. (NBL). The level of NPA of Nepal Bangladesh Bank Ltd.(NBBL), Nepal SBI Bank Ltd. (NSBIBL), and Bank of Kathmandu Ltd (BOKL) seems very unsatisfactory. If the situation is not handling right now, it will be unmanageable and difficult to handle. In other, level of NPA of Nepal Investment Bank and NABIL bank has been gradually decreasing every year. The NPA of NIBL is least (minimum) than all of other banks at the end of 2059/60. Finally, the high degree of negative correlation of different commercial banks between NPA and ROA, and NPA and ROE indicates towards the inverse relation between NPA and ROA, and NPA and ROE. It means the level of

NPA effect the return on assets and return on shareholder's equity. Therefore, banks should reduce their level of NPA to increase the ROE and ROA.

Pradhan (2008), in his study “*A study on Non-Performing Assets of commercial bank with references to SCBNL, RBB, Everest bank, NB bank and NBBL*”, has the main objective to analyze the non-performing position in commercial banks. The specific objectives of the study are; to find out the proportion of non-performing loan and the level of NPA in total assets, total deposit and total lending in the selected commercial bank, to examine loan loss provision in the commercial bank, and to analyze the impact of non-performing assets in the performance of commercial bank.

The study has found that improper credit policy, political pressure to lend, lack of supervision and monitoring, economic slow down, overvaluation of collateral are the major cause of occurring NPA. In recent year, not only the private sector's bank (like NBBL, EBL and SCBNL) but also public sector's banks (RBB and NBL) are trying to maintain their loan and advances to control over becoming the non-performing assets. Also, high level of non-performing assets are not only decreasing the profitability of the banks but also affecting the entire financial as well as operational health of the organization. If NPA isn't controlled immediately, it will be main causes for shutdown of the banks in future.

Aryal (2008), in his study, “*Impact of NPA on Commerical Bank*”, has the main objective to analyze and identify the impact of NPA on profitability. The other specific objectives of the study are; to evaluate the relationship of loan and advances with total deposit and total assets, to find out the level of NPA in total loan and advance and total assets and its

relationship with loan and advances, total assets and loan loss provision, to find out the return on loan and advances and its relationship with loan loss provision and to evaluate the relationship between profit (loss) and loan loss provision.

The study has found that the average loan and advances to total assets ratio on NABIL, SCBNL, EBL, NBL, RBB and NBBL are 50.38%, 29.16%, 59.62%, 32.25%, 37.17% and 64.64% respectively during the study period. The relatively low ratio of SCBL is the indication of risk averse attitude of the management or they have the policy of investing low in the risky assets like loan and advance. The loan and advances to total deposit of NABIL, SCBNL, EBL, NBL, RBB and NBBL during the study period are 58.70%, 36.85%, 73.79%, 57.79%, 70.56% and 79.42% respectively. The NBBL has the highest average ratio but SCBNL has the relatively lower ratio. Also, the average ratio of non-performing assets to total loan and advances of NABIL, SCBNL, EBL, EBL, RBB and NBBL are 7.43%, 4.43%, 2.73%, 48.83%, 56.95% and 16.34% respectively. Similarly, the means 92.57%, 95.57%, 97.27%, 51.17%, 43.05% and 83.66% of loan and advances of NABIL, SCBNL, EBL, NBL, RBB and NBBL are performing loan respectively. Eventually, it has been found that the average return on total loans and advance ratio of NABIL, SCBNL, EBL, NBL, RBB and NBBL are 4.61%, 7.73%, -3.99%, -15.67% and 1.42% respectively, and the return on loan and advances revealed that RBB seems to be failure to earn return on loan and advances.

Tamrakar (2008), in his study *“Non-Performing Assets & Profitability of Selected Nepalese Commercial Banks”*, has the main to examine and study the non-performing assets in total assets, total deposit and total lending of the Nepalese commercial banks. The specific objectives of the

study are; to analyze the non-performing assets of the banks under study, to evaluate the relationship between the profitability and the non-performing assets of the commercial banks under study, and to examine whether the Nepalese commercial banks are following the NRB directives regarding non-performing assets or not.

The study has found that in case of Lumbini Bank Limited (LUBL), total NPA and net profit have been found to be increasing. NPA to total lending ratio have been found increasing over the years as it was 19.32% in the fiscal year 2002/03 and increased to 30.99% in the fiscal year 2006/07. In case of Himalayan Bank Limited (HBL), total NPA have been decreased and net profit has been found to be increasing. Similarly, in Nepal SBI Bank, total NPA and net profit have been found to be increasing. NPA to total lending ratio have found to be slightly decreasing over the years as it was 6.32% in the fiscal year 2002/03 and increased to 6.13% in the fiscal year 2006/07. The percentage of performing assets to total assets of LUBL was found to be highest among the sample banks and that of EBL was found to be lowest. Moreover, the correlation coefficient between ROA and level of NPA was found to be negative for each of the bank except NBBL under the study period.

Nepal (2009), in her study, "*Evaluation of Non Performing Assets of Commercial Banks: With Special Reference to Standard Chartered Bank, Bank of Kathmandu and Everest Bank Limited,*" has the main objective to examine non performing assets of sampled banks. The specific objectives are: to the relationship between the non performing assets and the profitability of the commercial bank, to measure the relationship between NPA with total deposit and net profit, to determine the risk in total assets, and to ascertain determinants of non performing assets.

The study has found that the performing loan of SCBNL has covered 97.73% of the total loans and advances, whereas the non-performing loan has covered 2.27% of the total loans and advances. Similarly, in BOK the performing loan has occupied 96.25% and non-performing loan has covered 3.75% of the total loans and advances. And in EBL, the performing loan has represented 98.78% and non-performing loan has represented 1.22% of the total loan. The average sub-standard loan, doubtful loan and loss loan of SCBNL are Rs. 13.66 millions, Rs. 83.07 millions, and Rs. 103.31 millions respectively, BOK are Rs. 81.83 millions, Rs. 44.59 millions, and Rs. 152.03 millions respectively, while EBL are Rs. 7.34 millions, Rs. 9.25 millions and Rs. 104.07 millions respectively. Also, in average, the non-performing asset has represented 2.33% in SCBNL, 3.93% in BOK and 1.24% in EBL of the total performing loan of the respective bank, which has indicated that BOK has more risky investment sector than SCBNL and EBL. Similarly, 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 asset 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.

Gyawali (2010), in his study, "*Scrutinizing Non Performing Assets in Commercial Banks (With Special Reference to SBI, NIC, and MBL)*", has the main objective to make scrutiny of non performing assets of commercial banks, especially of Nepal SBI Bank Limited, Nepal Industrial and Commercial Bank Limited and Macchapucchre Bank Limited. The specific objectives are: to measure to what extent does the non performing asset adversely affect the profitability of banks, to

measure the credit risk of the banks, and to measure the relationship between non performing assets and total deposit.

The study has found that NIC is slightly better than MBL and SBI, as the coverage of performing loan in total loans and advances of NIC is greatest in comparison to that of SBI and MBL. However, the non-performing loan aid to consider that there is highest credit risk in SBI in comparison with MBL and NIC, since the loss loan of SBI is greatest than that of others, which verifies the inefficiency of SBI in converting the status of loss loan. In contrast, the non-performing loan to performing loan clarifies that that the chances of turning total loans and advances in non-performing loan is lowest in NIC than in SBI and MBL, as the ratio of non-performing assets to performing loan of NIC is lowest than that of SBI and MBL. Also on the basis of non-performing loan to total assets, NIC is best in comparison to that of SBI and MBL, since the average ratio of NIC is least than that of SBI and MBL. However, the declination in the ratio of SBI is also creditable.

2.5 Research Gap

All of the above research is based on the quantitative analysis and has ignored the qualitative analysis. In other words, it has been observed that the previous studies have neglected the factors that augment the chances of the turning good loans to non performing loan. Further, the aforementioned studies have not considered the opinions of the borrowers on the loan management procedures of the banks, the internal reasons for the non performing loan and other aspects that can alleviate the non performing loan. The present study attempts to fill all these research gaps, along with the analysis of the secondary data related to the non performing loan. Further, the study measures the impact of non

performing loan on the profitability of the bank through regression and correlation analysis.

So, this study is different from previous study because both primary and secondary data has been used as well as latest data from FY 2007/08 to 2011/12 were used.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Design

This study basically analyses the non performing assets in the commercial banks based on macro picture along with future predictions. The data for the study is collected from both secondary and primary sources and the collected data is presented and analyzed using different tables, and statistical tools. Thus presentation and analysis are the core aspects of this study. In this perspective, this research follows descriptive and analytical research design.

3.2 Population and Sample

Quantitatively, the number of commercial banks is increasing in the country, although non performing asset has been the major challenges for the sustainability of the present banks. Altogether, 31 commercial banks are providing the banking services to the citizens since mid July 2013. However, the analysis of non performing of all these banks in this study is somewhat impossible. For the study, only 3 commercial banks have been chosen judgements method. More concisely, Himalayan Bank Limited, Bank of Kathmandu Limited and Everest Bank Limited are taken as the sample banks.

3.3 Nature and Sources of Data

Both secondary and primary sources of data have been requested for the collection of data. The secondary data have been collected mainly through the annual reports of HBL, BOK and EBL. Further, the official websites of these institutions along with that of Nepal Rastra Bank have

been visited. However, the primary data have been collected through field survey.

3.4 Data Analysis Tools

For the analysis of the data, both financial and statistical tools have been extensively used.

3.4.1 Financial Tools

The major financial tools used in the study are as follows;

A) Non Performing Assets to Total Loan

The non-performing asset to total loan also measures the credit risk of financial institutions. Lower ratio is considered better, while ratio is unhealthy to the institutions. It measures how much of the performing loan is represented by the non-performing loan. It is calculated as follows:

$$NPA \text{ to Total Loan} = \frac{NPA}{Total \text{ Loan}} \times 100$$

B) Composition of Non-Performing Assets

Non-Performing Assets of bank is composed of sub-standard loan, doubtful loan and loss loan. This composition demonstrates the actual credit risk of the bank by clearly depicting the coverage and amount of substandard loan, doubtful loan and loss loan on non-performing assets.

$$Composition \text{ of } NPA = Substandard \text{ Loan} + Doubtful \text{ Loan} + Loan \text{ Loss}$$

C) Non Performing Assets to Total Assets

This ratio indicates the ratio between the non-performing assets and total assets. Higher NPA to assets ratio implies the bad effects in banks performance and decreases the profit ability of the banks whereas lower

ratio implies the better performance of the bank and increases the profitability of banks. This ratio can be calculated as follows:

$$NPA \text{ to Total Assets} = \frac{\text{Non-Performing Loan}}{\text{Total Assets}} \times 100$$

D) Non Performing Assets to Total Deposits

The main objective of the commercial banks is to collect deposit and lend it to secure sector. The non performing assets to total deposits measures the portion of total deposit that is having credit risk. Higher the ratio is unfavorable and thus lower ratio is preferable. This ration is calculated as:

$$NPA \text{ to Total Deposit} = \frac{\text{Non-Performing Loan}}{\text{Total Deposit}} \times 100$$

E) Loan Loss Provision to Total Loans and Advances

Each bank has to keep the loan loss provision for loan and advances as per the direction of Nepal Rastra Bank. The loan loss provision to total loans and advances measures the aggregate percentage of loan loss provision kept by bank on loans and advances and thus eventually measures the security position. It is calculated as follows:

$$LLP \text{ to Loan and Advance} = \frac{\text{Loan Loss Provision}}{\text{Total Loan and Advance}} \times 100$$

F) Loan Loss Provision to Non Performing Assets

This ratio describes the proportion of provision held to non-performing assets of the bank. This ratio measures up to what extent of risk inherent in NPA is covered by the total loan provision. Higher ratio signifies that the banks are safeguarded against future contingencies that may create due to non-performing assets. So, higher the ratio better is the financial strength of the bank. This ratio is calculated as follows:

$$LLP \text{ to NPA} = \frac{\text{Loan Loss Provision}}{\text{Non - Performing Assets}} \times 100$$

G) Net Profit to Non Performing Assets

This ratio indicates the proportion of the return over the non-performing loan. It describes how efficiently the bank has employed its resources in recovering its non-performing loan along with the interest. Higher the ratio indicates better performance of bank and lower non-performing assets. It is calculated as follows:

$$\text{Net Profit to NPA} = \frac{\text{Net Profit}}{\text{Non - Performing Assets}} \times 100$$

3.4.2 Statistical Tools

The major statistical tools used in the study are as follows:

A) Mean

The arithmetic mean (or simply the mean) of a list of numbers is the sum of the list divided by the number of items in the list. The mean is the most commonly-used type of average and is often referred to simply as the average.

$$\bar{X} = \frac{\sum X}{N}$$

B) Standard Deviation

Standard deviation is a widely used measure of the variability or dispersion, being algebraically more tractable though practically less robust than the expected deviation or average absolute deviation. It may be thought of as the average difference of the scores from the mean of distribution, how far they are away from the mean. A low standard deviation indicates that the data points tend to be very close to the mean,

whereas high standard deviation indicates that the data are spread out over a large range of values.

$$\sigma = \sqrt{\frac{\sum(X - \bar{X})^2}{N-1}}$$

Where,

σ = Standard Deviation

C) Coefficient of Variation

The coefficient of variation represents the ratio of the standard deviation to the mean, and it is a useful statistic for comparing the degree of variation from one data series to another, even if the means are drastically different from each other.

$$C. V. = \frac{\sigma}{\bar{X}} \times 100$$

D) Regression

Regression refers to any approach to modeling the relationship between one or more variables denoted Y and one or more variables denoted X, such that the model depends linearly on the unknown parameters to be estimated from the data. The simple regression line of Y on X is given by;

$$Y = a + bx \dots\dots\dots (i)$$

Where, Y = Dependent Variable

a = Constant

b = Regression Coefficient

X = Independent Variable

CHAPTER FOUR

PRESENTATION AND ANALYSIS OF DATA

4.1 Secondary Data Analysis

Under this section of the study, the data related to the non performing assets and extracted from the annual reports of the observed banks have been interpreted to meet the objectives set out in the first chapter.

4.1.1 Non-Performing Assets to Total Loan

This ratio measures the representation of non-performing assets on the total loan of the bank. The lower the ratio of non-performing assets to total loan, the better will be the loan management. The ratio of non-performing assets to total loan of HBL, BOK and EBL from the fiscal year 2007/08 to 2011/12 is presented in the table 4.1.

Table 4.1
Non-Performing Assets to Total Loan

Rs. in Millions

| FY | HBL | | | BOK | | | EBL | | |
|--------------|---------|----------|--------------|--------|----------|--------------|--------|----------|--------------|
| | NPA | TL | Ratio | NPA | TL | Ratio | NPA | TL | Ratio |
| 2007/08 | 1257.72 | 15761.98 | 7.98 | 216.26 | 7488.70 | 2.89 | 155.27 | 10136.25 | 1.53 |
| 2008/09 | 940.90 | 17793.72 | 5.29 | 255.24 | 9694.10 | 2.63 | 125.61 | 14082.68 | 0.89 |
| 2009/10 | 835.17 | 20179.61 | 4.14 | 252.13 | 12747.72 | 1.98 | 141.17 | 18836.43 | 0.75 |
| 2010/11 | 951.64 | 25519.52 | 3.73 | 202.19 | 14945.72 | 1.35 | 126.32 | 24469.56 | 0.52 |
| 2011/12 | 1525.97 | 29123.75 | 5.24 | 270.48 | 17044.30 | 1.59 | 50.57 | 28156.40 | 0.18 |
| Mean | | | 5.27 | | | 2.09 | | | 0.77 |
| S.D. | | | 1.35 | | | 0.54 | | | 0.41 |
| C.V.% | | | 25.66 | | | 25.80 | | | 52.98 |

(Source: Annual Reports of HBL, BOK & EBL)

In each fiscal year, HBL has increased its loan disbursement, however, the non performing assets has fluctuated during the periods. The loan disbursement of HBL has increased from Rs. 15761.98 millions in the

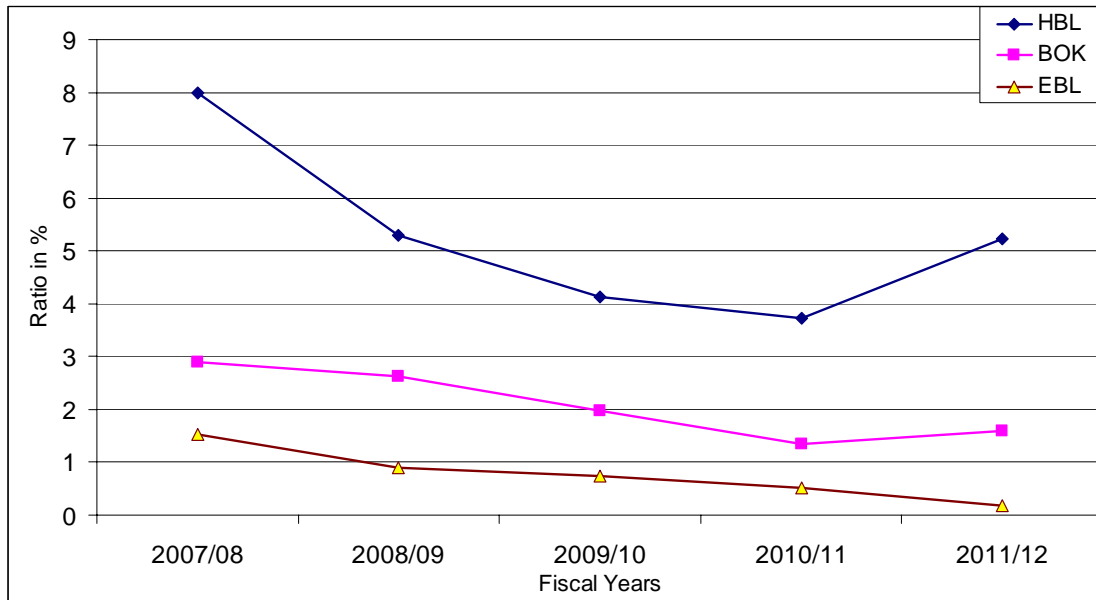
fiscal year 2007/08 to Rs. 29123.75 millions in the fiscal year 2011/12. However, the non performing asset has ranged from Rs. 835.17 millions in the fiscal year 2009/10 to Rs. 1525.97 millions in the fiscal year 2011/12. Further, the non performing assets to total loan has decreased in the first four fiscal years, i.e. from 7.98% in the fiscal year 2007/08 to 3.73% in the fiscal year 2010/11, and increased in the final year to 5.24%. In average, the ratio is 5.27% and the variation is 25.66%.

Also, despite the increment in the loan and advances in each fiscal year, the non performing asset of BOK has fluctuated during the periods. The loan and advances has increased from Rs. 7488.70 millions in the fiscal year 2007/08 to Rs. 17044.30 millions in the fiscal year 2011/12, and the non performing asset has ranged from Rs. 202.19 millions in the fiscal year 2010/11 to Rs. 270.48 millions in the fiscal year 2011/12. Consequently, the non performing asset to total loan and advances of BOK has decreased for the first four fiscal years, i.e. from 2.89% in the fiscal year 2007/08 to 1.35% in the fiscal year 2010/11, and has increased to 1.59% in the fiscal year 2011/12. In average, the ratio is 2.09% and the variation is 25.80%.

Moreover, it has been ascertained that although the loan and advances has increased in each fiscal year, EBL has been able to decrease the non performing asset in most of the fiscal year, and eventually to decrease the credit risk. The loan and advances of EBL has been increased to Rs. 28156.40 millions in the fiscal year 2011/12 from Rs. 10136.25 million in the fiscal year 2007/08, and the non performing asset has been decreased to Rs. 50.57 millions in the fiscal year 2011/12 from Rs. 155.27 millions in the fiscal year 2007/08. Nevertheless, the EBL has been able to decrease the credit risk, since the non performing asset to total asset has decreased in each fiscal year. The ratio has been decreased to 0.18% in

the fiscal year 2011/12 from 1.53% in the fiscal year 2007/08. In average, the ratio is 0.77% and the variation in the ratio is 52.98%.

Figure 4.1
Non-Performing Assets to Total Loan



Source: Table No. 4.1

Comparing the banks on the basis of the non performing asset to total loan and advances, it can be assumed that the credit risk ratio is lowest in EBL and highest in HBL, since the ratio is lowest in EBL and highest in HBL. Thus, it can be inferred that EBL is much efficient in loan management than other banks.

4.1.2 Composition of Non-Performing Loan

As per the direction of NRB, the non-performing loans should be further categorized into sub-standard loan, doubtful loan and loss loan. The lower the loss loan and doubtful loan the higher the chances of lower credit risk. The composition of non-performing assets of HBL, BOK and EBL for the five consecutive years are presented in the table 4.2.

Table 4.2
Composition of Non-Performing Loan

| FY | HBL | | | BOK | | | EBL | | |
|--------------|---------------|---------------|---------------|--------------|--------------|---------------|--------------|---------------|--------------|
| | SSL | DL | LL | SSL | DL | LL | SSL | DL | LL |
| 2007/08 | 107.23 | 228.50 | 705.03 | 71.61 | 8.80 | 123.21 | 10.67 | 0.68 | 117.88 |
| 2008/09 | 72.08 | 194.98 | 374.56 | 39.86 | 36.58 | 166.86 | 4.22 | 2.35 | 106.61 |
| 2009/10 | 53.92 | 214.48 | 208.83 | 100.18 | 19.25 | 117.47 | 6.30 | 0.75 | 120.26 |
| 2010/11 | 167.83 | 194.70 | 188.78 | 36.91 | 21.09 | 132.32 | 1.36 | 28.51 | 88.11 |
| 2011/12 | 122.76 | 220.52 | 681.55 | 11.46 | 70.85 | 174.91 | 5.47 | 12.63 | 25.60 |
| Mean | 104.76 | 210.64 | 431.75 | 52.00 | 31.31 | 142.95 | 5.60 | 8.98 | 91.69 |
| S.D. | 39.90 | 13.64 | 223.20 | 30.74 | 21.67 | 23.43 | 3.04 | 10.73 | 34.94 |
| C.V.% | 38.09 | 6.48 | 51.70 | 59.11 | 69.20 | 16.39 | 54.18 | 119.40 | 38.11 |

(Source: Annual Reports of HBL, BOK & EBL)

The table manifests that in the fiscal year 2008/09, all of the components of non performing loan of HBL have been reduced. The sub standard loan in that fiscal year has been reduced to Rs. 72.08 millions, doubtful loan has been reduced to Rs. 194.98 millions and loan loss has been reduced to Rs. 374.56 millions. However, in other fiscal years, there is no such simultaneous decrement in all the composition of non performing loans. The table emblazons that up to the fiscal year 2010/11, there is significant control in all the composition of non performing loan, however, at the end of the fiscal year 2011/12, there is less difference on the amount of these components as that of first observed period. Nonetheless, the sub standard loan has ranged from Rs. 72.08 millions in the fiscal year 2008/09 to Rs. 167.83 millions in the fiscal year 2010/11, the doubtful loan has ranged from Rs. 194.70 millions in the fiscal year 2010/11 to Rs. 228.50 millions in the fiscal year 2007/08, and loan loss has ranged from Rs. 188.78 millions in the fiscal year 2010/11 to Rs. 705.03 millions in the fiscal year 2007/08. In average, the sub standard loan is Rs. 104.76 millions, the doubtful loan is Rs. 210.64 millions and loan loss is Rs. 431.75 millions.

Alike in HBL, the components of non performing loan of BOK have oscillated during the periods. The substandard loan is highest, Rs. 100.18 millions, in the fiscal year 2009/10 and lowest, Rs. 11.46 millions, in the fiscal year 2011/12, the doubtful loan is highest, Rs. 70.85 millions, in the fiscal year 2011/12 and lowest, Rs. 8.80 millions, in the fiscal year 2007/08, and the loss loan is highest, Rs. 174.91 millions in the fiscal year 2011/12, and lowest, Rs. 117.47 millions, in the fiscal year 2009/10. In average, the substandard loan has been measured to be Rs. 52.00 millions, the doubtful loan has been ascertained to be Rs. 31.31 millions and loss loan has been found to be Rs. 142.95 millions. It has been observed that BOK has reduced the substandard loan, but it could not reduce the doubtful loan and loss loan.

EBL has been able to decrease the substandard loan and loan loss during the five year periods, however, the doubtful loan has been increased within the observed periods. The substandard loan has been recorded to be Rs. 5.47 millions at the end of the fiscal year 2011/12, while at the onset it has been Rs. 10.67 millions, and in lowest it is Rs. 1.36 millions in the fiscal year 2010/11. Further, at the outset, the doubtful loan is Rs. 0.68 millions and by the end of the fiscal year 2011/12, it is Rs. 12.63 millions. Also, the loss loan at the inception of the observed periods is Rs. 117.88 millions and at the end of the fiscal year 2011/12 is Rs. 25.60 millions. In average, the substandard loan of EBL is Rs. 5.60 millions, doubtful loan is Rs. 8.98 millions and loan loss is Rs. 91.69 millions.

It has been observed that in each bank, the loan loss is higher than substandard loan and doubtful loan and thus indicates greater amount to be in risk. However, comparing the banks, it can be said that EBL is most efficient to other banks in controlling each component of non performing loan, and eventually in reducing the non performing assets.

4.1.3 Non-Performing Assets to Total Assets

This ratio measures the coverage of non-performing assets on total assets of the organization. The higher the ratio indicates higher maintenance of risky assets, as the recovery of non-performing assets is uncertain. The non-performing assets to total assets of HBL, BOK and EBL for the five fiscal year periods taken for study are presented in the Table 4.3.

Table 4.3

Non-Performing Assets to Total Assets

| FY | HBL | | | BOK | | | EBL | | |
|--------------|---------|----------|--------------|--------|----------|--------------|--------|----------|--------------|
| | NPA | TA | Ratio | NPA | TA | Ratio | NPA | TA | Ratio |
| 2007/08 | 1257.72 | 29460.39 | 4.27 | 216.26 | 12278.33 | 1.76 | 155.27 | 15959.29 | 0.97 |
| 2008/09 | 940.90 | 33519.14 | 2.81 | 255.24 | 14581.39 | 1.75 | 125.61 | 21432.57 | 0.59 |
| 2009/10 | 835.17 | 36175.53 | 2.31 | 252.13 | 17721.92 | 1.42 | 141.17 | 27149.35 | 0.52 |
| 2010/11 | 951.64 | 39330.13 | 2.42 | 202.19 | 20496.01 | 0.99 | 126.32 | 36916.85 | 0.34 |
| 2011/12 | 1525.97 | 42717.12 | 3.57 | 270.48 | 23396.19 | 1.16 | 50.57 | 41382.76 | 0.12 |
| Mean | | | 3.08 | | | 1.42 | | | 0.51 |
| S.D. | | | 0.68 | | | 0.28 | | | 0.26 |
| C.V.% | | | 22.06 | | | 20.05 | | | 50.68 |

(Source: Appendix - II)

It has been ascertained that the non performing assets of HBL has decreased for the first three fiscal years and then increased in the last two fiscal years, while the total assets of the bank persistently increased in each fiscal year. The total asset of the bank has been raised to Rs. 42717.12 millions in the fiscal year 2011/12 from Rs. 29460.39 millions in the fiscal year 2007/08. As a consequence, the non performing assets to total assets of the bank has decreased for the first three fiscal years, i.e. from 4.27% in the fiscal year 2007/08 to 2.31% in the fiscal year 2009/10, and then increased in the last two fiscal years, i.e. from 2.42% in the fiscal year 2010/11 to 3.57% in the fiscal year 2011/12. In average,

the non performing asset to total assets of HBL is 3.08%, with the variation of 22.06% in the ratio.

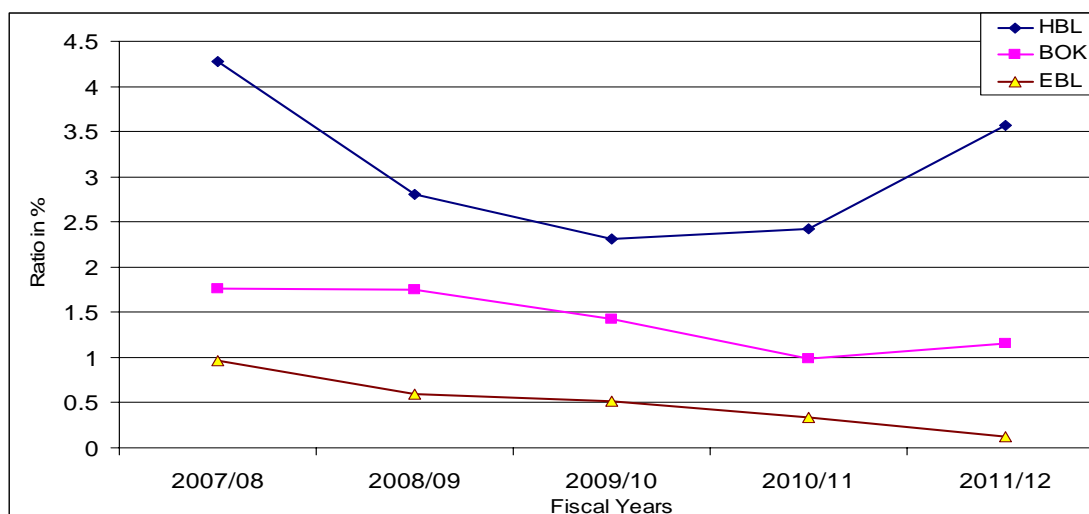
Also, it is ubiquitous that the total asset of BOK has increased in each fiscal year. The total assets of BOK is Rs. 12278.33 millions in the fiscal year 2007/08 and by the end of the fiscal year 2011/12, it has been gauged to be Rs. 23396.16 millions, however, the non performing assets of the bank has been in fluctuating trend, and as a result the non performing assets to the total assets ratio of the bank has been also in oscillating trend. The ratio of the bank is highest, 1.76%, in the fiscal year 2007/08 and lowest, 0.99%, in the fiscal year 2010/11, and in average, the ratio is 1.42% with the variation of 20.05%.

Only in EBL, there is positive indication in the decrement of the risk assets in each fiscal year, since the non performing asset has been persistently decreased and the total asset of the bank has been continuously increased. The total asset of the bank has been raised to Rs. 41382.76 millions in the fiscal year 2011/12 from Rs. 15959.29 millions in the fiscal year 2010/11. The non performing assets to total assets of the bank, however, has been gradually decreased to 0.12% in the fiscal year 2011/12 from 0.97% in the fiscal year 2007/08. In average, the ratio is only 0.51% and the variation in the ratio is 50.68%.

The table substantiates the fact that among the three observed banks, the total assets is most risky in HBL and least risky in EBL, since the average ratio is lowest in EBL and highest in HBL. The efficiency of EBL in reducing the ratio is certainly the landmark for other banks in reducing the risk.

Figure 4.2

Non-Performing Assets to Total Assets



Source: Table No. 4.3

4.1.4 Non-Performing Assets to Total Deposit

The non-performing asset to total deposit measures the mobility of total deposit in non-performing assets. The higher ratio indicates higher misuse of total deposits. The ratio of HBL, BOK and EBL for the five fiscal year periods is presented in table 4.4.

Table 4.4

Non-Performing Assets to Total Deposits

| FY | HBL | | | BOK | | | EBL | | |
|--------------|---------|----------|--------------|--------|----------|--------------|--------|----------|--------------|
| | NPA | TD | Ratio | NPA | TD | Ratio | NPA | TD | Ratio |
| 2007/08 | 1257.72 | 26490.85 | 4.75 | 216.26 | 10485.36 | 2.06 | 155.27 | 13802.44 | 1.12 |
| 2008/09 | 940.90 | 30048.42 | 3.13 | 255.24 | 12388.93 | 2.06 | 125.61 | 18186.25 | 0.69 |
| 2009/10 | 835.17 | 31842.79 | 2.62 | 252.13 | 15833.74 | 1.59 | 141.17 | 23976.30 | 0.59 |
| 2010/11 | 951.64 | 34682.31 | 2.74 | 202.19 | 18083.98 | 1.12 | 126.32 | 33322.95 | 0.38 |
| 2011/12 | 1525.97 | 37611.20 | 4.06 | 270.48 | 20315.83 | 1.33 | 50.57 | 36932.31 | 0.14 |
| Mean | | | 3.46 | | | 1.63 | | | 0.58 |
| S.D. | | | 0.75 | | | 0.35 | | | 0.30 |
| C.V.% | | | 21.55 | | | 21.28 | | | 51.64 |

(Source: Appendix - II)

In each fiscal year, HBL has been able to increase the deposit. In fact, HBL is the highest deposit collector among non government banks till the fiscal year 2009/10. The deposit collection of HBL has been raised to Rs. 37611.20 millions in the fiscal year 2011/12 from Rs. 26490.85 millions in the fiscal year 2007/08. The table shows that the non performing assets of the bank to the total deposit has decreased for the first three fiscal years and then increased in the last two fiscal years. More concisely, the ratio has ranged from 4.75% in the fiscal year 2007/08 to 2.62% in the fiscal year 2009/10. Thus, the rate of turning deposit into credit risk has been fluctuated during the periods, and in average such rate is 3.46%, and the variation in the ratio is 21.55%, indicating inconsistency.

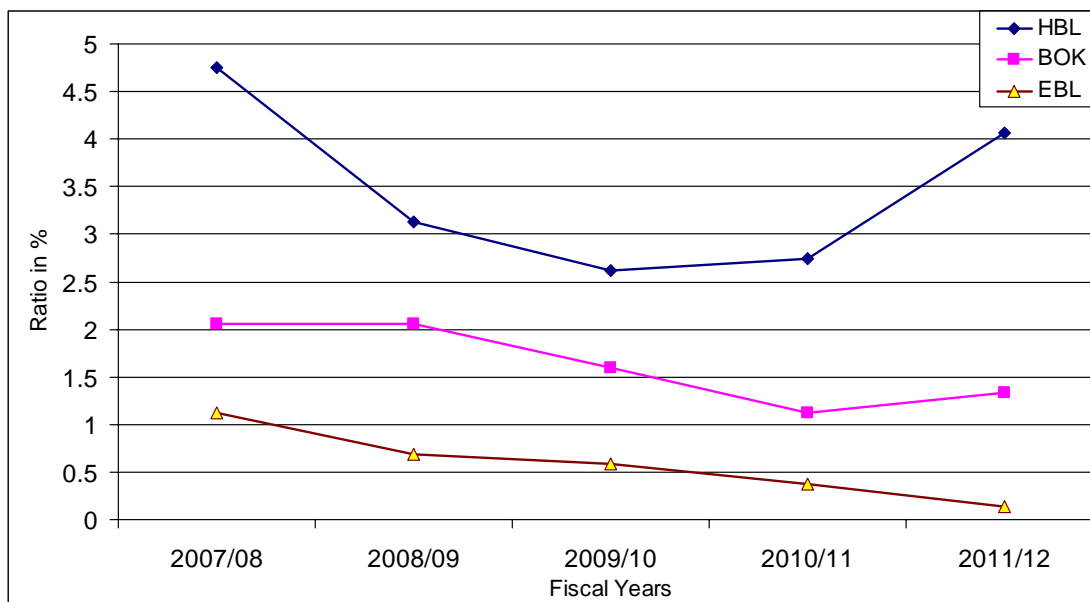
Further, it has been ascertained that the total deposit of BOK has also been raised in each fiscal year, and by the end of the fiscal year 2011/12, it has been appraised to be Rs. 20315.83 millions. As the trend of the non performing assets, the non performing assets to the total deposit ratio has also oscillated during the periods, and thus the ratio has ranged from 2.06% in the fiscal year 2007/08 and 2008/09 to 1.12% in the fiscal year 2010/11. In average, the ratio has been measured to be 1.63%, with the variation of 21.28%. In other word, 1.63% of the total deposit has been ineffectively mobilized in granting loans and thus indicates credit risk on deposit.

Alike in other two observed banks, the deposit collection in EBL has also been increased and thus it has been gauged to be Rs. 36932.31 millions at the end of the fiscal year 2011/12. However, the decrement in the non performing assets of the bank has led to the continuous decrement in the non performing assets to the total deposit, indicating less credit risk on the mobilized deposit amount. The ratio has been decreased from 1.12% in the fiscal year 2007/08 to 0.14% in the fiscal year 2011/12, and in average, the ratio is 0.58% with the variation of 51.64%.

Paraphrasing the above interpretation, it can be inferred that EBL is most efficient in mobilizing the deposit in granting loans and advances with less credit risk, in contrast, HBL is most inefficient on this matter.

Figure 4.3

Non-Performing Assets to Total Deposits



Source: Table No. 4.4

4.1.5 Loan Loss Provision to Total Loans and Advances

As per the direction of NRB, each bank has to keep 1% of the pass loan, 25% of the sub-standard loan, 50% of the doubtful loan and 100% of the loss loan as provision. The loan loss provision to total loan and advances measures the aggregate provision kept by the bank. The loan loss to total loans and advances of HBL, BOK and EBL for the five consecutive years is presented in Table 4.5.

Table 4.5**Loan Loss Provision to Total Loans and Advances**

| FY | HBL | | | BOK | | | EBL | | |
|--------------|---------|----------|--------------|--------|----------|--------------|--------|----------|--------------|
| | LLP | LA | Ratio | LLP | LA | Ratio | LLP | LA | Ratio |
| 2007/08 | 1119.42 | 15761.98 | 7.10 | 229.62 | 7488.70 | 3.07 | 334.94 | 10136.25 | 3.30 |
| 2008/09 | 795.73 | 17793.72 | 4.47 | 294.77 | 9694.10 | 3.04 | 418.60 | 14082.68 | 2.97 |
| 2009/10 | 682.09 | 20179.61 | 3.38 | 285.08 | 12747.72 | 2.24 | 497.34 | 18836.43 | 2.64 |
| 2010/11 | 726.36 | 25519.52 | 2.85 | 298.42 | 14945.72 | 2.00 | 584.88 | 24469.56 | 2.39 |
| 2011/12 | 1143.13 | 29123.75 | 3.93 | 379.37 | 17044.30 | 2.23 | 600.04 | 28156.40 | 2.13 |
| Mean | | | 4.35 | | | 2.51 | | | 2.69 |
| S.D. | | | 1.48 | | | 0.45 | | | 0.42 |
| C.V.% | | | 34.09 | | | 17.89 | | | 15.45 |

(Source: Appendix - II)

The loan loss provision kept by HBL has fluctuated during the periods, and thus it has ranged from Rs. 682.09 millions in the fiscal year 2009/10 to Rs. 1143.13 millions in the fiscal year 2011/12. The loan loss provision to total loan and advances, however, has decreased for the first four fiscal years, i.e. 7.10% in the fiscal year 2007/08 to 2.85% in the fiscal year 2010/11, and then it has increased to 3.93% in the fiscal year 2011/12. In average, 3.93% of the total loan and advances has been kept as loan loss provision, and the variation in such provision ratio is 34.09%. Certainly, the decrement in loan loss provision ratio indicates the non performing assets in proportion to the loan and advance has been diminished.

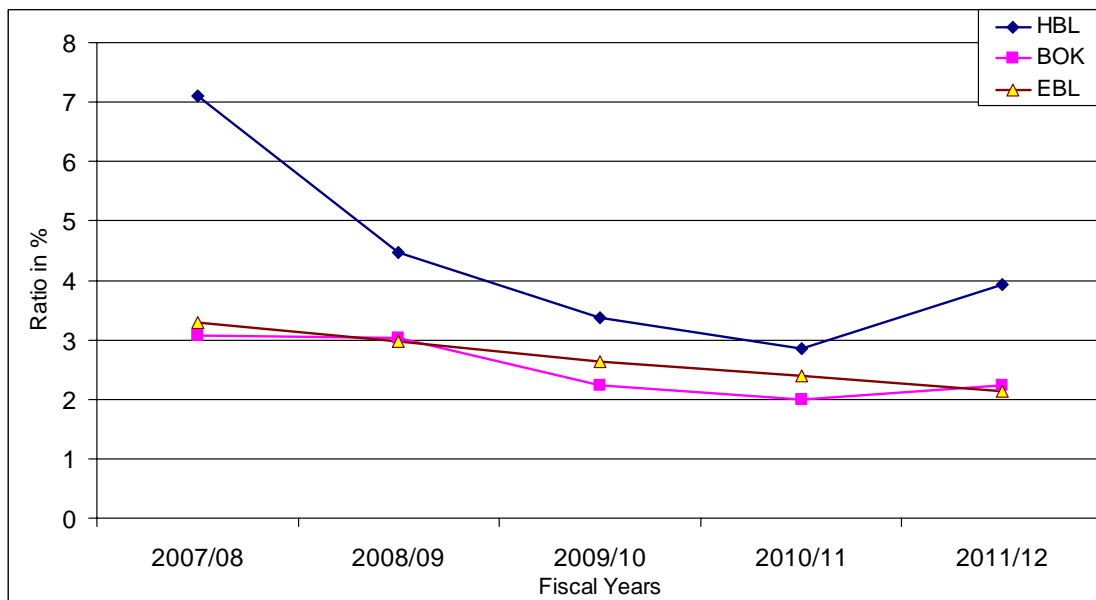
The table also depicts that the loan loss provision kept by BOK has increased in most of the fiscal years, and it has ranged from Rs. 229.62 millions in the fiscal year 2007/08 to Rs. 379.37 millions in the fiscal year 2011/12. The loan loss provision in proportion to the loan and advance has decreased for the first four fiscal years, i.e. from 3.07% in the fiscal year 2007/08 to 2.00% in the fiscal year 2010/11, and at the end of the fiscal year 2011/12, it has been increased to 2.23%. In average, the

ratio has been measured to be 2.51% and the variation in the ratio is 17.89%. The decrement in the ratio for the first four fiscal years signals that the performing loan has been augmented, and thus there is less loan loss provision percentage requirement to confront the credit risk.

In concomitant with the increment in loan and advances, the loan loss provision kept by EBL has also increased in each fiscal year, and thus it has ranged from Rs. 334.94 millions in the fiscal year 2007/08 to Rs. 600.04 millions in the fiscal year 2011/12. The loan loss provision to total loan and advances, however, has decreased in each fiscal year and thus the ratio has gradually decreased from 3.30% to 2.13% in the five observed periods. In average, the ratio is 2.69% with the variation of 15.45% in the ratio. As the non performing assets of the bank has followed decreasing trend, the increment in the loan loss provision in each fiscal year is due to the increment in performing loan.

Figure 4.4

Loan Loss Provision to Total Loans and Advances



Source: Table No. 4.5

4.1.6 Loan Loss Provision to Non-performing Assets

The non-performing assets is considered much risky than the performing loan and finally affects the financial performance of the company. Thus, to remain secure each bank has to keep more portion of the non performing assets, 25% of sub-standard loan, 50% of doubtful loan and 100% of loss loan as provision. The loan loss provision to non-performing assets measures the aggregate representation of loan provision on non-performing assets. The ratio of HBL, BOK and EBL for the five year periods is presented in the Table 4.6.

Table 4.6
Loan Loss Provision to Non-performing Assets

| FY | HBL | | | BOK | | | EBL | | |
|--------------|---------|---------|--------------|--------|--------|---------------|--------|--------|---------------|
| | LLP | NPA | Ratio | LLP | NPA | Ratio | LLP | NPA | Ratio |
| 2007/08 | 1119.42 | 1257.72 | 89.00 | 229.62 | 216.26 | 106.18 | 334.94 | 155.27 | 215.71 |
| 2008/09 | 795.73 | 940.90 | 84.57 | 294.77 | 255.24 | 115.49 | 418.60 | 125.61 | 333.25 |
| 2009/10 | 682.09 | 835.17 | 81.67 | 285.08 | 252.13 | 113.07 | 497.34 | 141.17 | 352.30 |
| 2010/11 | 726.36 | 951.64 | 76.33 | 298.42 | 202.19 | 147.59 | 584.88 | 126.32 | 463.01 |
| 2011/12 | 1143.13 | 1525.97 | 74.91 | 379.37 | 270.48 | 140.26 | 600.04 | 50.57 | 1186.55 |
| Mean | | | 81.30 | | | 124.52 | | | 510.17 |
| S.D. | | | 4.76 | | | 14.88 | | | 316.92 |
| C.V.% | | | 5.85 | | | 11.95 | | | 62.12 |

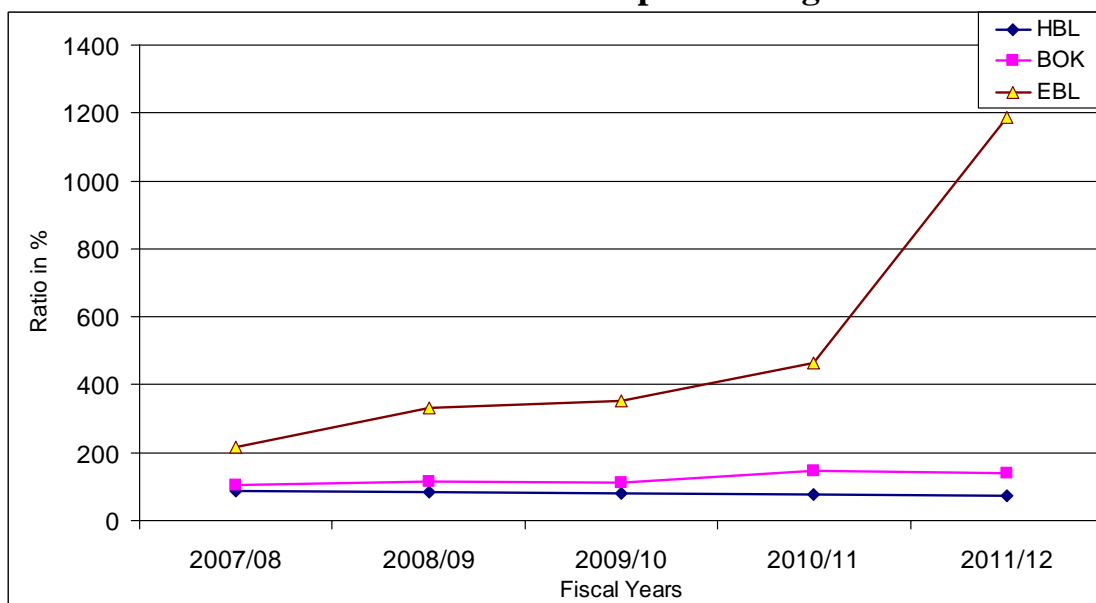
(Source: Appendix - II)

Both the loan loss provision and non performing assets of HBL have decreased for the first three fiscal years, however, the ratio of loan loss provision to non performing asset has increased in such fiscal years. This indicates that the decrement rate of non performing assets is higher than the decrement rate of loan loss provision. The table shows that the loan loss provision to non performing asset ratio is highest, 89.00%, in the fiscal year 2007/08, and lowest, 74.91%, in the fiscal year 2011/12. The ratio in average has been ascertained to be 81.30%, and the variation in the ratio is 5.85%.

The loan loss provision and non performing assets of BOK both have swung up during the five year periods, and consequently the loan loss provision to non performing asset ratio of the bank has fluctuated during the periods. The ratio has ranged from 106.18% in the fiscal year 2007/08 to 147.59% in the fiscal year 2010/11, and in average, the ratio is 124.52%.

In EBL, the loan loss provision in comparison to the non performing asset ratio is extremely high. The ratio has been increased in each fiscal year, and thus it has increased from 215.71% in the fiscal year 2007/08 to 1186.55% in the fiscal year 2011/12. Such increment in the ratio is due to the increment in the ratio of performing loan to total loan and advances. In average, the ratio of loan loss provision to non performing asset is 510.17%. Comparing the banks, it has been found that the loan loss provision to non performing asset ratio is highest in EBL, indicating that the credit risk is lowest in EBL in comparison to that in other banks. And the provision kept by EBL is extremely higher to cover the risk arising from the loan and advances.

Figure 4.5
Loan Loss Provision to Non-performing Assets



Source: Table No. 4.6

4.1.7 Net profit to Non-Performing Assets

This ratio shows the relationship of non-performing assets with the net profit of the company. The higher the non-performing assets, the lower will be the net profit. The net profit to non-performing assets of HBL, BOK and EBL for the five year periods are presented in the Table 4.7.

Table 4.7

Net Profit to Non-Performing Assets

| FY | HBL | | | BOK | | | EBL | | |
|--------------|--------|---------|--------------|--------|--------|---------------|--------|--------|---------------|
| | NP | NPA | Ratio | NP | NPA | Ratio | NP | NPA | Ratio |
| 2007/08 | 457.46 | 1257.72 | 36.37 | 202.44 | 216.26 | 93.61 | 237.29 | 155.27 | 152.82 |
| 2008/09 | 491.82 | 940.90 | 52.27 | 262.39 | 255.24 | 102.80 | 296.41 | 125.61 | 235.98 |
| 2009/10 | 635.87 | 835.17 | 76.14 | 361.50 | 252.13 | 143.38 | 451.22 | 141.17 | 319.63 |
| 2010/11 | 752.83 | 951.64 | 79.11 | 461.73 | 202.19 | 228.36 | 638.73 | 126.32 | 505.64 |
| 2011/12 | 508.80 | 1525.97 | 33.34 | 509.26 | 270.48 | 188.28 | 831.77 | 50.57 | 1644.79 |
| Mean | | | 55.45 | | | 151.29 | | | 571.77 |
| S.D. | | | 17.56 | | | 46.64 | | | 501.26 |
| C.V.% | | | 31.67 | | | 30.83 | | | 87.67 |

(Source: Appendix - II)

The table shows that there is inverse relationship, as expected, between net profit and non performing assets for the first three fiscal years of HBL. However, in the fiscal year 2010/11, the net profit of the bank has increased regardless of the increment in the non performing assets. The net profit of the bank has persistently increased from Rs. 457.46 millions in the fiscal year 2007/08 to Rs. 752.83 millions in the fiscal year 2010/11 and then decreased to Rs. 508.80 millions in the fiscal year 2011/12. Further, the net profit to non performing assets of the bank has increased from 36.37% in the fiscal year 2007/08 to 79.11% in the fiscal year 2010/11, and at the end of the fiscal year 2011/12, it is 33.34%. In average, the ratio of net profit to non performing assets is 55.45%, which

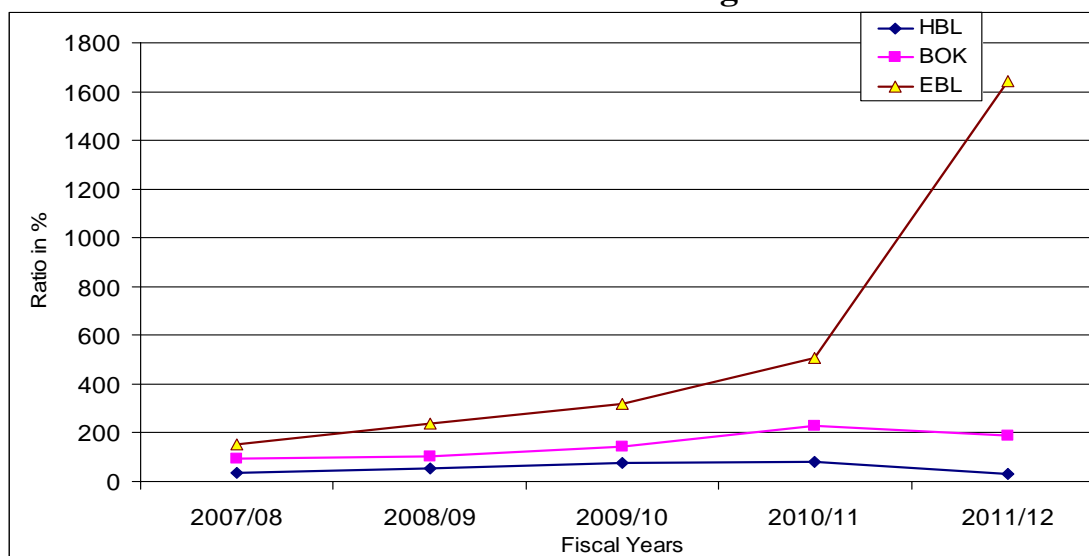
means that the net profit can recover 55.45% of the non performing assets if all such asset has to be written off.

In addition, regardless of the fluctuating trend of the non performing assets, the net profit of BOK has also found to be in increasing trend in each fiscal year. The net profit of the bank has increased from Rs. 202.44 millions in the fiscal year 2007/08 to Rs. 509.26 millions in the fiscal year 2011/12. Moreover, the net profit to non performing asset ratio of the bank has followed increasing trend in the first four fiscal years, which means that the rate of increment in the net profit is higher than the rate of increment in non performing assets. The ratio has increased from 93.61% in the fiscal year 2007/08 to 228.36% in the fiscal year 2010/11, while the ratio is 188.28% in the fiscal year 2011/12. In average, the ratio has been measured to be 151.29%, and the variation in the ratio is 30.83%.

Except in the fiscal year 2009/10, there seems inverse relationship between net profit and non performing assets of EBL. The net profit has been found to be in increasing trend in each fiscal year, and thus it has been persistently raised to Rs. 831.77 in the fiscal year 2011/12 from Rs. 237.29 millions in the fiscal year 2007/08. Also, the ratio of net profit to non performing assets of the bank has increased in each fiscal year, indicating that the net profit is suffice to cover the possible losses that can arise from the non performing assets. In average, the net profit to non performing assets ratio of the bank is 571.77% and the variation in the ratio is 87.67%

Comparing the banks, it has been ascertained that there is much inverse relationship between the net profit and non performing assets in EBL than that in other banks. Also, the ratio is highest in EBL, indicating that the net profit of EBL is much capable to adjust the possible losses that could arise from non performing assets.

Figure 4.6
Net Profit to Non-Performing Assets



Source: Table No. 4.7

4.1.8 Simple Correlation and Regression Analysis

To analyze the relationship of NPA with total loan and net profit, simple correlation coefficient and regression analysis have been done.

4.1.8.1 Correlation between Non-Performing Assets and Total Loan

The correlation coefficient measures the relationship between two variables, Non-Performing Assets (NPA) and Total Loan and Advances (LA). To whether NPA increases with the increment in loan and advances, the Karl Pearson's correlation coefficient 'r' has been calculated and the significance of the value of 'r' is tested through probable error.

Table 4.8

Correlation Coefficient between NPA and LA

| Bank | r | r ² | P.E. | 6 P.E. | Remarks |
|------|---------|----------------|--------|--------|---------------|
| HBL | 0.4261 | 0.1815 | 0.2469 | 1.4813 | Insignificant |
| BOK | 0.2815 | 0.0792 | 0.2777 | 1.6665 | Insignificant |
| EBL | -0.7914 | 0.6263 | 0.1127 | 0.6764 | Insignificant |

(Source: Appendix- III)

The table shows that the non performing asset has positive relationship, as assumed, with the loan and advances in HBL and BOK. The correlation coefficient between these two variables in HBL is 0.4261 and in BOK is 0.2815. Astonishingly, there is inverse relationship between these two variables in EBL, and the correlation coefficient between these two variables is -0.7914. Moreover, the coefficient of determination indicates that 18.15% change in the non performing assets of HBL, 7.92% change in the non performing assets of BOK and 62.63% change in the non performing assets of EBL has been explained by the variation in loan and advances of the corresponding bank. However, the ascertained relationship between these two variables is statistically insignificant in BOK and HBL, since the absolute 'r' value is lower than the calculated 6 P.E. of the corresponding banks. However, the absolute value of r is greater than the 6 P.E. ($|r| = |-0.7914| = 0.7914 > 6 \text{ P.E.} = 0.6764$) indicates that EBL is more meticulous when it grants high loan and advances, and pays more concern in decreasing the non performing assets, and thus the inverse relationship between these two variables is statistically substantiated.

4.1.8.2 Regression Line of NPA on LA

Let NPA be the dependent variable, Y and LA be the independent variable, X then the regression lines of NPA on LA calculated in the *Appendix-III* are;

$$\begin{aligned}
 Y &= a + bX \\
 \text{NPA}_{\text{HBL}} &= 627.56 + 0.02 \text{ LA}_{\text{HBL}} \\
 \text{NPA}_{\text{BOK}} &= 213.33 + 0.002 \text{ LA}_{\text{BOK}} \\
 \text{NPA}_{\text{EBL}} &= 203.31 - 0.004 \text{ LA}_{\text{EBL}}
 \end{aligned}$$

Table 4.9
Regression Analysis of NPA on LA

| Bank | a-value | b-value | t-cal | t-tab | Remarks |
|------|---------|---------|-------|-------|---------------|
| HBL | 627.56 | 0.02 | 1.48 | 2.78 | Insignificant |
| BOK | 213.33 | 0.002 | 0.51 | 2.78 | Insignificant |
| EBL | 203.31 | -0.004 | -2.24 | 2.78 | Insignificant |

(Source: Appendix- III)

The regression analysis indicates that the non performing assets of HBL increases by Rs. 0.02 with per rupee disbursement of loan and advances. However, such relationship is insignificant, since the calculated t-value (1.48) is lower than the tabulated t-value (2.78) at 5% level of significance and 4 degree of freedom. Further, the regression line indicates that the non performing asset of BOK increases by Rs. 0.002 with per rupee increment in loan and advances, if other variable remain constant. Also, this extracted relationship is statistically insignificant, as the calculated t-value (0.51) is lower than the tabulated t-value. Finally, with per rupee increment in the loan and advances, the non performing dramatically decreases by Rs. 0.004, although this relationship is statistically insignificant, as the calculated t-value (-2.24) is lower than tabulated t-value.

4.1.8.3 Correlation between Net Profit (NP) and Non-performing Assets

The correlation coefficient between Net Profit and NPA calculated in the Appendix-III and the test of significance through 6 P.E. has been presented in the Table 4.10.

Table 4.10
Correlation Coefficient between NP and NPA

| Bank | r | r ² | P.E. | 6 P.E. | Remarks |
|------|---------|----------------|--------|--------|---------------|
| HBL | -0.5436 | 0.2955 | 0.2125 | 1.2751 | Insignificant |
| BOK | 0.1999 | 0.0400 | 0.2896 | 1.7375 | Insignificant |
| EBL | -0.8424 | 0.7096 | 0.0876 | 0.5256 | Significant |

(Source: Appendix- III)

As expected, the net profit has negative relationship with non performing assets in two banks; HBL and EBL, which means that the net profit of these bank decreases with the increment in the non performing assets. The correlation coefficient between these two variables is -0.5436 in HBL and -0.8424 in EBL. However, the net profit of BOK has positive relationship with non performing assets, as the correlation coefficient between these two variables is 0.1999. Moreover, the coefficient of determination indicates that 29.55% variation in net profit of HBL, 4.00% variation in net profit of BOK and 70.96% variation in net profit of EBL has been explained by the change in non performing assets of the respective banks. Further, the inverse relationship is statistically significant only in EBL, as the absolute 'r' value is higher than the 6 P.E. only in EBL, while that of HBL is lower than the 6 P.E. Also, the positive relationship between these two variables in BOK is statistically insignificant on the basis of 'r' value and 6 P.E.

4.1.8.4 Regression line of NP on NPA

Let NP be the dependent factor, Y and NPA be the independent factor, X. Then the regression line of dependent variable, NP on the independent variable, NPA is given by;

$$\begin{aligned}
 Y &= a + bX \\
 NP_{HBL} &= 827.91 - 0.23 NPA_{HBL} \\
 NP_{BOK} &= 143.90 + 0.90 NPA_{BOK} \\
 NP_{EBL} &= 1102.56 - 2.71 NPA_{EBL}
 \end{aligned}$$

Table 4.11
Regression Analysis of NP on NPA

| Bank | a-value | b-value | t-cal | t-tab | Remarks |
|-------------|----------------|----------------|--------------|--------------|----------------|
| HBL | 827.91 | -0.23 | -1.12 | 2.78 | Insignificant |
| BOK | 143.90 | 0.90 | 0.35 | 2.78 | Insignificant |
| EBL | 1102.56 | -5.10 | -2.71 | 2.78 | Significant |

(Source: Appendix- III)

The table 4.11 delineates the regression line of dependent variable, NP on independent variable, NPA. The table delineates that the beta coefficient of NPA on regression line of HBL is -0.23, which indicates that if NPA increases by Re. 1, NP decreases by Rs. 0.23, assuming that the other variable, 827.91, remains stable. However, the lower the absolute value of t_{cal} , 1.12, than the value of t_{tab} , 2.78, at 5% level of significance and 4 d.f. debilitates this fact and implies that there exist insignificant relationship between NP and NPA.

In contrast, the regression line of Net Profit on Non Performing Assets of BOK indicates that Net Profit has positive relationship with Non Performing Assets and hence NP increases along with the increase in NPA and vice-versa. The beta coefficient of NPA, 0.90, signals that NP increases by Rs. 0.90 along with per rupee increase in NPA, if the other variable, 143.90, remains constant. However, the t-statistics shows that t_{cal} , 0.35, is lower than t_{tab} , 2.78, at 5% level of significance and 4 d.f. and hence denies to agree that Net Profit should increases by Rs. 0.90 when Non Performing Assets increases by Rs. 1.

In contrast, there exists negative relationship between net profit and non-performing assets of EBL. The beta coefficient indicates that the net profit decreases by Rs. 5.10 with per rupee increase in non-performing assets. However, the lower absolute value of t_{cal} (2.71) than the t_{tab} (2.78)

debilitates this results and further signifies the relationship between net profit and non performing loan is statistically insignificant.

4.1.9 Relationship of Net Profit with NPA and Loan & Advances

To measure the joint effect of NPA and Total Loan and Advances (LA) on Net Profit (NP), the multiple correlation and multiple regression analysis have been analyzed.

4.1.9.1 Multiple Correlations between NP, NPA and LA

Let correlation coefficient between NP and NPA be denoted by r_{12} , NPA and LA be denoted by r_{23} , and NP and LA be denoted by r_{13} . Then the multiple correlation coefficient of NP on NPA and LA is given by;

$$R_{1.23} = \sqrt{\frac{r_{12}^2 + r_{13}^2 - 2 r_{12} r_{23} r_{13}}{1 - r_{23}^2}}$$

$$R_{NP.NPA LA} (HBL) = 0.8945$$

$$R_{NP.NPA LA} (BOK) = 0.9997$$

$$R_{NP.NPA LA} (EBL) = 0.9921$$

Table 4.12

Multiple Correlations between NP, NPA and LA

| Banks | R | Relationship | R ² | P.E. | 6 P.E. | Remarks |
|-------|--------|--------------|----------------|--------|--------|-------------|
| HBL | 0.8945 | +ve | 0.8002 | 0.1348 | 0.0603 | Significant |
| BOK | 0.9997 | +ve | 0.9994 | 0.0004 | 0.0002 | Significant |
| EBL | 0.9921 | +ve | 0.9844 | 0.0105 | 0.0047 | Significant |

(Source: Appendix-IV)

The above table 4.12 shows the multiple correlation between Net Profit (NP), Non-Performing Assets (NPA) and Loan and Advances (LA) of the concerned banks during the year covered for research. The multiple

correlation coefficients (R) between NP, NPA and LA of HBL, BOK and EBL is 0.8945, 0.9997 and 0.9921 respectively, which show the positive relationship between these variables of all the banks.

The coefficient of multiple determination (R^2) of HBL is 0.8002, which is lower in comparison than that of BOK (0.9994) and EBL (0.9844). It shows that, in case of HBL, 80.02% of variation in dependent variable (NP) is explained by the variation in independent variables (NPA and LA). Similarly, 99.94% variation in dependent variable (NP) of BOK and 98.44% of the dependent variable (NP) of EBL is explained by the variation in independent variables (NPA and LA).

To measure the significance of the relationship between NP, NPA and LA of the concerned banks, it would be more preferable to calculate the probable error of correlation coefficient. The same table depicts that R of HBL is greater than 6 P.E ($R = 0.8945 > 6 \text{ P.E.} = 0.0603$), R of BOK is higher than 6 P.E. ($R = 0.9997 > 6 \text{ P.E.} = 0.0002$), and R of EBL is also higher than 6 P.E. ($R = 0.9921 > 6 \text{ P.E.} = 0.0047$). So, it can be concluded that the relationship between NP, NPA and LA is statistically significant in all the three banks, HBL, BOK and EBL.

4.1.9.2 Multiple Regression Equation of NP on NPA and LA

Let NP, NPA and LA be denoted by X_1 , X_2 and X_3 respectively. Then the multiple regression equation of NP on NPA and LA is given by;

$$\begin{aligned} X_1 &= a + b_1 X_2 + b_2 X_3 \\ \text{NP}_{\text{HBL}} &= 609.49 - 0.38 \text{NPA}_{\text{HBL}} + 0.02 \text{LA}_{\text{HBL}} \\ \text{NP}_{\text{BOK}} &= 29.92 - 0.39 \text{NPA}_{\text{BOK}} + 0.03 \text{LA}_{\text{BOK}} \\ \text{NP}_{\text{EBL}} &= 61.55 - 0.99 \text{NPA}_{\text{EBL}} + 0.03 \text{LA}_{\text{EBL}} \end{aligned}$$

Table 4.13

Multiple Regression Line of NP on NPA and LA

| Banks | No. of year | Constant (a) | Regression Coefficient | |
|-------|-------------|--------------|------------------------|----------------|
| | | | b ₁ | b ₂ |
| HBL | 5 | 609.49 | -0.38 | 0.02 |
| BOK | 5 | 29.92 | -0.39 | 0.03 |
| EBL | 5 | 61.55 | -0.99 | 0.03 |

(Source: Appendix - IV)

The above table represents the linear relationship between NP, with NPA and LA of the concerned banks. The constant (a) is positive in HBL (609.49), BOK (29.92) and EBL (61.55). In case of HBL, the beta coefficient of NPA and LA are -0.38 and 0.02 respectively. It indicates that a one-rupee increase in NPA leads to Rs. 0.38 decrease in NP, if LA remains constant and one rupee increase in LA leads to an average about Rs. 0.02 increase in NP if NPA remains constant.

On the other hand, in case of BOK, the regression coefficients of NPA and Loan and Advances (LA) are -0.39 and 0.03 respectively, which indicates that a one-rupee increase in NPA causes Rs. 0.39 decrease in NP if LA remains stable and one-rupee increase in LA leads to an average about Rs. 0.03 increase in NP if NPA remains uniform.

Similarly, per rupee increase in NPA of EBL leads to Rs. 0.99 decrease in NP, if Loan and Advances (LA) remains constant, and per rupee increase in LA causes Rs. 0.03 increase in NP, if NPA remains constant. Hence, NPA has negative relationship with net profit in EBL and loan and advances has positive relationship with net profit. However, the bank should not be panic to reduce the NPA, since NPA increases the interest income with the same loan, as long as the NPA is good loan. In other word, NPA would be lucrative to the bank unless it turns to bad loan.

4.1.10 Relationship of NPA with NPL, NBA & IS

To measure the joint effect of non performing loan, non banking assets and interest suspense on non performing assets, the average of each of them in each fiscal year of the three banks has been calculated and the correlation test and regression test have been conducted.

Table 4.14

Multiple Correlations between NP, NPA and LA

| Correlation Test | | | | | |
|-------------------------|----------------------|----------------------|----------------------|---------------|----------------|
| R | Relationship | R² | P.E. | 6 P.E. | Remarks |
| 1.00 | +ve | 1.00 | 0 | 0 | Significant |
| Regression Test | | | | | |
| a | b₁ | b₂ | b₃ | | |
| -0.01 | 0.9999 | 1.0 | 1.0 | | |

(Source: Appendix-IV)

The table shows that there is absolute positive correlation between the non performing assets and non-performing loan, non banking assets, and interest suspense, and such result is ubiquitous, since the non performing asset is the sum of these assets. Also, as the relationship is absolutely positive, there is no probable error, substantiating the axiom that the non performing asset has statistically significant relationship with its components. Thus, the non performing asset increases by Rs. 1, if the sum of its components increases by Rs. 1. Moreover, the regression test indicates that if the variable -0.01 remains constant, the per rupee increment in non performing loan actuates to increase Rs. 0.9999 in non performing assets, while the per rupee increment in non banking assets and interest suspense each leads to increase Rs.1 correspondingly in the non performing assets.

4.2 Primary Data Analysis

For the purpose of collecting primary data, a questionnaire having a set of 8 questions were prepared and presented to 40 respondents. The respondents were selected randomly from Investors, Borrowers and Employees. The questions 1 to 8 contained objective question. The targeted 40 respondents were composed by 10 investors, 15 borrowers and 15 employees. Out of 40 questions distributed, responses from only 32 personnel obtained. Among the 32 respondents, 9 were investors, 12 were borrowers and 11 were employee of HBL, BOK and EBL.

4.2.1 Effect of NPA on Financial Health of Bank

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

Table 4.15
Effect of NPA on Financial Health of Bank

| Effect | Responses | | | Total | |
|--------------|-----------|-----------|-----------|-----------|------------|
| | Investor | Borrower | Employee | Responses | % |
| Yes | 8 | 8 | 10 | 26 | 81 |
| No | 1 | 1 | 0 | 2 | 6 |
| Don't Know | 0 | 3 | 1 | 4 | 13 |
| Total | 9 | 12 | 11 | 32 | 100 |

(Source: Field Survey, 2013)

The table delineates that the 81% of the respondents, 26 out of 32, are in the view that NPA has direct effect on the financial health of the bank, whereas only 6% of the respondents, 2 out of 32, are in the view that NPA has no effect in the financial health of the company, and 13% of the respondents, 4 out of 32, have remained neutral on this query. Also, the

majority of each category, 8 out of 9 investors, 8 out of 12 borrowers and 10 out of 11 employees are in the view that NPA has direct impact on the financial performance of the company. So, embracing the majority of each category and the whole majority, it cannot be denied with the fact that NPA has direct influence on the financial health of the bank.

Figure 4.7

Effect of NPA on Financial Health of Bank



Source: Table No. 4.15

4.2.2 Degree of Effect of NPA on Banking Industry

To know the degree of effect that NPA has on banking industry, the respondents are asked to express their view. The responses obtained from them have been presented in the table.

Table 4.16
Degree of Effect of NPA on Banking Industry

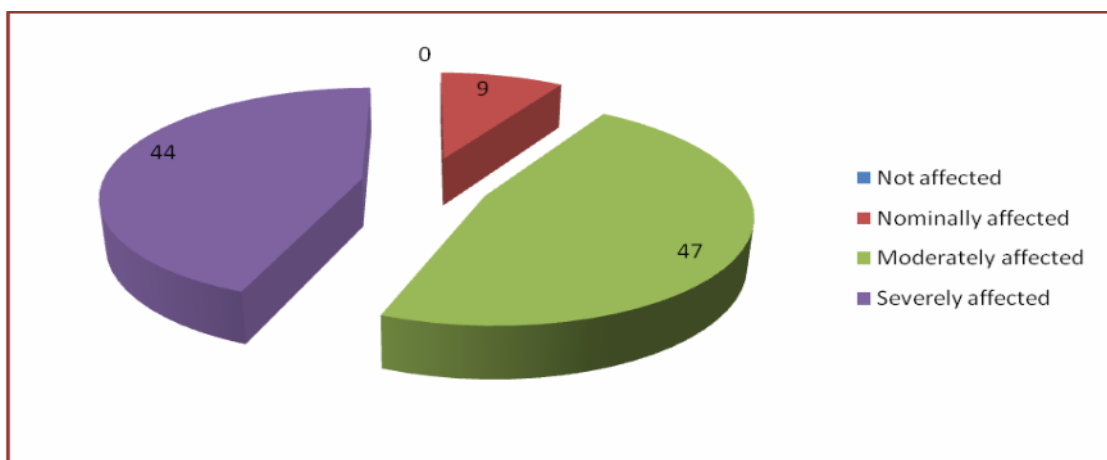
| Degree | Responses | | | Total | |
|---------------------|-----------|-----------|-----------|-----------|------------|
| | Investor | Borrower | Employee | Responses | % |
| Not affected | 0 | 0 | 0 | 0 | 0 |
| Nominally affected | 0 | 1 | 2 | 3 | 9 |
| Moderately affected | 6 | 4 | 5 | 15 | 47 |
| Severely affected | 3 | 7 | 4 | 14 | 44 |
| Total | 9 | 12 | 11 | 32 | 100 |

(Source: Field Survey, 2013)

The table shows that 47% of the respondents, 15 out of 32, have stated that the banking industry has been moderately affected by the problem of NPA. Similarly, 44% of the respondents, 14 out of 32, have said that the problem of NPA has severe effect on the banking industry. Also, 9% of the respondents, 3 out of 32, have stated that the banking industry had been nominally affected by the problem of NPA. Looking each category, the majority of the investors, 6 out of 9 and the majority of the employees, 5 out of 11, have stated that banking industry has been moderately affected by NPA. However, the majority of the borrower, 7 out of 12, state that the banking industry has been severely affected by the problem of NPA. Finally, considering the overall majority, 15 out of 32, it can be concluded that NPA has moderate effect on banking industry.

Figure 4.8

Degree of Effect of NPA on Banking Industry



Source: Table No. 4.16

4.2.3 Sector Covering More Default Loan

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

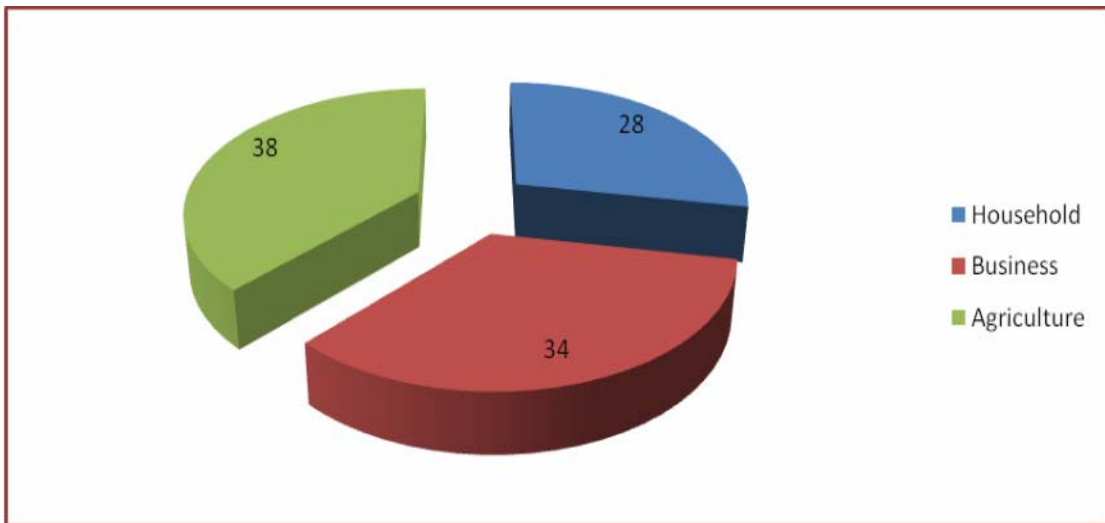
Table 4.17
Sector Covering More Default Loan

| Sector | Responses | | | Total | |
|--------------|-----------|-----------|-----------|-----------|------------|
| | Investor | Borrower | Employee | Responses | % |
| Household | 2 | 4 | 3 | 9 | 28 |
| Business | 4 | 2 | 5 | 11 | 34 |
| Agriculture | 3 | 6 | 3 | 12 | 38 |
| Total | 9 | 12 | 11 | 32 | 100 |

(Source: Field Survey, 2013)

The table depicts that the majority of the respondents, 12 out of 38, have pointed out that agricultural sector covers the more default loan. While, 34% of the respondents, 11 out of 32, have opined that business sector covers more default loan and 28% of the respondents, 9 out of 32, have stated that household covers more default loan. Similarly, looking each category the majority of the investors, 4 out of 9 and the majority of the employees, 5 out of 11, strongly support that business sector covers more default loan. However, the majority of the borrowers, 6 out of 11, have said that agriculture sector covers more default loan. Eventually, considering the overall majority, 38% of the respondents, it can be concluded that agriculture sector is more risky while recovering loan than household and business sector.

Figure 4.9
Sector Covering More Default Loan



Source: Table No. 4.17

4.2.4 Internal Reasons for Turning Bad Loan

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

Table No. 4.18
Internal Reasons for Turning Bad Loan

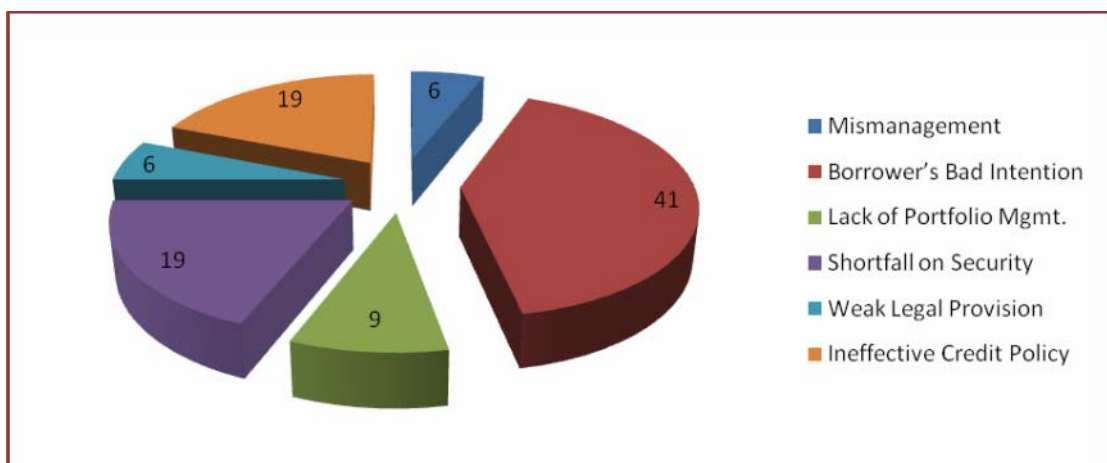
| Reasons | Responses | | | Total | |
|---------------------------|------------------|-----------------|-----------------|------------------|------------|
| | Investor | Borrower | Employee | Responses | % |
| Mismanagement | 1 | 0 | 1 | 2 | 6 |
| Borrower's Bad Intention | 3 | 7 | 3 | 13 | 41 |
| Lack of Portfolio Mgmt. | 0 | 1 | 2 | 3 | 9 |
| Shortfall on Security | 3 | 1 | 2 | 6 | 19 |
| Weak Legal Provision | 0 | 0 | 2 | 2 | 6 |
| Ineffective Credit Policy | 2 | 3 | 1 | 6 | 19 |
| Total | 9 | 12 | 11 | 32 | 100 |

(Source: Field Survey, 2013)

The table shows that the majority of the respondents, 13 out of 32 (41%) have strongly affirmed that the bad intention of borrower turns the loan into bad loan. Similarly, 6 respondents (19%) have said that overvaluation of security and ineffective credit policy of the bank each is equally responsible for turning loan into bad loan. However, 3 respondents (9%) have stated that lack of good portfolio loan management is responsible for bad loan, while 2 respondents each (6%) opined that mismanagement and weak legal provisions are responsible for formation of bad loan. Considering the majority of each category, 3 out of 9 investors, 7 out of 12 borrowers, 3 out of 11 employees and the overall majority, 13 out of 32 respondents, it can be concluded that the borrower's bad intention is the major reason for turning bad loan.

Figure 4.10

Internal Reasons for Turning Bad Loan



Source: Table No. 4.18

4.2.5 External Reasons for Turning Bad Loan

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

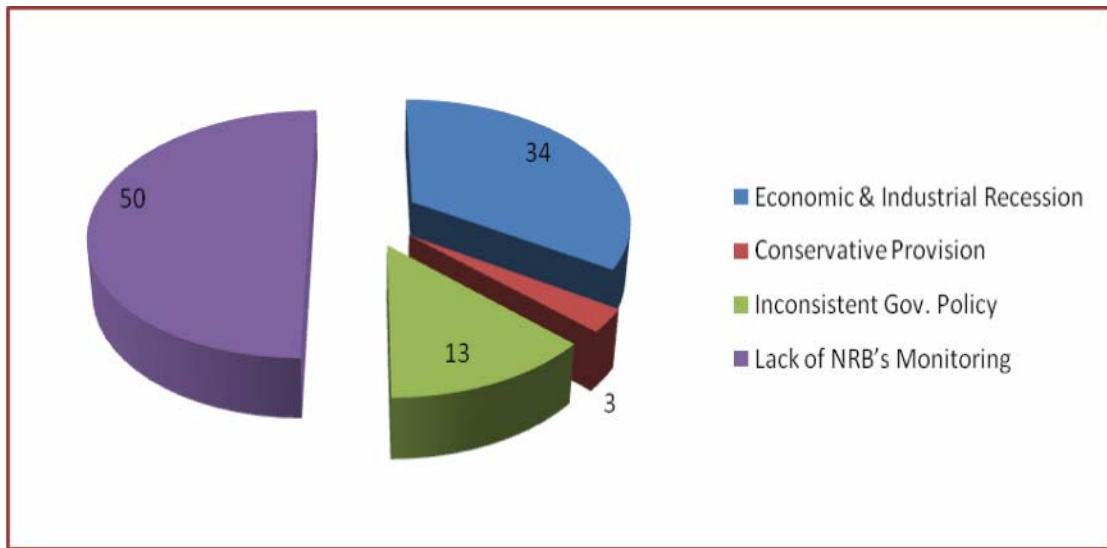
Table 4.19
External Reasons for Turning Bad Loan

| Reasons | Responses | | | Total | |
|---------------------------------|-----------|-----------|-----------|-----------|------------|
| | Investor | Borrower | Employee | Responses | % |
| Economic & Industrial Recession | 3 | 5 | 3 | 11 | 34 |
| Conservative Provision | 0 | 1 | 0 | 1 | 3 |
| Inconsistent Gov. Policy | 1 | 2 | 1 | 4 | 13 |
| Lack of NRB's Monitoring | 5 | 4 | 7 | 16 | 50 |
| Total | 9 | 12 | 11 | 32 | 100 |

(Source: Field Survey, 2013)

The table shows that the majority of the respondents, 16 out of 32, half of the total respondents, have opined that the lack of NRB's monitoring and supervision is the main reason behind turning loan into bad loan. Likewise, 11 respondents, 34% of the total respondents, have said that recession in economy and industry causes loan to turn bad. However, 3% of the respondents, 1 out of 32 and 13% of the respondents, 4 out of 32, have stated that conservative provision for loan and inconsistent government policy are the main reasons for having bad loan. However, looking each category, the majority of the investors, 5 out of 9 and the majority of employee, 7 out of 11 have supported lack of NRB's proper monitoring and supervision are the main reason, while the majority of the borrower have stated that economic and industrial recession is the main reason for bad loan. Eventually on the basis of overall majority it can be considered that lack of NRB's proper monitoring and supervision is the main external reason that causes loan to turn bad.

Figure 4.11
External Reasons for Turning Bad Loan



Source: Table No. 4.19

4.2.6 Best Measures to Resolve NPA Problem

To solve the NPA problem has become the greatest challenge of today's banking industry to reduce the credit risk. Hence, to know what measures can be taken for resolving the NPA problem, the respondents are asked on this regard.

Table No. 4.20

Best measures to resolve NPA Problem

| Degree | Responses | | | Total | |
|---------------------------|-----------|-----------|-----------|-----------|------------|
| | Investor | Borrower | Employee | Responses | % |
| Strict Recovery Policy | 4 | 6 | 3 | 13 | 41 |
| New rules & regulations | 0 | 1 | 2 | 3 | 9 |
| Monitoring | 2 | 3 | 4 | 9 | 28 |
| Rebate for timely Payment | 3 | 2 | 2 | 7 | 22 |
| Total | 9 | 12 | 11 | 32 | 100 |

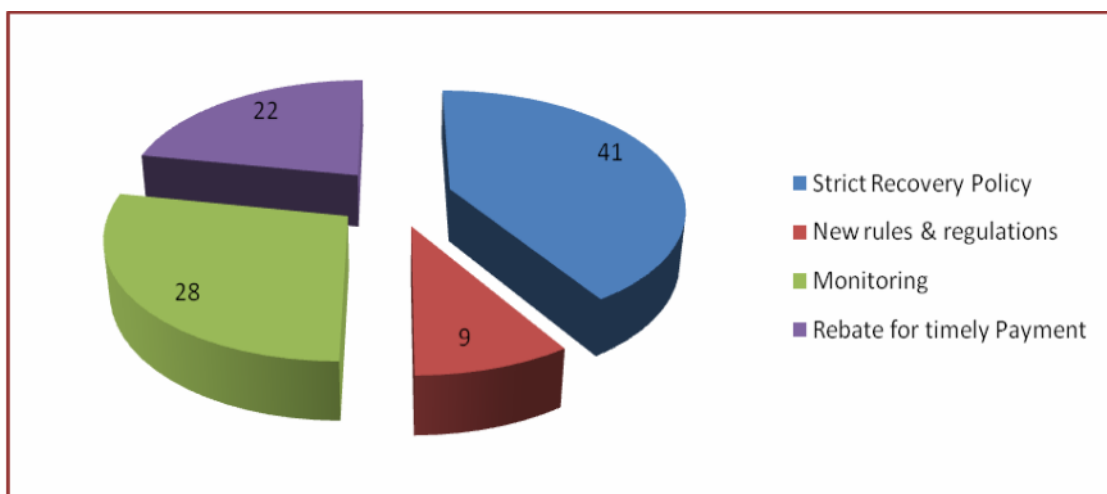
(Source: Field Survey, 2013)

The table depicts that 41% of the respondents, 13 out of 32 sought that the adoption of strict recovery policy can only reduce the problem of

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

Figure 4.12

Best measures to resolve NPA Problem



Source: Table No. 4.20

4.2.7 Best Time to Follow up after Due date

To examine the best time within which the bank should follow up for recovery after due date, the respondents have been asked on this regard. The responses obtained from them have been presented in the table.

Table 4.21**Best Time to Follow up after Due date**

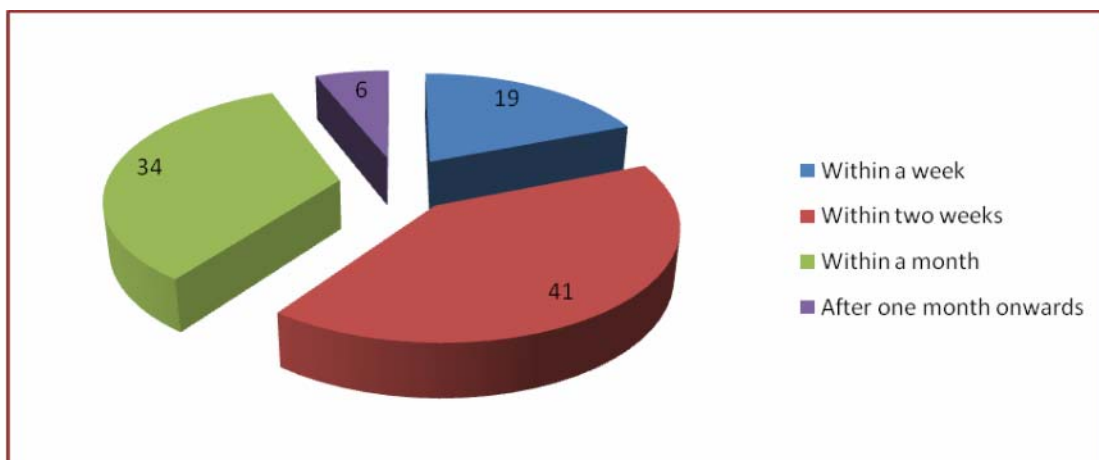
| Degree | Responses | | | Total | |
|-------------------------|------------------|-----------------|-----------------|------------------|------------|
| | Investor | Borrower | Employee | Responses | % |
| Within a week | 2 | 1 | 3 | 6 | 19 |
| Within two weeks | 4 | 3 | 6 | 13 | 41 |
| Within a month | 3 | 6 | 2 | 11 | 34 |
| After one month onwards | 0 | 2 | 0 | 2 | 6 |
| Total | 9 | 12 | 11 | 32 | 100 |

(Source: Field Survey, 2013)

The table shows that 41% of the respondents, 13 out of 32, are in the view that banks should follow up for the recovery within two weeks after due date. Similarly, 34% of the respondents, 11 out of 32, have opined that within a month after due date will be the best time that the bank should start for recovery. Also, 19% of the respondents, 6 out of 32 and 6% of the respondents, 2 out of 32, opine that within a week and after one month onward respectively will be the best time for follow up. Looking each category, the majority of investors, 4 out of 9 and the majority of employees, 6 out of 11, have supported within two weeks, whereas the majority of borrowers, 6 out of 12, have supported within a month for follow up after due date. Eventually, considering the overall majority, it can be concluded that within two weeks after the matured date of loan will be the best time for bank to follow up for recovery process.

Figure 4.13

Best Time to Follow up after Due date



Source: Table No. 4.21

4.2.8 Loan Floatation Basis

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

Table 4.22

Loan Floatation Basis

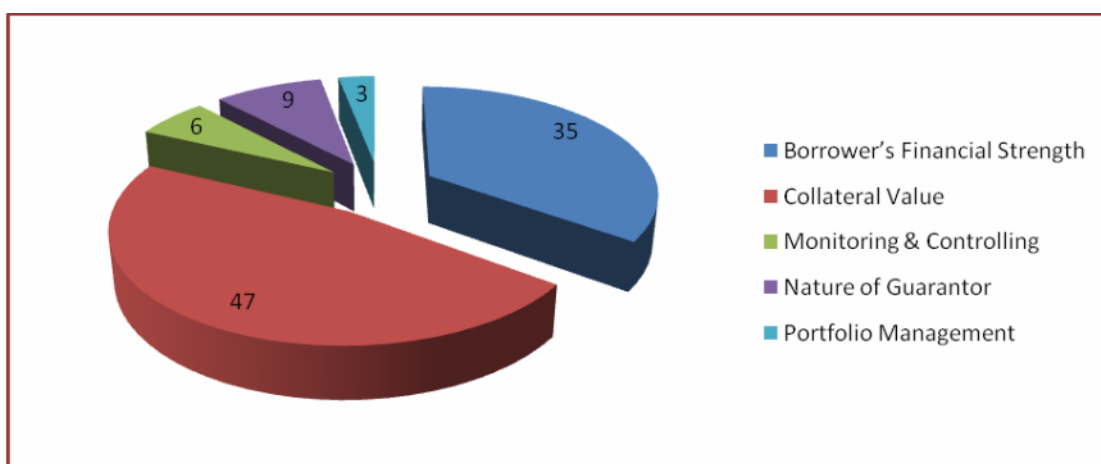
| Basis | Responses | | | Total | |
|-------------------------------|-----------|-----------|-----------|-----------|------------|
| | Investor | Borrower | Employee | Responses | % |
| Borrower's Financial Strength | 2 | 4 | 5 | 11 | 35 |
| Collateral Value | 4 | 6 | 5 | 15 | 47 |
| Monitoring & Controlling | 1 | 1 | 0 | 2 | 6 |
| Nature of Guarantor | 1 | 1 | 1 | 3 | 9 |
| Portfolio Management | 1 | 0 | 0 | 1 | 3 |
| Total | 9 | 12 | 11 | 32 | 100 |

(Source: Field Survey, 2013)

The table shows that the majority of the respondents have stated that the collateral value should be given more consideration while disbursing loan. Out of the 32 respondents, 15 respondents (47%), have supported this option. Besides collateral value, 35% of the respondents, 11 out of

32, have opined that evaluation borrower's financial strength should be the main basis while floating loan. Similarly, 9% of the respondents (3 out of 32), 6% of the respondents (2 out of 32) and 3% of the respondents (1 out of 32) have affirmed that nature of guarantor, monitoring and controlling and portfolio of loan management respectively should be the main basis for loan floatation.

Figure 4.14
Loan Floatation Basis



Source: Table No. 4.22

4.3 Major Findings of the Study

On the basis of both primary and secondary data analysis, the following major findings have been drawn up;

Findings from Secondary Data Analysis

1. The chance of the credit default is highest in HBL and lowest in EBL. The average non performing asset to total loan in HBL is 5.27%, in BOK is 2.09% and in HBL is 0.77%.
2. The average sub-standard loan, doubtful loan and loss loan of HBL are Rs. 104.76 millions, Rs. 210.64 millions, and Rs. 431.75 millions respectively, of BOK are Rs. 52.00 millions, Rs. 31.31 millions, and Rs. 142.95 millions respectively, while those of EBL

are Rs. 5.60 millions, Rs. 8.98 millions and Rs. 91.69 millions respectively.

3. The non-performing assets covered 3.08% of the total assets of HBL, 1.42% of the total assets of BOK, and 0.51% of the total assets of EBL, thus implying more risky assets in HBL compared to BOK and EBL.
4. The non-performing asset to total deposit of HBL is 3.46% and that of BOK is 1.63%, and EBL is 0.58%, which has indicated better loan management in EBL than in BOK and HBL.
5. In average, HBL has kept 4.35% of the total loans as loan loss provision and BOK has kept 2.51% of the total loans as loan loss provision and EBL has kept 2.69% as loan loss provision. Similarly, the loan loss provision represented 81.30% and 124.52% and 510.17% of non-performing assets in HBL, BOK and EBL respectively.
6. Also, the net profit to non-performing assets of HBL is 55.45% in average and that of BOK is 151.29% in average and EBL is 571.77% in average for the five year periods.
7. There exists positive correlation of 0.4261 between NPA and LA of HBL, 0.2815 correlation between NPA and LA of BOK and negative correlation of -0.7914 between NPA and LA of EBL. Similarly, the correlation coefficient between net profit and non-performing assets is -0.5436 in HBL, 0.1999 in BOK and -0.8424 in EBL.
8. The multiple correlations between net profit, non performing assets and loan and advances are 0.8945 in HBL and 0.9997 in BOK, and 0.9921 in EBL.

Findings from Primary Data Analysis

1. About 81% of the respondents, 26 out of 32, have opined that NPA has effect on the financial health of the banks. Similarly, 47% of the respondents, 15 out of 32, have stated that the banking industry has been moderately affected by the problem of NPA.
2. 38% of the respondents have said that agriculture is the major sector that covers more default loan. Similarly, 34% of the respondents and 28% of the respondents have claimed business and household respectively that covers default loan.
3. Similarly, 41% of the respondents, 13 out of 32, have stated that bad intention of borrower is the main internal reason that provokes the loan to turn out into bad. Further, lack of NRB's proper monitoring and supervision is the major external reason that turns loan into bad. About 50% of the respondents, 16 out of 32, chose this option.
4. 41% of the respondents, 13 out of 32, have suggested adoption of strict recovery policy to reduce the problem of non-performing loan and the same percentage of the respondents suggested within two weeks after the due date will be the best time to follow up for loan recovery. Eventually, 47% of the respondents are in the view that the collateral evaluation should be the main basis to be considered while disbursing loan.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The nonperforming loan ratio is used to express credit risk. As the credit risk is higher, the banking return is expected to be lower. As with the nonperforming loans, the macroeconomic conditions should have an impact on the banking returns. The net difference between the lending rate and the deposit rate is another important determinant of performance, and should have a positive impact on bank returns. Consistent with previous literature, the size of the loan portfolio is also expected to affect bank returns positively.

It is widely accepted that the quantity or percentage of non-performing loans (NPLs) is often associated with bank failures and financial crises in both developing and developed countries. In fact, there is abundant evidence that the financial/banking crises in East Asia and Sub-Saharan African countries were preceded by high non-performing loans. The current global financial crisis, which originated in the US, was also attributed to the rapid default of sub-prime loans/mortgages. In view of this reality it is therefore understandable why much emphasis is placed on non-performing loans when examining financial vulnerabilities. Higher non-performing assets can be a cause to decrease profit of the commercial banks. As the provisioning required as NRB circular is very much stick, major chunk of operating profit has been allocated for maintaining loan loss provisioning.

The main objective behind making this study is to analyze the non-performing assets in commercial banks of Nepal, which elaborates whether CBS are efficient in managing credit and how NPAs play its role to the operations of the Banks. To achieve the objective both primary data and secondary data have been analyzed. Further, books, articles and past Master's research works are reviewed in this research. With regard to secondary data, three commercial banks, viz, HBL, BOK and EBL are taken as sample. The data collected from various sources are recorded systematically and presented in appropriate forms

of tables and charts and appropriate mathematical, statistical and graphical tools have been applied to analyze the collected data in a suitable manner. The data of five consecutive years of the two commercial banks have been analyzed to meet the objectives of the study.

5.2 Conclusion

It can be assumed that EBL is better than BOK and HBL in controlling the non performing assets, as the non performing assets to total loan and advances of EBL is least. This assumption has also been substantiated by the lowest amount of loan loss in EBL in comparison to that in BOK and HBL. Also, the lowest non performing asset to total asset of EBL indicates that EBL possess lowest credit risk than does BOK and HBL. Further, the non performing asset to total deposit is lowest in EBL. Among the three observed banks, HBL posses highest credit risk.

Further, from the statistical analysis, it can be deducted that the higher loan and advances disbursement does not necessarily indicates the higher non performing assets, thus tacitly indicating that credit management of bank should be strong enough to control the non performing assets. Also, it can be inferred that the non performing assets does not always ultimately deduct the profitability of the bank, since the relationship between these two variables is insignificant in HBL and BOK. Eventually, it can be concluded that except EBL, HBL and BOK will be fiasco to decrease the non performing assets in future.

From the primary data analysis, it can be inferred that collateral value should be the main basis while disbursing loan. Moreover, it can be concluded that borrower's bad intention is the major internal reason and lack of NRB's proper monitoring is the major external reason behind turning the loan into bad loan. It can also be concluded that agriculture is much risky sector than business and household while loan disbursement. Also, NPA has inverse effect on the financial health of the banks and the bank is moderately affected by the problem of NPA. Finally, it can be concluded that strict recovery policy should be adopted to reduce the NPA.

5.3 Recommendations

The following recommendations have been provided for the enhancement of credit situation of the banks;

- a. Each bank should have its own independent credit rating agency which should evaluate the financial capacity of the borrower before than credit facility. The credit rating agency should regularly evaluate the financial condition of the clients.
- b. Special accounts should be made of the clients where monthly loan concentration reports should be made.
- c. All three banks should quest for more productive and secured sector for investment so as to divert the total deposits and earn more profitability in order to sustain in the industry.
- d. Independent settlement procedure should be more strict and faster and the decision made by the settlement committee should be binding both borrowers and lenders and any one of them failing to follow the decision of the settlement committee should be punished severely.
- e. The banks before providing the credit facilities to the borrower company should analyze the major heads of the income and expenditure based on the financial performance of the comparable companies in the industry to identify significant variances and seek explanation for the same from the company management. They should also analyze the current financial position of the major assets and liabilities.
- f. Banks should evaluate the SWOT analysis of the borrowing companies i.e. how they would face the environmental threats and opportunities with the use of their strength and weakness, and what will be their possible future growth in concerned to financial and operational performance.
- g. It is also wise for the banks to carryout special investigative audit of all financial and business transactions and books of accounts of the borrower company when there is possibility of the diversion of the funds and mismanagement.

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QUESTIONNAIRE

Dear Sir/Madam,

In order to meet the partial requirement for the fulfillment of Master's Degree of Birendra Multiple Campus, I am doing research entitled "Non Performing Assets Analysis (With Reference to HBL, BOK & EBL)". So, in order to achieve the objective the study, I humbly request you to fill up the below questionnaire.

Name:

Relation to Bank as: Investor/Borrower/Employee (Please Tick One)

Please Tick the best alternative (Q.N. 1 to 8)

1. Does NPA affect the financial health of the commercial bank?
 - a. Yes
 - b. No
 - c. Don't Know
2. To what extent today's banking industry is affected by the problem of NPA?
 - a. Not affected
 - b. Nominally affected
 - c. Moderately affected
 - d. Severely affected
3. What sector covers the more default loan?
 - a. Household
 - b. Business
 - c. Agriculture
4. In your opinion, what are the internal reasons for turning good loan into bad loan?
 - a. Mismanagement
 - b. Bad intention of borrower
 - c. Lack of Portfolio Management
 - d. Shortfall on Security
 - e. Weak Legal Provision
 - f. Ineffective Credit Policy

5. In your opinion, what are the external reasons for turning good loan into bad loan?
 - a. Economic and Industrial Recession
 - b. Conservative Provision
 - c. Inconsistent Government Policy
 - d. Lacking of NRB's Monitoring
6. Which measure is the best option to resolve the problem of NPA?
 - a. Strict Recovery Policy
 - b. New rule and regulations
 - c. Monitoring
 - d. Rebate for timely Payment
7. If the borrower is having with overdue outstanding, the bank should start follow up;
 - a. Within a week
 - b. Within two weeks
 - c. Within one month
 - d. After one month onwards
8. What should be the basis for floating loan?
 - a. Financial strength of borrower
 - b. Collateral value
 - c. Monitoring and Control System
 - d. Guarantor
 - e. Portfolio Management

*Thank You,
Dilip Gurung*