

CHAPTER- I

INTRODUCTION

1.1 Background

The world is changing at a fastest rate. Developed and leading countries like USA, China, Japan, Europe, India etc. are the leading examples of this. Intense competition, globalization, standardization, free trade policy, different human rights, development in technology is the crucial factor for change. One of the main factors to measure the development of a country is economic factor.

Nepal, a land locked country with agro based economy, known for its Great Himalayas, beautiful temples, masterpiece arts and sculptures, is the ninth poorest country of the world. Though tremendous natural resources exist they have not been fully or partially utilized. Political instability, low economic growth rate, medium literate population, unawareness are the factors for this. The total population of Nepal is 29,391,883 (2068 B.S) & its growth rate is 1.596% (2068 B.S). The economic growth rate of Nepal is very low. The important components of economic dimensions of an economy are Gross Domestic product (GDP), Per Capita income, personal consumption expenditure, unit labor cost & private investment. GDP (Purchasing power parity) of Nepal is US \$35.81 billion (2067 B.S). Per capita income of a country can be used as an indicator of the purchasing power of its people. Nepal's per capita income is US \$ 472, the revised macro economic indicator reveals, which is one of the lowest in the world. This is also the lowest among the SAARC countries.

Financial institution is one of the sinequanon factors to measure the economic development of a country. It is reckoned as a barometer to measure the economic growth and also the hub of a financial system. Any organization or institution which is engaged in any type of financial activities is known as financial institution. They accept savings of public as deposit and mobilize such deposit providing loan against security deposit or on the guarantee of group to the needy person, business and industries. According to NRB Act 2012 "Financial Institution means a financial institution established under the prevailing laws with the objectives of providing loans for agriculture, co-operative, industry for any other specific economic purpose of

collecting deposits from the general public and the word also includes an institution prescribed as financial institution by Government of Nepal by publishing notice in the Nepal Gazette”.

The economic development of any country is supported by financial infrastructure of that country. A small financial institution is a vital contributor to the financial health of the national economic. The financial institutions are often fragile and susceptible to failure because of poor management particularly financial management. Financial infrastructure indicates the financial strength, position and environment of the institutions. They are currently viewed as catalyst in the process of economic growth of a country. The importance of financial intermediaries has been stressed by these words “Economists and historians agree that the process of modern economic growth has been closely associated with the expansion and increasing diversification of financial intermediation”. The key factor in the development of an economy is the mobilization of the domestic resources. A sound healthy, efficient and secured financial system helps accelerate the dynamics of an economy and thus plays a significant role as a growth facilitator. The Nepalese financial sector is composed of banking sector and non-banking sector. Banking sector comprises of Nepal Rastra Bank and commercial banks. Nepal Bank Limited (NBL) is the first Bank of Nepal. According to Dictionary of Banking and Finance (P.H. Collin, reprint 2054, “Business which holds money for its clients, which lends money at interests and trades generally in money” is bank. The non-banking sector includes development banks, micro-credit development banks, finance companies, co-operative financial institutions, non-government organizations (NGOs) performing limited banking activities. Other financial institutions comprise of insurance companies, employees provident fund, citizen investment trust, postal saving offices and Nepal Stock exchange. The restoration of multiparty democracy and government major step to take liberal policy buttressed the banking sector. As a result of this, there is an increment in the number of commercial banks and its branches in context to Nepal within the last five years,(Adhikari:2006:270).

Banks are such types of institutions, which deals in money and substitute for money. They deal with credit and credit instruments. The most important thing for the bank is good circulation of credit. Banking plays a significant role in the development of

national economic; it is a financial institution which primary classes in borrowing and lending. Modern bank prefers varieties of function therefore it is difficult to decide the function of a modern bank because of their complexity and versatility in operation. Various authors have defined the word “Bank” in different ways. “A commercial bank is dealer of money and it substitutes for money such a check or bills of exchange, it also provides a variety of financial service” - (The new Encyclopedia of Britannica, Vol. 4:2042; 600).

The total deposits at commercial banks stand at around Rs. 642 billion 2068, development banks and finance companies have deposits around Rs. 56 billion and 67 billion respectively 2066. Of the total commercial banks’ deposits, demand deposits, saving deposits, and fixed deposits stand at 12%, 36% and 52% respectively. They have liquid funds of Rs. 114 billion (cash in hand is just 16.2 billion, and deposits with NRB Rs. 39.3 billion). More than Rs.110 billion is invested in real estate by the commercial banks alone. Over 72% of commercial banks’ credit flows against fixed assets. Loans and advances of commercial banks (without claims on government) stand at Rs. 572 billion 2068. Meanwhile, loans and advances of development banks and advances of development banks and finance companies stand at Rs. 52 billion and 70 billion respectively 2066. As a share of gross domestic product (GDP), total deposit, total credit (including claims on government) and private sector credit are 51%, 54.9%, and 43.6% respectively.

Total assets of bank can be divided into two parts performing assets and non performing assets/loan. Performing assets are those assets which direct generates cash to organization or indirectly helps to generate cash or it facilitates the set ups for better productivity. Loan and advances is direct contributor to banks income whereas cash in vault balance in other bank, fixed assets and other assets are the facilitators which helps the daily operation of bank. Performing assets add positive value to bank as well as to nation. Performing assets are those loans that repay principle and interest to the bank from the cash flow it generates. Non-performing assets can be defined as those assets that cannot be used productively. Non-performing assets is the outdated loan, and bad and doubtful debts. Non-performing assets could wreak banks profitability both through a loss of interest income and write off the principal loan amount. (Dangol: 2058:230).

Non performing Assets (NPA) can be defined as a loan or lease that is not meeting its stated principal and interest payments. Non performing assets are commercial loans and consumer loans which have not been paid until the time to pay loan is overdue. For a bank, a Non Performing Asset (NPA) or bad debt is usually a loan that is not producing income. Earlier it was largely applicable to businesses. But things have changed with banks widely extending consumer loans (home, car, personal and education, among others) and strict asset classification norms. Banks usually classify as nonperforming assets as any commercial loans which are more than 90 days overdue and any consumer loans which are more than 180 days overdue. More generally, it is an asset which is not producing income. If a borrower misses paying his equated monthly installment (EMI) the loan is considered bad, or an NPA. High NPA's are a sign of bad financial health. This has wide-ranging ramifications for a bank, especially in the stock market and money market. So, as soon as a debt goes bad, the banks want it either made better or taken out of their books. (Pradhan:2058:320).

According to the issue published by Reserve Bank of India (RBI): "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." (Bindani, 2060: 48-56).

NPA may be defined broadly as the bad debt; however, in terms of banking sector consists of those loans and advances which are not performing well and likely to be turn as bad debt. NPA as per the current directives of Nepal Rastra Bank (NRB) has been categorized as classified loans and advances. NPA has severe impacts on the financial institutions. On the one hand, the investment becomes worthless as expected return cannot be realized and on the other due to the provision required for the risk mitigation the profitability is directly affected. The existence of the bank can be questioned in this situation. Thus, interest along with principal has to be recovered timely and without any obstacles.

"Non-performing assets could wreck bank's profitability both through a loss of interest income and need to write off the principal loan amount. It tackles the subject of an entire starting from the stage of their identification till the recovery of dues in such amount". (Bindani, 2060: 36-38).

“To start with performance in terms of profitability in a benchmark for any business enterprises, including the banking industry, however increasing non performing assets have a direct impact on bank’s profitability as legally banks are not allowed to book income on such accounts and at the same time banks are forced to make provisions on such assets.” (Manamohan, 2059: 06).

Loan and advances dominates the assets side of balance sheet of any bank. Similarly, earning from such loans and advances occupy major space in income statement of the bank. Lending can be said to be raison de enter of the bank. The objectives of loan policy are to maintain the financial health of the banks, which result in safety of depositor’s money and increase in the returns to the shareholders. Since the loan is a risky asset there is inherent risk in every loans, however, the bank should not take risk above the certain degree irrespective of the returns prospects. Most of the bank failures is due to shrinkage in the value of the loan and advances. Hence loan is known as risky assets. Risk of non-payment of loan is known as credit risk or default risk.

1.2 Brief Introductions of Sample Banks

1.2.2 Nepal Investment Bank Limited

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 2043 as a joint venture between Nepali and French partners. The French partner (holding 50%) of the capital) was Credit Agricole Indosuez, a subsidiary of one of the largest banking groups in the world. When Credit Agricole Indosuez decided to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen acquired 50% of the holdings of Credit Agricole Indosuez in Nepal Indosuez Bank in 2060. The name of the Bank was changed to Nepal Investment Bank Ltd. upon approval of the Bank’s Annual General Meeting, Nepal Rastra Bank and Company Registrar’s Office.

NIBL states, “We believe that NIBL, being managed by a team of experienced bankers and professionals with a proven track record, can match your particular needs. We are sure that your choice of bank will be guided, among other things, by its reliability and professionalism.”

Table: 1.2
Share capital Structure

Particulars	Current Year Rs.	Previous Year Rs.
1. Share Capital		
1.1 Authorized Capital		
A) 40,000,000 Ordinary Shares of Rs. 100 each	4,000,000,000	4,000,000,000
1.2 Issued Capital		
A) 37,680,077 Ordinary Shares of Rs. 100 each (of which 13,562,684 Right Share & 23,517,393 bonus shares)	3,768,007,700	3,012,924,200
1.3 Paid Up Capital		
A) 37,680,077 Ordinary Shares of Rs. 100 each (of which 13,562,684 Right Share & 23,517,393 bonus shares)	3,768,007,700	3,012,924,200
1.4 Proposed Bonus Shares	376,800,770	753,231,050
1.5 Calls in Advance	-	-
Total	4,144,808,470	3,766,155,250

Source: *www.nibl.com*

1.2.3. Kumari Bank Limited (KBL)

Kumari Bank Limited came into existence as the fifteenth commercial bank of Nepal by starting its banking operations from Chaitra 21, 2057 B.S with an objective of providing competitive and modern banking services in the Nepalese financial market. The bank has paid up capital of Rs. 1,485,000,000 of which 70% is contributed from promoters and remaining from public.

Kumari Bank Ltd has been providing wide - range of modern banking services through 28 points of representations located in various urban and semi urban part of the country, 19 outside and 9 inside the valley. The bank is pioneer in providing some of the latest / lucrative banking services like E-Banking and SMS Banking services in Nepal. The bank always focus on building sound technology driven internal system to cater the changing needs of the customers that enhance high comfort and value. The adoption of modern Globus Software, developed by Temenos NV, Switzerland and arrangement of centralized data base system enables customer to make highly secured transactions in any branch regardless of having account with particular branch. Similarly the bank has been providing 365 days banking facilities, extended banking

hours till 7 PM in the evening, Utility Bill Payment Services, Inward and Outward Remittance services, Online remit Services and various other banking services.

Visa Electron Debit Card, which is accessible in entire VISA linked ATMs (including 30 own ATMs) and POS (Point of Sale) terminals both in Nepal and India, has also added convenience to the customers. The bank has been able to get recognition as an innovative and fast growing institution striving to enhance customer value and satisfaction by backing transparent business practice, professional management, corporate governance and total quality management as the organizational mission. The key focus of the bank is always center on serving unfulfilled needs of all classes of customers located in various parts of the country by offering modern and competitive banking products and services in their door step. The bank always prioritizes the priorities of the valued customers.

Table: 1.3
Share capital structure

Authorized Capital	Rs. 2,000,000,000
Issued Capital	1,603,800,000
Paid up Capital	1,603,800,000
Value Per Share	100

Source: *www.kbl.com*

1.3 Statement of the Problems

Financial companies and institutions are nowadays facing a major problem of managing the Non Performing Assets (NPA) as these assets are proving to become a major setback for the growth of the economy. Undoubtedly, the world economy has slowed down. Globally stock markets have tumbled and business itself is getting hard to do with the simple reason that the banks (creditor) money in the form of funds gets blocked. Under such a situation, it goes without saying that banks are no exception and are bound to face the heat of a global downturn.

Assets are the most critical factor in determining the strength of any bank. The primary factors that can be considered are the quality of the loan portfolio, mix of risk assets and the credit administration system. The lower NPL ratio indicates better risk

assessment and robust credit management system are in place and vice-versa. At the same time higher loan loss provisions indicate poor credit management; it also indicates adequate reserve for possible loan loss, protecting the balance sheets of respective banks.

Currently the banking sector is facing various problems. One of them is the banking has been becoming a victim of huge non-performing assets. Non-performing assets are one of the serious problems faced by the commercial banks. There are six research questions in this study to find out the effect of NPA on the bank.

- 1) What is the overall impact of the NPA on the profitability of the Commercial Banks under study?
- 2) What is the relationship between NPA and the profitability of the Commercial Banks and the other Non-Banking Assets, NBA?
- 3) What might be the other factors that influence the non-performing assets of the Commercial Banks in the banking industry of Nepal?
- 4) What percentage of total assets and total lending is occupying by non-performing assets of Nepalese commercial banks?
- 5) Whether or not Nepalese commercial banks is following NRB's regulation regarding their lending's, especially to maintain the provision for non-performing assets?
- 6) What are the internal factors of the individual Commercial Banks in increment of the non-performing assets of them?

1.4 Focus of the Study

The process of lending takes into consideration the people and system required for the evaluation and approval of loan requests, negotiations of term, documentation, disbursement, administration of outstanding loans. Knowledge of the process awareness of its strengths and weakness are important in setting objectives and goals for lending activities and for allocating available funds.

Increasing non-performing assets is one of the emerging problems of Nepalese commercial banks. This study mainly focused on non-performing loans or assets of selected commercial banks. Several ratios like loan and advances to total assets, loan

and advances to total deposit, non-performing loans to total loans and advances, provision held to non-performing assets were used for performance evaluation for comparable forum on non-performing assets. It also tried to show the effects on profitability of commercial banks and related NRB directives, concerning towards the rendering loan and loan loss provision. The total NPA of Nepalese commercial banks are growing rapidly and it is the main cause of failure of bank. In this study, the NPA of commercial banks were presented, analyzed, summarized and drawing findings forwarded and recommendation

1.5 Objectives of the Study

The improper strength, weakness, opportunity and threat analysis is another reason for rise in NPA. Increase in NPA has now become the major issue for every commercial bank. Every bank now has put the NPA management under the top priority and is functioning to reduce the major part of it from the assets side of their balance sheet. The main objective of this research is to examine and study of level of non-performing loans in total assets, total deposit and total lending of Nepalese commercial banks. The specific objectives are as follows:

- To examine the proportion of non-performing loan in the selected commercial banks.
- To analyze the level of non-performing loans in total assets, total deposit and total lending of Nepalese commercial banks.
- To examine the relationship between loan and loan loss provision in the commercial bank.
- To analyze the impact of loan loss provision on the profitability of the commercial banks.
- To recommend for the improvement of the management of NPA on the basis of the findings of the study.

1.6 Important of the Study

The success and prosperity of the bank heavily depends upon the successful implementation and investment is collected resources, which develops the economy of the country. Good investment policy of the bank has positive impact on economic development of the country and vice versa. Therefore success of any bank does not

depend upon how much money a bank able to lend? But it depends upon the quality of loan. So success of any bank depends upon the amount of performing loan/assets. Performing assets are those loans that repay principal and interest to the bank from the cash flow it generates. Vice versa. Increasing non-performing loan followed by increasing loans and loan loss provision is one of the challenges faced by banks in the present context.

- Proper loan provision and loan loss provision helps to get financial strengthening of the banks. This research is able to give some of the present issues, latest information and data regarding non-performing assets and loan loss provision.
- Not only that, this study also gives the real picture of the current non-performing assets to its stakeholders. The main focus of the study is to know about the non-performing assets of selected Nepalese banks and make comparative study.
- The study is mainly concerned with the analysis of the level of NPA in the total assets; total deposited and total lending of Nepalese banks. Therefore, it is significant to find out the level of NPA & also significant to find out whether the Nepalese banks maintain loan loss provision in accordance to NRB's directives or not. It examines the return on loan and advances of the banks.
- Last but not the least, it provides literatures to the researcher who wants to carry out further research in this field.

1.7 Limitations of the Study

This study is simply a partial study for the fulfillment of M.B.S. degree, which had to be finished within limited period. Hence this study is not far from several limitation of its own kind, which weakens the heart of the study. It has certain limitations as follows:

- This study has employed secondary data published by and collected from selected banks.
- The study is focused on the Nepalese commercial banks only. Hence, the findings may not be applicable to all other banks finance companies and other companies of Nepal.
- The study covers a period of 5 fiscal years which will be tabulated and processed for drawing conclusion from 2066/067 to 2069/070.
- The accuracy of the research work will be dependent on data provided by concerned organization.
- Time factor is major limitation of this study.
- This study concentrates only on those factors, which are related with nonperforming assets of Nepalese commercial banks. It does not consider other aspects of the banks.
- Profitability of an organization is caused by many factors. This study, however, covers only those factors, that are directly affected by the non-performing assets of the Commercial Banks.

1.8 Organization of the Study

To make the study precise and attractive in presentation, this research work has been divided into five chapter namely Introduction, Review of literature, Research methodology, data presentation and analysis and finally summary, conclusion and recommendation.

Chapter I: Introduction

The first chapter includes narrow aspects of this study like General background of the study, Statement of the problem, Objective of the study, Focus of the study, Significance of the study along with limitation of the study.

Chapter II: Review of Literature

The second chapter incorporates that the conceptual thoughts and related study regarding the subject matter.

Chapter III: Research Methodology

The third chapter discussed the “Research Methodology” used in the study. It comprises research design, nature & source of data, data gathering method along with different statistical and financial tools used.

Chapter IV: Presentation and Analysis of Data

The fourth chapter deals with the “Data presentation and analysis” of data and scoring the empirical findings of the study through definite course of research methodology. Major findings

Chapter V: Summary, Conclusion & Recommendation

The last chapter named as “Summary, Conclusion & Recommendation” is followed by the basic conclusion of the study based in the fourth chapter. On the basis of the summary, conclusion is taken out and recommendation has also been presented for consideration.

The Bibliography and Appendix are references

CHAPTER- II

REVIEW OF LITERATURE

Conceptual Framework

The next step is to develop concepts and ideas about the selected topic by reviewing all the relevant materials regarding the study. In fact, review of literature begins with a search for a suitable topic and continues throughout the duration of the research work. It deals with a literature survey of the existing volumes of similar related subjects. Review of literature means reviewing research studies or other relevant propositions in the related area of the study so that all the past studies, their conclusions and deficiencies may be known and further research can be conducted. It is an integral and a mandatory process in research works. The purpose of literature review is to find out what research studies have been conducted in one's chosen field of study and what remains to do. The next step is to develop concepts and ideas about the selected topic by reviewing all the relevant materials regarding the study. In fact, review of literature begins with a search for a suitable topic and continues throughout the duration of the research work. It deals with a literature survey of the existing volumes of similar related subjects. Review of literature means reviewing research studies or other relevant propositions in the related area of the study so that all the past studies, their conclusions and deficiencies may be known and further research can be conducted. The purpose of literature review is to find out what research studies have been conducted in one's chosen field of study and what remains to do. The primary purpose of literature review is to learn not to accumulate (Wolff & Pant; 2062: 146).

2.1 Origin and concept of the bank

The word bank was borrowed in Middle English from Middle French banquet, from Old Italian bank, from Old High German bank, bank "bench, counter". Benches were used as desks or exchange counters during the Renaissance by Florentine bankers, who used to make their transactions atop desks covered by green tablecloths.

Banking in the modern sense of the word can be traced to medieval and early Renaissance Italy, to the rich cities in the north like Florence, Venice and Genoa. The Bardi and Peruzzi families dominated banking in 14th century Florence, establishing branches in many other parts of Europe. Perhaps the most famous Italian bank was the Medici bank, set up by Giovanni Medici in 1454 B.S. The earliest known state deposit bank, Banco di San Giorgio (Bank of St. George), was founded in 1464 B.S at Genoa, Italy. (Van Horne, J.C. 2057: 145).

The earliest evidence of money-changing activity is depicted on a silver Greek drachm coin from ancient Hellenic colony Trapezus on the Black Sea, modern Trabzon, c. 350–325 BC, presented in the British Museum in London. The coin shows a banker's table (trapeza) laden with coins, a pun on the name of the city. In fact, even today in Modern Greek the word Trapeza means both a table and a bank.

The first banks were the merchants of ancient world that made loans to farmers and traders that carried goods between cities. The first records of such activity dates back to around 2057 B.S in Assyria and Babylonia. Later in ancient Greece and during the Roman Empire lender based in temples would make loans but also added two important innovations that of accepted deposits and changing money. During this period there is similar evidence of the independent development of lending of money in ancient China and separately in ancient India.

The development of banking spread through Europe and a number of important innovations took place in Amsterdam during the Dutch Republic in the 16th century and in London in the 17th century. During the 20th century developments in telecommunications and computing resulting in major changes to way banks operated and allowing they dramatically increase in size and geographic spread. The Late-2007 financial crisis saw significant number of bank failures, including some of the world's largest banks and much debate about bank regulation.

2.1.1 Earliest forms of banking

The history of banking is closely related to the history of money but banking transactions probably predate the invention of money. Deposits initially consisted of grain and later other goods including cattle, agricultural implements, and eventually

precious metals such as gold, in the form of easy-to-carry compressed plates. Temples and palaces were the safest places to store gold as they were constantly attended and well built. As sacred places, temples presented an extra deterrent to would-be thieves. In Egypt, from early times, grain had been used as a form of money in addition to precious metals, and state granaries functioned as banks. When Egypt fell under the rule of a Greek dynasty, the Ptolemies 332-30 B.S the numerous scattered government granaries were transformed into a network of grain banks, centralized in Alexandria where the main accounts from all the state granary banks were recorded. This banking network functioned as a trade credit system in which payments were affected by transfer from one account to another without money passing. In the late 3rd century BC, the barren Aegean island of Delos, known for its magnificent harbor and famous temple of Apollo, became a prominent banking center. As in Egypt, cash transactions were replaced by real credit receipts and payments were made based on simple instructions with accounts kept for each client. With the defeat of its main rivals, Carthage and Corinth, by the Romans, the importance of Delos increased. Consequently it was natural that the bank of Delos should become the model most closely imitated by the banks of Rome. (Kothari, 2052: 65).

In ancient India during the Maurya dynasty, an instrument called adesha was in use, which was an order on a banker desiring him to pay the money of the note to a third person, which corresponds to the definition of a bill of exchange as we understand it today. During the Buddhist period, there was considerable use of these instruments. Merchants in large towns gave letters of credit to one another.

In ancient China starting in the Qin Dynasty 221 to 206 BC the Chinese currency developed with the introduction of standardized coins which allowed the much easier trade across china and led to the development of letters of credit. These letters were issued by merchants that acted in ways that today we would understand as banks.

The concept of modern commercial bank came into existence by the emergence of the bank of England in 1694 with a capital of 1.2 million pound by a group of wealthy London merchants and financiers. Since at that time, there was no concept of joint stock Company, it was necessary to obtain a special charter from the crown to poll their money in common venture. King William III was too pleased to grant a royal

charter to Bank of England, because in return a capital subscribed of 1.2 million pound was lent to him to finance his war against France. The charter also gave the new bank the right to issue notes, payable on demand, up to the amount of loan to the King (Joshi, 2058: 96).

2.1.2 Concept of Commercial Bank and Historical Review in Nepalese Perspective

The evolution of banking industry had started a long time back, during ancient times. Nepal has been ruled over by many rulers like Kirati, Lichhavi, Malla, Ranas and Shahs. Mostly Kirati, Lichhavi, and Malla regimes were concerned with the construction of temples, pati, pouwa, chautari etc. At that period neither the people nor the government were interested to think about the economic development of the country. According to ancient “vanshawali” in fourteenth century, the ruler of the Kathmandu Jayasthiti Malla segregated the local domiciles into 64 different classes according to profession they had undertaken. Tankadhari was one of those classes who used to deal in coins and precious metals such as gold. These Tankadhari’s were said to have carried out the borrowings and lending on money (coins). Hence, Tankadhari’s can be regarded as the traditional bankers of Nepal (Singh and Khadka, 2056: 163).

Like many other countries, goldsmiths, merchants and money lenders were the ancient bankers of Nepal. “Tejarath Adda” was established in 1880 during the period of Prime Minister Ranoddip Singh was the first step towards the institutional development of banking in Nepal. Some historians says that Kaushi Tosha Khana established during the time of king Prithivi Narayan Shah 1723-1755 is the first banking institution but there is very little known about it. Tejarath Adda did not collect deposits from the public but provided loans to public under the security of gold and silver to the public and to the government employees against the security of their salary. Since the interest rate of Tejarath Adda was just 5% beneficiaries were very much relieved of exorbitant interest rate being charged by the traditional bankers. The government established its various branches and sub-branches at different places of the country for the sake of benefits of people. In the overall development of the banking system in Nepal, the Tejarath Adda may be regarded as the father of modern banking institutions and for a quite long time it provided a good service to

government employee as well as to the general public. (Singh and Khadka, 2056: 164).

Banking in modern sense started with the inception of Nepal Bank Limited (NBL) on 15 November 1937 under Nepal Bank Act 1937 though in Europe modern banks were setup in the 12th century itself. NBL was set up with cooperation of Imperial Bank of India. The bank was inaugurated by the then king Tribhuvan. It was established with the purpose of supplying loan to industries and commerce providing banking facilities to the people such as collecting deposits provide long term and short term loan against collateral and guarantee. The bank has dominance role in banking transactions all over the country. The shareholders of bank consists Nepal Government and general public.

Nepal Bank Limited, the first commercial bank of the country had a Herculean responsibility of attracting the people toward the banking sector from pre-dominant money lenders' net and expanding banking services to various parts of the country. It could not open the branches across the country due to various factors. It had only 12 branches till 1956. Nepal bank limited was also serving as the central bank of the country before the establishment of Nepal Rastra Bank. However the stand of Nepal Bank Limited alone in total monetary and financial sector was not sufficient and satisfactory In 2013.01.14 .Nepal Rastra Bank was set up to work as a central bank of the country under Nepal Rastra Bank acts 2012 B.S. The capital of this bank was fully subscribed by Nepal Government. Similarly on 2022.10.10 Rastriya Banijya Bank was established as a fully government owned commercial bank. With the emergence of RBB, banking service spread to both the urban and rural areas but customers failed to have taste of quality/competitive service because of excessive political and bureaucratic interference. For industrial development, industrial development center was set up in 2013 B.S. which was converted to Nepal Industrial Development Corporation (NIDC) in 2016 B.S. Similarly Agriculture Development Bank (ADB) was established in 2024.10.07 with an objective to promote agriculture products so that agricultural productivity could be enhanced through introduction of modern agricultural techniques. The government introduced Commercial Bank act in Nepal in 2033 B.S. to cover the vast field of financial sector. This act has helped to emerge number of commercial bank with a view to maintain the economic interest in comfort

of the public in general facilitated to provide loan for agriculture, industry and trade and make a available banking services to the country and people (Dahal & Dahal; 2059: 65).

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

The NABIL Bank Ltd is the first joint venture bank established in 2041 B.S. and started its operation with modern banking services. In the same way, Nepal Indosuez Bank (present Nepal Investment Bank), the second joint venture bank established in 2042 B.S. with an objective to encourage efficient banking services and facilities. Likewise Standard Chartered Bank is operated under the direction of Indian management. (Dahal & Dahal, 2059: 56).

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

2.2. Definition of Loans and Advances

Banks accepts deposit from the surplus group of society (or from those who want less risk to their money with less return) and supply those fund to the deficit group of society or to those entrepreneurs who have skill and knowledge but less financial resources to implement those viable project. Almost all banks have the loan and

advances as their prime assets and interest earning from loan and advances are the major sources of income. This asset constitute primary source of income to banks.

Loan is defined as a sum of money transferred to another for temporary use, to be repaid with or without interest according to terms of the loan agreement written in the accompanying bond, note, mortgage or other document of indebtedness. However, in financial terms loan or debt means principal or interest availed of to the borrower against the security. Debt means the money that bank owes or lends to individual or person. Likewise, the term loan is defined as a lending, a sum of money, and delivery by one party and receipt by another party upon agreement expressed to implied, to repay it with or without interest. Anything furnished for temporary use to a person at his request on condition that it shall be returned, or its equivalent in kind, with or without compensation for its use. (Boerne & Colwell; 2057: 125-129).

Debt means “Principal and interest provided to debtor by banks or financial institutions, with or without the pledge of immovable or movable property or other securities or guarantees or without guarantee, and the word also mean over dues of the transactions beyond balance or fees, commission and interest incurred in that relation.” (Boerne & Colwell; 2054: 145-148).

Loans and advances dominate the assets side of the balance sheet of any bank. Similarly, earning from such loans and advances occupy a major space in income statement of the bank. They are also the least liquid of the bank’s entire assets. Loans and advances may take different forms and are allowed against various types of securities. Loans, overdrafts, discounting of bills of exchange etc. are some of the forms of bank lending. Granting loans and advances always carries a certain degree of risk. Loans and advances are regarded as the risky asses of the banks.

The supreme court of India has defined the debt during the decision of the case of United Bank of India vs. DRT. Sudhir Gupta states that “In the case in hand, there cannot be any dispute that the expression, debt has to be given the widest amplitude to mean any liability which is alleged as dues from any person by a bank during the course of any business activities undertaken by the bank either in cash or otherwise, whether secured or unsecured, whether payable under a decree or order of any court

or otherwise and legally recoverable on the date of the application (Ghimire, 2062: 17).

2.2.1 The Loan Policy

The loan policy is the primary means by which senior management and the board guide lending activities. Although the policy primarily imposes standards, it also is a statement of the bank's basic credit philosophy. It provides a framework for achieving asset quality and earnings objectives, sets risk tolerance levels, and guides the bank's lending activities in a manner consistent with the bank's strategic direction. Loan policy sets standards for portfolio composition, individual credit decisions, fair lending and compliance management.

“Loan policies vary in length, organization, degree of detail and breadth of topics, there is no ideal format. Frequently the bank's general lending policy will be supplemented by more detailed underwriting standards, guidelines and procedures. Within the same banking company, certain aspects of the policy may vary because of factors such as geographic location, economic conditions, personnel, or portfolio objectives. The format should be tailored to fit the needs of a particular bank, and the scope and detail should be commensurate with the complexity of the bank's lending activities.” (William: 1960: 104)

“For the policy to be an effective risk management tool, it must clearly establish the responsibilities of those involved in the lending process. For example, who is authorized to approve a covenant violation, who arbitrates risk rating differences, can a credit-scored decision be overridden? Lenders must know what is expected of them, when policy is vague or too broad, credit standards may be unclear and virtually nothing may be regarded as an exception. If the policy states that a bank will extend credit to established business, almost any company would qualify. But a policy further requiring the business to be profitable, in operation for at least two years, and located within the bank's community is providing meaningful guidance.” (Grywinski: 2046: 77)

2.2.1.1 Loan Policy Topics

“While the form and contents of loan policies and procedures will vary from bank to bank, there are some topics that should be covered in all cases. These are - (Chopra: 2036: 17)

- Loan authorities
- Limits on aggregate loans and commitments
- Portfolio distribution by loan category and product
- Geographic limits
- Desirable types of loans
- Underwriting criteria
- Financial information and analysis requirements
- Collateral and structure requirements
- Margin requirements
- Pricing guidelines
- Documentation standards
- Collections and charge- offs
- Reporting requirements
- Guidelines for loan participants
- Off balance sheet exposure

The policy may also address insider transactions, affiliate transactions, conflicts of interest, the code of ethics, community support, appraisal requirements, environmental assessment requirements, relevant accounting issues (such as charge-off loans, non-performing loans, and debt restructuring) and the allowance for loan and lease losses. Any administrative requirements for granting loans should be covered in the policy. Policies and procedures should also ensure compliance with laws and regulations.

2.3 Definition of Non-Performing Assets

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.

Non-performing loan (NPL) can be defined as the non-productive assets of the banks. An asset is known as non-performing assets (NPA's) if the borrower does not pay the dues in the form of principal and interest in time. However with effect from March 2061, default status would be given to a borrower if dues are not paid for 90 days. If any advances or credit facilities granted by bank to a borrower becomes non-performing, then the bank will have to treat all the advances/ credit facilities granted to that borrower as nonperforming without having any regard to the fact that there may still exist certain advances/credit facilities having performing status. It is considered as one of the key economic indicator for financial stability and sustainable economic development.

The higher the non-performing assets/loans the lower the return to the organization, therefore management always focuses to utilize the deployed assets in maximum and reduce the level of non-performing assets. So, that a sustainable income is generated. Non-performing loans could wreck bank's profitability both through a loss of interest income and write of the principal loan amount. It tackles the subject of an entire starting from the stage of their identification till the recovery of such account. The standard international percentage of NPA is 5 %.

2.4 NRB Directives

The world has witnessed many financial crises and devastating consequences due to huge financial and economic losses that resulted from each episode. Every crisis was sudden in onset and their magnitude of losses was much larger than expected. If we go back to the history, then on 2054, the Asian crisis began in the form of liquidity problem of two finance companies. Later this spread over to other financial intuition within the Thai financial system. Simultaneously, crisis began to cover Malaysian, Indonesian and South Korean financial statement and loomed in the form of Asian crisis so this Asian crisis appealed the whole world for regular and timely supervision and assessment of financial system, its soundness and vulnerabilities. This event

forced the regulatory authorities for the enforcement of prudential measures on order to avoid further crisis review and revision in prudential regulations such as capital adequacy ratio, asset classification. Provisioning for impaired assets, exposures limit and enforcement of international accounting standard etc. have now become common issue all over the world since the late 2007.

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

The financial sector reform of Nepal was initiated in mid 2007. Since then NRB has been playing pioneer role in regulation, supervision and monitoring of commercial banks by issuing directives. At present the number of guidelines issued by NRB to commercial bank reaches sixteen which are listed as follows:

- 1) The provision of minimum capital fund to be maintained by the commercial bank.
- 2) The provision of loan classifications and loan loss provisioning on the credit.
- 3) The provision relating to limit on credit exposures and facilities to a single borrower, group of related borrowers and single sector of the economy.
- 4) The provision relating to accounting policy and the structure of financial statements to be followed by the commercial banks.
- 5) Regulation relating to minimization of risk inherent in the activities of commercial banks.

- 6) The provision of institutional good governance to be followed by commercial banks.
- 7) Time frame for implementation of regulatory directives issued in connection with inspection and supervision of commercial banks.
- 8) Regulation relating to investment in shares and securities by commercial banks.
- 9) The provision of submission of statistical data to the NRB, banking management division and inspection and supervision division.
- 10) Regulation relating to sale and ownership transfer of promoters shares.
- 11) Regulation relating to stringent blacklisting procedure for loan defaulters.
- 12) The provision relating to compulsory deposited amount of NRB.
- 13) Regulation relating to developing the branch office of commercial banks.
- 14) Provision relating to interest rates.
- 15) Provision relating to collection of financial sources.
- 16) Provision relating to consortium financing.

2.4.1 NRB Directives Relating to Loan Classification and loan Loss provision (www.nrb.org.np)

2.4.1.1 Classification of Loan and advances

Nepal Rastra Bank (NRB) has provided following directives for classification of loan and advances and its loss provisioning for the purpose of minimizing possible risk in bank's lending by using the authority given by sub section 1 of section 23 of NRB act 2068 (revised) and section 19(ka) Of commercial bank act 2031 (Revised).

a. Pass

Loans or assets in this category are fully protected by the current sound worth and paying capacity of the obligor or the collateral pledged, are performing in accordance with contractual terms, and are expected to continue doing so. (Sitaula, 2066: 165)

- Any asset which is past due period up to 90 days shall be classified as Pass.

b. Substandard

Loans or assets in this category are not adequately protected by the current sound worth and paying capacity of the obligor. The primary source of repayment is not sufficient to service the debt, and the financial institution

must rely on secondary sources such as realizing on collateral, sale of fixed assets, refinancing, or capital injections from external sources. Substandard assets have well-defined weaknesses that jeopardize the orderly repayment of the debt. These assets may, or may not, be past due but have a higher than normal risk due to absence of current credit documentation. There is a distinct possibility that the financial institution will sustain loss if deficiencies are not corrected. (Sitaula, 2066: 148)

- Any asset which is past due 90 days or more but less than 180 days shall be classified as Substandard, at a minimum.
- Re-negotiated and restructured loans shall be graded Substandard unless

- i. All past due interest is paid in cash at the time of restructuring,
- ii. All principal and interest payments have been made according to the modified repayment schedule for at least six consecutive months from the date the loan was re-structured, and
- iii. The terms and conditions of the restructured loan comply with the loan policy.

c. Doubtful

Loans and assets in this category have all the weaknesses inherent in substandard assets but the loans are not well-secured. Weaknesses make collection in full highly questionable and improbable on the basis of existing facts, conditions, and value. The possibility of loss is high, but the actual amount of loss cannot be fully determined because specific pending factors may mitigate. Pending factors may include a merger, acquisition, or liquidation; a capital injection; obtaining additional collateral; or refinancing. If pending events do not occur within 180 days and repayment must again be deferred, Loss classification is warranted. (Sitaula, 2066:)

- Any asset which is past due 180 days or more but less than 360 days shall be classified as Doubtful, unless
 - i. The asset is well-secured,
 - ii. Legal action has commenced, and
 - iii. The time to realize on collateral or on a guarantee does not exceed 180 days.

d. Loss

Loans and assets in this category are deemed uncollectible or of such little value that carrying on the books is no longer warranted. Loss classification does not mean there will never be a recovery, but rather that it is no longer appropriate to defer writing off the asset. Losses shall be taken when identified as uncollectible and shall not remain on the books while pursuing long-term recovery efforts. (Sitaula, 2066: 137)

- Any asset which is past due 360 days or more shall be classified as Loss, unless
 - The asset is well-secured,
 - Legal action has commenced, and
 - The time to realize on collateral or on a guarantee does not exceed 180 days. In some cases, a reduced carrying value or partial write-down is justified. If a partial write down is taken, the remaining book value must be supported by tangible facts.

Loans and advances falling in the category of Sub-standard, Doubtful and loss are classified and defined as Non-Performing Loan.

Note:

- i. If it is appropriate in the views of the bank management there is not restriction in classifying the loan and advances from low risk category to high risk category. For instance, loans falling under substandard may be classified into doubtful or loss and loans falling under doubtful may be classified into loss category.
- ii. The term 'loan and advances' also includes Bill purchased and Discounted.(Kandel, 2066:169)

2.4.1.2 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 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.

2.4.1.3. 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 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.

2.4.1.4. Additional Arrangement in Respect 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.

2.4.1.5. 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 customer’s account. Where a system in the bank exists as to recovery of principal and interest by

debiting the customer's 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.

2.4.1.6. 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 date of conversion into fund based. After 90 days such loan shall be classified as loss loan.

2.4.1.7. 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.

2.4.1.8. 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%

Effects of NPA on Profitability of the Banks

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

Profitability Impact

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

As a whole, his impact of NPA can be assessed with the following:

- Lower ROE and ROA
- Lower image and rating of Banks
- Disclosure reduces investor's confidences
- Increases costs/difficulties in raising capital.
- NPA do not generate income.
- They require provisioning
- Borrowing cost of resources locked in
- Opportunity loss due to non-recycling of funds.
- 100% risk weight on net NPA for CRR

- Capital gets blocked in NPA
- Utilizes capital but does not generate income to sustain the capital that is locked
- Recapitalization by government comes with string.
- Administration and recovery costs of NPA
- Effects in employee morale and decision-making (Ghimire, 2062: 21).
- 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.
- Time and efforts of management is another indirect cost which bank has to bear due to NPA.

2.5 Review of Previous Studies

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

2.5.1. Review of Articles/Journals

Shrestha (2060) “*Non-Performing Assets of Nepalese Commercial Banks*” in his article published in The Boss magazine says the management of bad loan is a high prioritized exercise in the country for past 10 years. But the remarkable achievements have not been sighted yet. Handover of management of two big government banks is an example of financial sector reform action in the country. It has been almost 4 years of handover of management of two big government banks to the foreign expert but the achievement is not satisfactory. He identifies not only government banks but private sector banks are also slowly affected by the non-performing loan. Therefore a strong focus should be made by management to reduce the level of NPL. He believes in coordination between the borrower and the lender. He further says if a viable project is not being completed in time and not being able to pay its interest in time the bank and the project owner should sit together and find out the way to complete it rather than blacklisting and running towards the legal action.

Poudel (2067) had written an article on “High Non-Performing Loan (NPL) and many Problematic Financial Institutions” in his article the best indicator of the health of the banking industry in a country is its level of NPL. Given this fact, Nepalese banks and financial institutions seem to be placed in a vulnerable to the high credit risk than they were in the past. Credit forms major source of income and its share of gross credit in total earning asset of all commercial bank are above 54 percent (2010 July). However, average NPL level of banking industry was at 6.08 percent (2010), which is higher as compared to internationally accepted form of 5 percent. Such higher level of NPL required banks to provide for such provisions which consumed earnings and deteriorated the capital in cases of few commercial banks. If we analyze further, we can find that poor corporate governance and poor risk management practices as the major reason for high NPL and cause of negative capital in problematic banks. Other external causes of high NPL are economic slowdown, legal hurdles for recovery, defaulting attitude of borrower and deficiency in enforcement of supervisory authority by central bank. Management practices in banks with higher NPL are still very weak in areas of credit analysis, credit administration, risk management and internal control system. Other reasons for increase in NPL are multiple banking, non-existing of system for registration of hypothecated current assets, poor credit information and lack of disclosures by borrowers.

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

Dhungana (2068), in his well article, “*Non Performing Assets of Commercial Banks*”, has concluded that poor credit management and deterioration in the quality of loans give birth to non-performing assets. The internal measures play significance role to control the growth of NPL. Best credit practices, culture and policies are

required to strengthen the internal factors. The banks should have a proper system and competency on risk management and should ensure that risk are accurately identified, assessed and controlled properly. A proper risk management is undoubtedly an important tool for a good banking and NPL management.

He further states that it can be expected that the financial sector reforms will lower down the level of NPL from the existing level and strengthening the banks and financial institution internally to manage the credit portfolio efficiently and support will be continued to make a good credit culture in the system.

Shivakoti (2069) *“Non- Performing Assets and profitability of Commercial Banks in Nepal.”* The best indicator of the health of the banking industry in a country is its level of NPL. Given this fact, Nepalese banks and financial institutions seem to be placed in a vulnerable to the high credit risk than they were in the past. Credit forms major source of income and its share of gross credit in total earning asset of all commercial bank are above 54 percent (2065). However, average NPL level of banking industry was at 6.08 percent (2065), which is higher as compared to internationally accepted form of 5 percent. Such higher level of NPL required banks to provide for such provisions which consumed earnings and deteriorated the capital in cases of few commercial banks. If we analyze further, we can find that poor corporate governance and poor risk management practices as the major reason for high NPL and cause of negative capital in problematic banks. Other external causes of high NPL are economic slowdown, legal hurdles for recovery, defaulting attitude of borrower and deficiency in enforcement of supervisory authority by central bank. Management practices in banks with higher NPL are still very weak in areas of credit analysis, credit administration, risk management and internal control system. Other reasons for increase in NPL are multiple banking, non-existing of system for registration of hypothecated current assets, poor credit information and lack of disclosures by borrowers.

2.5.2. Review of Unpublished Thesis

Mandal,S (2064) in his thesis paper, *“Non-Performing Assets of Nepalese Commercial and Development Bank”* has studied mainly three banks i.e. Nepal Arab Bank Ltd (NABIL), Nepal Indosuez Bank Ltd.(NIBL), and Nepal Grindlays Ltd. (SCBNL). His

main finding is that both SCBNL and NABIL have mobilized the debt funds in proper way for generating more return but NIBL could not do so as good as NABIL and SCBNL. He has recommended enhancing banking facilities in rural areas by encouraging small entrepreneurs development programmers, to play merchant banking role to mobilize.

His Main Objectives are as follows

- To analyze the lending practices and resources utilizations of NB bank.
- To examine the correlation and the signification of their relationship between different ratios related to capital structure.

His Research Methodologies are as follows

In this research, data are analyzed by using different types of tools. As per topic requirements, emphasis is given on statistical tools rather than financial tools. So for this study following statistical tools and financial tools are use such as Loans and advances to Total Risk Weighted Assets Ratio, non-performing Loan to Total Loans and advances Ratio, Loan Loss Provision to Non Performing Loan, Arithmetic Mean Standard Deviation and Hypothesis Test.

His Major Findings are as follows:

- Hence, the bank has been suggested to manage its investment portfolio efficiency
- Operational efficiency of the bank is indicate by the operational loss has been found unsatisfactory.

Poudel,M (2066) *had conducted a research on “Non-Performing Assets of Nepalese Commercial Banks”* “He had taken sample banks as Nepal SBI Bank Limited, Nepal Investment Bank limited, Nepal Bangladesh Bank limited, Bank of Kathmandu limited, and Nabil Bank Limited.

His Main Objectives are as follows

- To analyzed relations between different ratios.
- To examine the proportion of Comparative financial performance appraisal of joint venture banks
- To give suggestions and recommendations for the betterment of commercials banks.

His Research Methodologies are as follows

Research methodology is the focal part of the study. Ranges of financial and statistical tools are used to analyze the collected data and to achieve the objectives of the study. The analysis of the data will be done according to pattern of data available. Because of limited time and resources, simple analytical statistical tools such as graph, percentage, coefficient of correlation, regression analysis and the technique of least square are adopted in this study. Financial tools such as ratio analysis and trend analysis have also been used for financial analysis.

His Major Findings are as follows

- His study especially concentrated on the deposit collection of the bank and disbursement of the fund as loan and advances.
- He has focused on utilization and mobilization of funds and resources of Nepal Bank Ltd.
- He recommended that the bank should try to mobilize its resources efficiently by creating new business
- Service ideas which will certainly help for the better utilization of ideal resources and for the economic development of the country.

Tuladhar,S (2067) *had conducted a research topic on "Non Performing Assets of Commercial Banks Causes and Effects"*. The study found that NGBL has been successful to maintain in the best way both liquidity position and their consistency among **three banks**. Profitability position of NGBL is better than NABIL and HBL.

His Main Objectives are as follows:

- To analyze the impact of investment policy selected commercial banks.
- To examine the correlation and the significance of their relationship between different ratios related to capital structure

His Research Methodologies are as follows:

In his thesis the data are analyzed by using different types of tools. As per topic requirements, emphasis is given on statistical tools rather than financial tools. So for this study following statistical tools and financial tools are used such as Debt to Equity ratio, Debt Ratio Interest Coverage Ratio, Earnings per Share, Price Earnings Ratio, Return on Total Assets, Return on Share Holder's Fund or Equity, Arithmetic means, Standard Deviation and Correlation Coefficient.

His Major Findings are as follows:

- On the basis of this feedback information, regular changes or implementation of new rules and regulations can be easily carried out.
- NRB should also encourage frequent training to new entrants to provide orientation on the conceptual dimensions and practical aspects of operation of the banks
- Constraints of socio-economic political system on one hand and that of issues and challenges of JVBs commanding significant banking business of other spectrum
- The collection of deposit and loan investment done by the commercial banks also to sustain themselves in the environment of competitions,
- They should introduce novel technology and equipment's to collect deposit.

Regmi,P (2068) had explained in his research work about the topic “*Non-Performing Assets and profitability of Commercial Banks in Nepal.*”

His Main Objectives are as follows:

- To examine the relationship between different ratios.
- To calculate and analyze the financial and statistical tools

His Research Methodologies are as follows:

The research, data are analyzed by using different types of tools. For this study following statistical tools Arithmetic mean, Standard Deviation, Correlation Coefficient, Probable Error and Regression Analysis and financial tools Earnings per Share, Price Earnings Ratio, Return on Total Assets and Return on Share are also use.

His Major Findings are as follows:

- He has further suggests that both the banks should extends their resources to rural areas to promote development
- Hence, the bank has been suggested to manage its investment portfolio efficiency
- These are indeed significant milestone in the financial development process to the economy
- But keeping in mind, the social and economic structure of our country, we should not turn a deaf ear to regional balance.

Pokhrel, G (2069) had conducted in his research work about the topic “*A Study on Non Performing Loans of Commercial Banks*. With status of Nabil Bank limited, Nepal Bank limited, Everest Bank Limited & Nepal SBI Bank limited.

His Main Objectives are as follows:

- To analyze the impact of financial performance of Nepal Bangladesh bank Ltd and Everest Bank Ltd
- To examine the correlation and the signification of their relationship between different ratios related to capital structure

His Research Methodologies are as follows:

The research is analyzed by using different types of tools such as statistical tools and financial tools ie. Earnings per Share, Price Earnings Ratio, Return on Total Assets Return on Share, Holder's Fund or Equity, Arithmetic mean, Standard Deviation Correlation Coefficient, Probable Error and Regression Analysis.

His Major Findings are as follows:

- Therefore, there should be the awareness program, regularly conducted in terms of seminars
- Workshop from well experienced personnel such as top executives from banks and concerned regulating authorities.
- They should introduce novel technology and equipment's to collect deposit.
- His study especially concentrated on the deposit collection of the bank and disbursement of the fund as loan and advances.
- Financial credit worthiness of the borrower must be evaluated properly before granting the loans.

Adhikari, B (2070) has conducted thesis titled "*A Study of Non-Performing Assets of Commercial Banks of Nepal*" with reference to Nepal Bank Limited, Rastriya Banijya Bank, Nepal Bangladesh Bank, Everest Bank and Standard Chartered Bank Nepal Limited. The main objectives of his study are to find out the proportion of nonperforming loan and the level of NPA's in total assets total deposit and total lending, evaluate the relationship between loan and loan loss provision , present the trend line of the NPA, loan and advances, loan loss provision of selected commercial bank.

His Main Objectives are as follows:

- To examine the Evaluating the financial performance of Nepal Bank Limited
- To calculated and analyzed the financial and statistical tools by using secondary and primary data.

His Research Methodologies are as follows:

The research is analyzed by using different types of tools. For this study following statistical tools and financial tools are use such as Loans and advances to Total Risk, Weighted Assets Ratio, Non-performing Loan to Total Loans and advances Ratio, Loan Loss Provision to Non Performing, Loan Ratio Loan Loss Provision to Total Loans and Advances, Arithmetic mean, standard Deviation, Correlation Coefficient, Probable Error, Regression Analysis and Test of Hypothesis.

His Major findings are as follows:

- The collection of deposit and loan investment done by the commercial banks also to sustain themselves in the environment of competitions.
- The deposit funds in productive sectors and to grants more priority to the local manpower.
- Economic development of a country cannot be imagined without the development of commerce and industry
- He has focused on utilization and mobilization of funds and resources of Nepal Bank Ltd.

2.6. Research Gap

The performance of a bank and financial institution is largely affected by the NPA directly and indirectly. Banks main function is to earn profit and the percentage of NPA directly affects the profit margin of the banks. From the review of previous research and study it has been found that increasing nonperforming loan is one of the most challenging problems faced by existing commercial banks in the current scenario. Some researchers have studied on implementation aspects of NRB directives by commercial banks while some other studied non-performing loan and loan loss provisioning of commercial banks. No research has been found on the impact of the non-performing loan and loan loss provision on the performance of commercial banks, required profitability and capital adequacy of commercial banks as per NRB directives. According to the Non Performing loan status of Commercial banks published by NRB, the overall NPL to total gross loan percentage has been decreased from 3.53 in 2066 to 3.01 in mid January 2067. However, if we see individually we can see that some banks NPL to total gross loan% is decreasing while some banks are increasing and some have constant rate. Here in this study we are focusing on the banks whose NPL to total gross loan% are in increasing trend, decreasing trend and constant. The data obtained from this will help us to know and analyze the reason behind the data obtained. Therefore, this research is made to fulfill the research gap by taking the reference of Nepal Investment Bank Limited and Kumari Bank Limited.

CHAPTER-III

RESEARCH METHODOLOGY

3.1 Introduction

Research methodology is the way to solve systematically about the research problem. It is composed of two words, search and methodology which means the process of investigating in values a series of well thought and activates in gathering, recording, analyzing and interpreting the data with the purpose of finding answers to the problem. The entire process by which we attempt to solve the problem is called research while methodology is the method used to list the hypothesis.

Advanced learner's Dictionary of current English defined research as "a careful investigation or inquiry especially through search for new facts in any branch of knowledge". Research is a systematic inquiry of any particular topic and methodology is the method of doing research in well manner. Thus research methodology is a way to solve the problem systematically. It is understood as a science of studying how research is done scientifically. It is analysis of specific topic by a proper method. "Research may be defined as the systematic method of discovering new facts or verifying old facts, their sequences, interrelationship causal explanation and the natural laws which govern them."(P.V. Young).

3.2 Research Design

"Research design is the plan, structure and strategy of investigation conceived so as to obtain answer to research questions and to control variances. The plan is the overall scheme or program of the research." (Kerlinger, 2043: 116).

A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure (Claire Selltiz, 2019:52).

In fact, the research design is the conceptual structure within which research is conducted; it constitutes the blueprint for the collection, measurement and analysis of

data. Decisions regarding what, where, when, how much, by what means concerning an inquiry or a research study constitute a research design. As such the design includes an outline of what the researcher will do from writing the hypothesis and its operational implications to the final analysis of data. Preparation of the research design should be done with great care as any error in it may upset the entire project. Research design, in fact, has a great bearing on the reliability of the result arrived at and as such constitutes the firm foundation of the entire edifice of the research work.

For this study, both field and desk research has been adopted. The fieldwork has been conducted to collect necessary information and published documents from the experts and officials concerned, while deskwork has been conducted to analyze and interpret the information so collected. In order to make the report meaningful and purposeful the following procedural methodology will have been adopted.

3.3 Populations and Sample

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

The population of the present study is listed as under, the commercial banks operating in banking industry of Nepal. As this study is about non-performing loans and profitability of commercial banks, all 30 commercial banks of Nepal is taken into account as population and out of the total population four following commercial banks are selected as sample for this study.

- Nepal Investment Bank Limited
- Kumari Bank Limited

3.4 Data Collection Techniques

Data are collected from various sources were in raw form, which are included the annual financial report of concerned banks, the related publications of NRB and relevant websites of concerned banks. Data are collected using both primary and secondary data. Primary data have been obtained through field visit and telephone inquiries. While secondary data are collected through the annual reports of concerned banks which were collected from concerned banks and other reports were downloaded from websites. Various publications of NRB were collected from concerned department of NRB. Various reports, textbooks, journals and unpublished dissertation have been used for analysis.

3.5 Data Analysis Tools

The data collected from different sources are recorded systematically and identified after collection of research data, an analysis of data and interpretation result are necessary. Applying different financial and statistical tool made data analysis. Further to represent the data in simple form bar diagram and graphs have also been used.

3.5.1 Financial Tools

While adopting financial tools, a ratio is used as a barrack for evaluating the financial position and performance to any firm. Financial analysis is the process of identifying the financial strength and weakness of balance sheet and profit and loss account (Party, 2056: 108).

Financial analysis's the use of financial statement to analyze a company's financial position and performance (Wild, Stemma & Halsey, and 2060:210).

Ratio Analysis

Ratio analysis is a tool for scanning the financial statement of the firm. A ratio analysis is the widely used tool of financial analysis. A ratio is simply one number expressed in terms of another and as such it expresses the numerical or quantitative relationship between two variables. Ratio analysis reflects the relative strengths and weakness of any organization and also indicates the operating and financial growth of the organization.

“Ratio helps to summarize large quantities of financial data and to make quantitative judgment about the firm’s financial performance. The relationship between two accounting figure expressed mathematically is known as financial ratio”. (Pandey. Op cit p.10). Even though there are many ratio, only these ratios have been calculated which are related to the subject matter. Following ratios have been computed and analyzed in this study.

NPA to total lending ratio:

This ratio determines the proportion of nonperforming assets to total lending of the bank. Higher ratio indicates bad effect and decrease in the profitability of the bank and lower ratio indicates better performance and increase in the profitability. It is calculated as under:

$$\text{NPA to total lending ratio} = \frac{\text{Non per forming Assets}}{\text{Total Lending}}$$

Total lending to total deposit ratio:

This ratio determines the proportion of total lending to total deposit ratio. Loans and advances yield high rate of return but liquidity requirements also needs due consideration. Greater ratio implies the better utilization of total deposits and better earning. Hence 70-80% ratio is considered as appropriate. This ratio is calculated as follows:

$$\text{Total lending to total deposit ratio} = \frac{\text{Total Lending}}{\text{Total Deposit}}$$

Net profit to total assets ratio:

This ratio determines the proportion of total net profit to total assets ratio. Higher the ratio indicates the better performance of the bank and lower the ratio indicates low performance of the bank. It is calculated as under:

$$\text{Net profit to total assets ratio} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

3.5.2 Statistical Tools

Statistical tools are the mathematical techniques used to facilitate the analysis and interpretation of numerical data. “Statistical analysis is one particular language, which describes the data and makes possible to talk about the relations and the difference of the variables”. Following statistical tools have been used in this study.

3.5.2.1 Arithmetic Mean

The arithmetic mean or simple mean of a set of observation is the sum of all the observation divided by the number of observation. It is the best possible value of a group of variables that singly represents to whole group. In the statistical analysis the central value falls within the approximately middle value of the whole data. Mean is the arithmetic average of a variable. Arithmetic mean of a series is given by:

$$\text{Mean} = \frac{\sum X}{N}$$

3.5.2.2: Correlation Analysis:

Correlation is a statistical tool that can be used to describe the degree of linear relationship of one variable to other variables. Correlation analysis is another important tool of statistic. It describes the relationship between variables and shows the degree of dependency of one variable with another variable. Two variables are said to be correlated when the change in one variable result in change in other variables. There are five types of correlation coefficient which are Positive correlation, negative correlation, linear correlation, non-linear or partial correlation and multiple correlations. The coefficient of correlation measures the linear association between variable. Different models for correlation analysis has been formulated and we have used Karl Pearson’s coefficient of correlation to determine the relationship between variables studied.

Probable error of correlation coefficient is an old measure for testing the reliability of an observed correlation coefficient. If $r < P.E.$, there is no evidence of correlation i.e. correlation is not significant. If $r > P.E.$, there is evidence of significant i.e. correlation is significant.

Coefficient of Correlation (r_{xy}):

$$r = \frac{n\sum XY - \sum X \cdot \sum Y}{\sqrt{n \sum x^2 - (\sum X)^2} \times \sqrt{n \sum Y^2 - (\sum Y)^2}}$$

The Karl Pearson Coefficient always falls between -1 to +1. The value of correlation in negative signifies, the negative correlation and in plus signifies the positive correlation. If,

$r = 0$, there is no relationship between the variables.

$r < 0$, there is negative relationship between the variables.

$r > 0$, there is positive relationship between the variables.

$r = +1$, the relation is perfectly positive.

$r = -1$, the relation is perfectly negative.

CHAPTER- IV

DATA PRESENTATION AND ANALYSIS

Simple percentage is used to analyze the data as arithmetic tools. Karl's Pearson's correlation coefficient is used to analyze the data as statistical tool. Nowadays Non-Performing Assets/Loan (NPA/L) has been occupying major space in the total assets and total lending of the bank. Keeping this fact into consideration, a provision has been set up by Nepal Rastra Bank to control the level of NPA of Nepalese Commercial Banks in FY 2057/58. According to that provision, every bank has to classify its total loan and advances [including purchased and discounted bills] as pass loan, substandard loan, doubtful loan and bad loan, on the basis of overdue aging schedule. Commercial Banks are also directed to maintain loan loss provision as stated in section 11 of directives No. 2 of NRB's directives for Commercial Banks 2059. Main purpose was to find out the level of NPA in Nepalese Commercial Banks and to take necessary steps to control the level in future. Data of five FY starting from FY 2065/66 to 2069/070 have been presented to analyze the level of NPA in total assets, total lending and total deposits of the commercial banks. Data are also presented to analyze the effects to NPA on the profitability of the banks under the study.

4.1 Data presentation and analysis of sample banks

A) Nepal Investment Bank Limited (NIBL)

Table: 4.1

Relation between NPA, Net profit, Total Lending and Total deposits (NIBL)

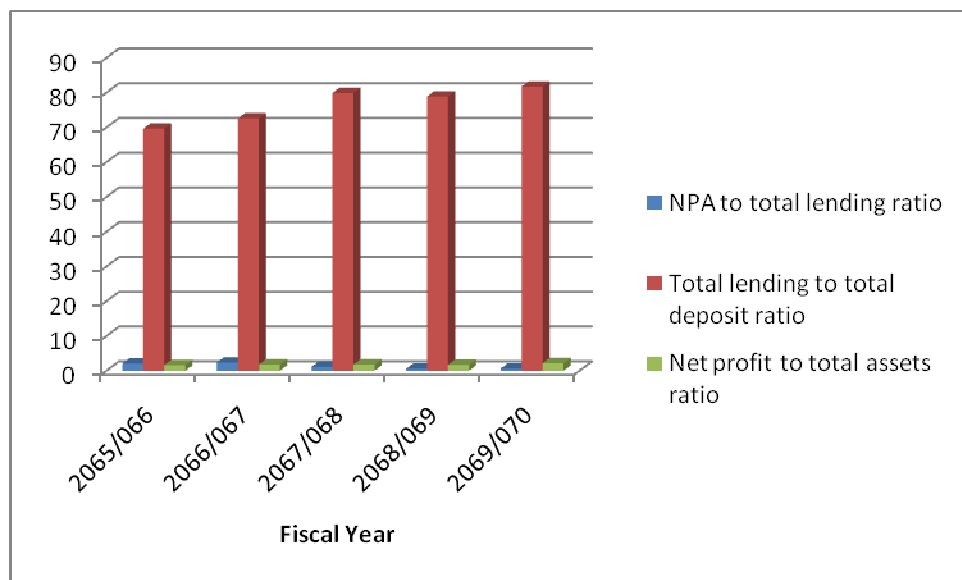
Year/Ratios	2065/066	2066/067	2067/068	2068/069	2069/070
NPA to total lending ratio	2.07	2.37	1.12	0.58	0.62
Total lending to total deposit ratio	69.63	72.56	79.91	78.86	81.74
Net profit to total assets ratio	1.61	1.79	1.77	1.68	2.19

Source: Annual reports of FY: 2065-2070

The table 4.1 shows the relationship between NPA, net profit, total lending and total deposit. The NPA to total lending ratio in FY 2065/066 is 2.07% and in FY 2069/070 NPA is 0.62%. In the FY 2066/067 it is 2.37% which is increasing and in FY 2067/068 to 2068/069 NPA is decreasing from 1.12% to 0.58% respectively. The total lending to total deposit ratio has been constantly increasing. In FY 2065/066 total lending was 69.63% which increased every year and in FY 2069/070 total lending reach to 81.74%.The net profit to total assets ratio is not constant. In the FY 2067/068 net profit is 1.77% and in FY 2068/069 net profit is 1.68% which is decreasing in comparison to the previous year 2066/067 which is 1.79%. But in the FY 2069/070 net profit has increased to 2.19%.This shows the profit is in increasing trend.

Figure: 4.1

Level of NPA, ROA & Loan-Deposit Ratio of NIBL



Source: Table: 4.1

The figure 4.1 shows the trend line of NPA, total lending and net profit of NIBL bank. Total lending to total deposit ratio is increasing till year 2067/068 and again decreasing and then increasing in FY 2069/070. NPA to total lending ratio is decreasing and slightly increasing in FY 2069/070. The net profit to total asset is also increasing except in the FY 2068/069.

Table: 4.2

Total Assets, Total Deposits, Total Lending and Total NPA (NIBL)

(In millions)

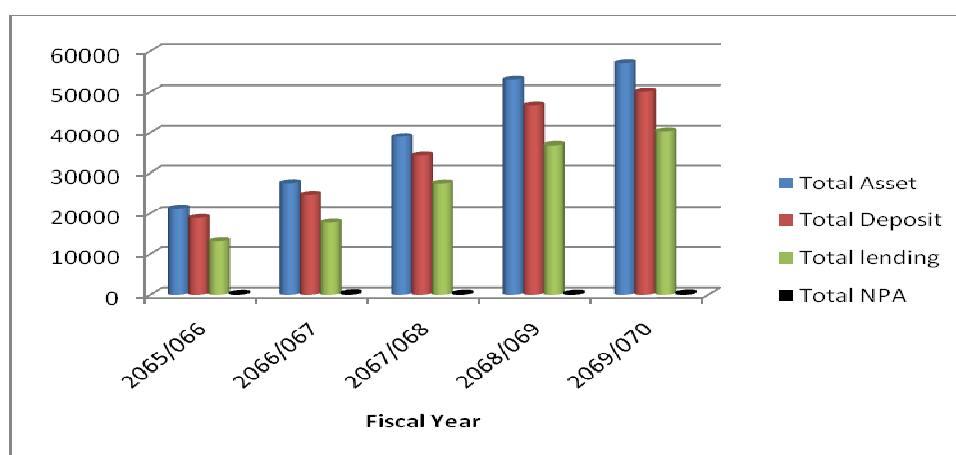
Fiscal Year	Total Asset	Total Deposit	Total lending	Total NPA
2065/066	21330	18927	13178	272
2066/067	27591	24489	17769	422
2067/068	38873	34452	27529	309
2068/069	53011	46698	36827	307
2069/070	57305	50095	40319	355

Source: Annual Reports of FY 2065/66-2069/70

The table 4.2 gives the information on total asset, total deposit, total lending and total NPA of NIBL bank. The total asset has been increasing at a faster rate. It was 21330m in the FY 2065/066 and has reached to 57305m in the FY 2069/070. The total deposit of the bank has also been increasing. It was 18927m in the fiscal year 2065/066. Till the FY 2069/070 the deposit has reached to 50095m. This shows the interest of public in the bank. The total lending of the bank also has been increasing. It was 13178m in the FY 2065/066 which increased continuously and reached to 40319m in the FY 2069/070. The level of NPA is fluctuating. It increased and reached to 422m in FY 2066/067. The level of NPA from then has been decreasing till FY 2068/069 to 307m. Again the NPA has increased to 355m in FY 2069/070.

Figure: 4.2

Graphical Representation of TA, TD, TL and TNPA (NIBL)



Source: Table: 4.2

The figure 4.5 shows the relationship between total asset, deposit, lending and total NPA of the corresponding years. The total asset of the bank has been increasing tremendously. Similarly the total deposit and total lending of the bank are also increasing. There is fluctuation in the level of NPA which is highest in the FY 2069/070.

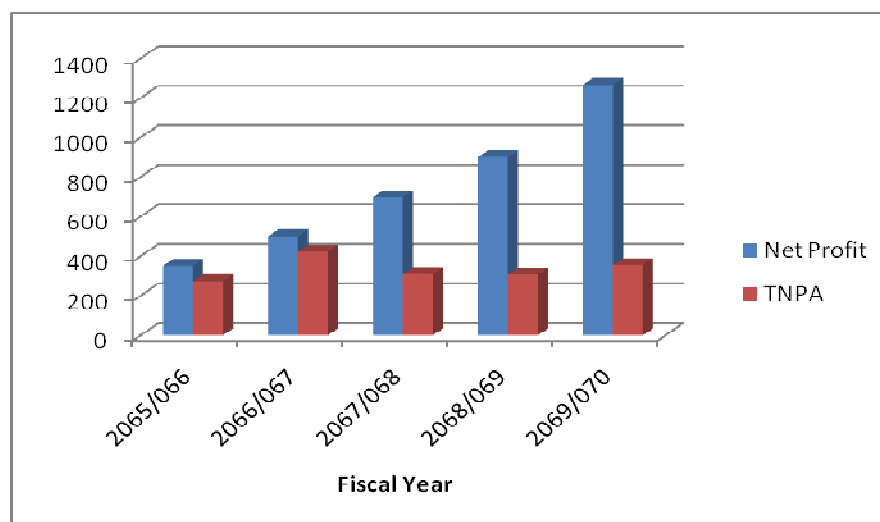
Table: 4.3
Net Profit and Total NPA (NIBL)
(In millions)

Fiscal Year	Net Profit	TNPA
2065/066	351	273
2066/067	501	422
2067/068	697	309
2068/069	901	307
2069/070	1266	355

Source: Annual reports of FY: 2065-2070

The table 4.3 gives the information on the net profit and TNPA of NIBL. The net profit in FY 2065/066 is 351m which increased about 4 times and reached to 1266 m in FY 2069/070. The NPA is fluctuating in the 5 year period. It has increased than the previous year's which shows the measures of bank to balance level of NPA is not satisfactory.

Figure: 4.3
Graphical Representation of Net Profit and TNPA (NIBL)



Source: Table: 4.3

The figure 4.3 displays relation of level of net profit and NPA in the 5 year period. The total profit is in the increasing trend which is 3 times in FY 2069/070 than FY 2065/066. The total NPA is highest in FY 2066/067. The NPA is fluctuating.

C) Kumari Bank Limited (KBL)

Table: 4.4

Relation between NPA, Net profit, Total Lending and Total deposits (KBL)

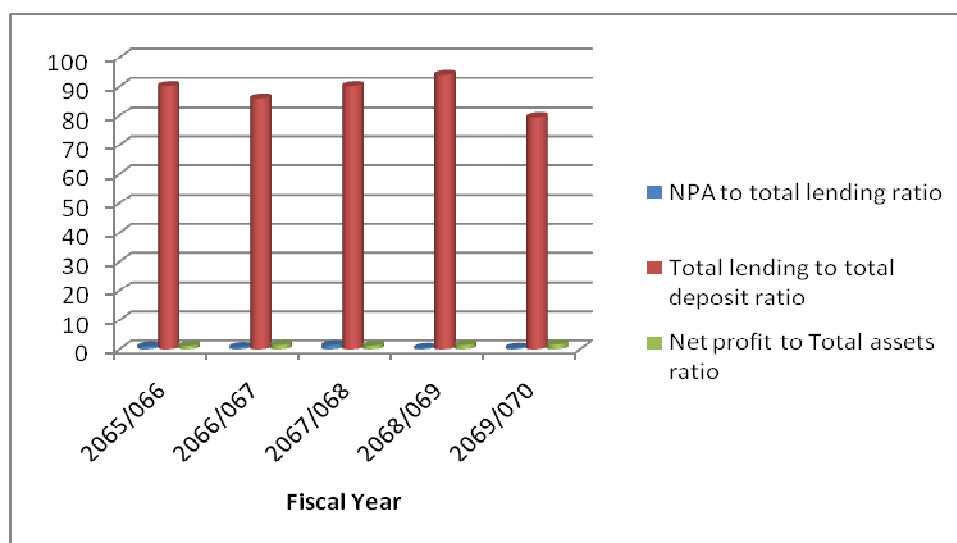
Year/Ratios	2065/066	2066/067	2067/068	2068/069	2069/070
NPA to total lending ratio	0.92	0.73	1.32	0.44	0.50
Total lending to total deposit ratio	90.20	85.84	90.20	94.17	79.45
Net profit to Total assets ratio	1.15	1.43	1.16	1.41	1.59

Source: Annual reports of FY: 2065-2070

The table 4.4 shows the relationship between the NPA, net profit, total lending and total deposit of Kumari Bank Limited. The NPA to total lending ratio is in decreasing trend except in the FY 2067/068 which has increased the highest at 1.32%. Then NPA has been constantly decreasing reaching 0.50 % in the FY 2069/070. The total lending to total deposit ratio is fluctuating. It has reached maximum in the year 2068/069 at 94.17% and has decreased to 79.45% in the fiscal year 79.45%. Similarly, the net profit to total asset ratio is also in fluctuating. Net profit has decreased in the FY 2067/068 at 1.16% and has reached maximum in the FY 2069/070 at 1.59%.

Figure: 4.4

Level of NPA, ROA & Loan-Deposit Ratio (KBL)



Source: Table: 4.4

The figure 4.4 shows the trend line of NPA, total lending and net profit of KBL. The total lending to total deposit ratio is fluctuating. It has decreased in FY 2066/067 and FY 2069/070. NPA to total lending ratio is also fluctuating which is maximum in FY 2067/068 and minimum in FY 2068/069. Net profit to total asset ratio is also maximum in the FY 2069/070 which is a positive indicator of the bank.

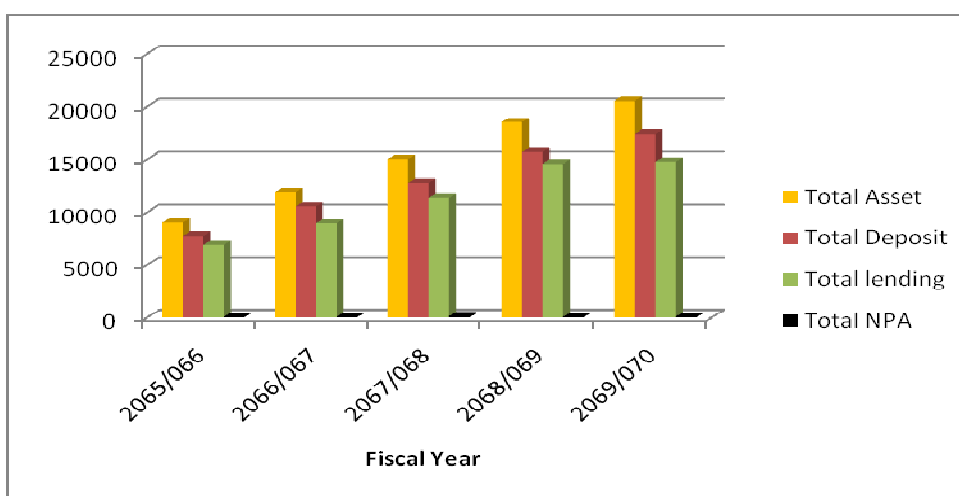
Table: 4.5
Total Assets, Total Deposits, Total Lending and Total NPA (KBL)
(In millions)

Fiscal Year	Total Asset	Total Deposit	Total lending	Total NPA
2065/066	9010	7769	6892	64
2066/067	11918	10557	8929	66
2067/068	15036	12780	11335	152
2068/069	18538	15710	14593	64
2069/070	20522	17432	14765	75

Source: Annual Reports of FY 2065/66-2069/70

The table 4.5 gives the information on the total asset, total deposit, total lending and total NPA of KBL. The total asset is in increasing trend. It was 9010 m in FY 2065/066 and reached to 20522 m in the FY 2069/070. The total deposit has also been increasing from 7769 m in the FY 2065/066 to 17432 m in FY 2069/070. The total lending also has been increasing tremendously reaching 14764 m in FY 2069/070. There is variation in the level of NPA. It reached maximum in FY 2067/068 at 152 m. In FY 2068/069 it decreased to 64m and again increased to 75m in FY 2069/070.

Figure: 4.5
Graphical Representation of TA, TD, TL and TNPA (KBL)



Source: Table: 4.5

The figure 4.5 displays the information on the total asset, total deposit, total lending and total NPA of KBL. The total asset is in the increasing trend. The total deposit is also in the increasing trend. The total lending is also increasing continuously whereas total NPA is decreasing except in the FY 2067/068.

Table: 4.6
Net Profit and Total NPA (KBL)

(In million)

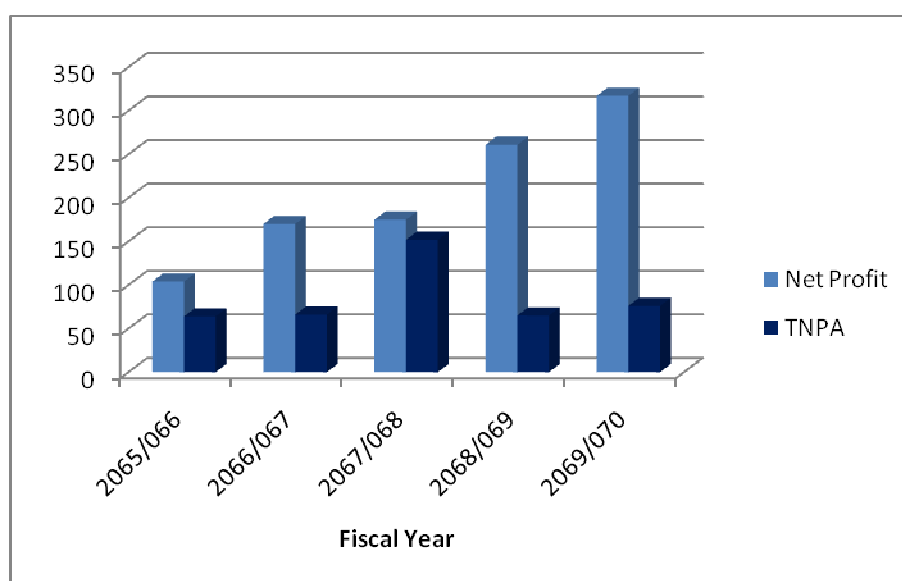
Fiscal Year	Net Profit	TNPA
2065/066	104	64
2066/067	170	66
2067/068	175	152
2068/069	261	65
2069/070	317	76

Source: Annual reports of FY: 2065-2070

The table 4.6 gives information about net profit and NPA. The net profit in FY 2065/066 is 104 m which increased 3 times and reached to 317 m in the FY 2069/070. The total NPA in FY 2065/066 is 64 m which increased to 152 m in FY 2067/068. Then NPA again decreased in following year. The NPA again increased and reached to 76 m in FY 2069/070

Figure: 4.6

Graphical Representation of Net Profit and TNPA (KBL)



Source: Table: 4.6

The net profit from the figure 4.6 has been increasing tremendously. It has reached to 3 times in FY 2069/070 than in FY 2065/066. The level of NPA is fluctuating. It is highest in FY 2067/068. The NPA is higher than previous year in FY 2069/070.

4.2 Correlation Analysis

Correlation Analysis generally used to describe the degree to which one variable is related to another, in statistics is used in order to depict the co-variance between two or more variables. It helps to determine whether:

- A positive or negative relation exists
- The relation is significant or insignificant
- Establishes cause and effect relation if any.

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

Table: 4.7
Correlation between NPA to total lending and NP to total assets

Banks	Coefficient of correlation(r)	Relation-ship	Coefficient of determination (r²)	6 (Prob. Error)	Significant/ Insignificant
NIBL	-0.4682	Negative	0.22	1.4124	Insignificant
KBL	-0.8266	Negative	0.6832	0.5787	Significant

Source: Annexure: i

The table 4.7 shows the correlation coefficient between the Non Performing Assets to total lending to NP to total assets of the sample banks. Only the NIBL bank has a positive relation between the NPA and ROA.20% of the relationship is affected by the NPA and 80% is affected by the other factors. NIBL has insignificant relationship since the value of r i.e. 0.45 is less than the value of 6 times P.E. i.e. 1.449.KBL has a high degree of negative relation between the two variables which is -0.8266. 68.32% of profitability is affected by the NPA of the bank and remaining 31.68% is affected

by the other factors. The test made for this bank is significant since t P.E. is less than the value of 't'. Similarly, NIBL bank also has a negative relationship between the variables. Only 22% of NIBL bank is affected by the NPA and remaining 65.99% and 78% of the bank is affected by the other factors. The value of t P.E. is 1.4124 of NIBL banks respectively which is more than the value of t. this shows that they have insignificant relationship between them.

From the above calculations, we can conclude that the profitability of the individual bank is fully dependent in the Non-Performing Assets of the respective banks. Higher the NPA lower will be the Net Profit and vice-versa.

Table: 4.8

Correlation between NPA and total lending of bank

Banks	Coefficient of correlation(r)	Relation-ship	Coefficient of determination (r²)	t (Prob. Error)	Significant/ Insignificant
NIBL	0.0171	Positive	0.0003	2.6820	Insignificant
KBL	0.0748	positive	0.0056	1.7820	Insignificant

Source: Annexure: ii

The table 4.8 presented shows the relationship between the total lending and the total NPA of the different commercial banks under study. It shows how much is NPA related with the lending of the bank. The NIBL bank has a high degree of positive relation between the two variables i.e.0.81. This shows that whenever the total lending of the bank goes on increasing the total NPA of the bank also goes on increasing. And this particular factor affects the NPA by 65.61% and the remaining 34.39% is caused by other factors. And the result is also significant since t P.E. is less than the value of correlation. Similarly, the table 4.11 also shows that the correlation of the NIBL and KBL to be 0.0171 and 0.0748, a low degree positive correlation. This shows that whenever the total lending of the bank goes on increasing the NPA of the bank also goes on increasing. But this factor affects only by 0.03% and by 0.56% and remaining 99.97% and 99.44% is affected by the other factors. And the result is insignificant

since the value of P.E. multiplied by 6 is more than the value of coefficient of correlation.

Table: 4.9
Correlation between NPA of the bank and total NPA population

Banks	Coefficient of correlation (r)	Relation-ship	Coefficient of determination (r²)	6(Prob. Error)	Significant/ Insignificant
NIBL	0.0783	Positive	0.0061	2.6922	Insignificant
KBL	0.1189	positive	0.0141	2.6703	Insignificant

Source: Annexure: iii

The table 4.9 shows the relationship between the Non-Performing Assets of the sample Banks with that of the total population i.e. all the twenty five commercial banks of the industry. The theory suggests that whenever the NPA of the individual bank goes on increasing there will be corresponding movement in the NPA of the population too. The table 4.12 shows NIBL and KBL correlation value is 0.0783 and 0.1189 respectively having a low degree of positive relation between the variables. This shows whenever the NPA value of individual bank goes on increasing the NPA of the population also goes on increasing. This is affected by 0.61% and 1.41% and remaining 99.39% and 98.59% is affected by the other factors of NIBL and KBL respectively.

4.4 Major findings

The study is fully based on the secondary data of related banks. From the data analysis of concerned banks, the major things, which has been finding are as follows.

- The relationship between the NPA, net profit, total lending and total deposit of Kumari Bank Limited. The NPA to total lending ratio is in decreasing trend except in the FY 2067/068 which has increased the highest at 1.32%. Then NPA has been constantly decreasing reaching 0.50 % in the FY 2069/070. The total lending to total deposit ratio is fluctuating.
- The total asset has been increasing at a faster rate. It was 21330m in the FY 2065/066 and has reached to 57305 m in the FY 2069/070. The total deposit of the bank has also been increasing.

- It has reached maximum in the year 2068/069 at 94.17% and has decreased to 79.45% in the fiscal year 79.45%. Similarly, the net profit to total asset ratio is also in fluctuating. Net profit has decreased in the FY 2067/068 at 1.16% and has reached maximum in the FY 2069/070 at 1.59%.
- The net profit to total assets ratio is not constant. In the FY 2067/068 net profit is 1.77% and in FY 2068/069 net profit is 1.68% which is decreasing in comparison to the previous year 2066/067 which is 1.79%. But in the FY 2069/070 net profit has increased to 2.19%. This shows the profit is in increasing trend.
- The net profit in FY 2065/066 is 351m which increased about 4 times and reached to 1266 m in FY 2069/070. The NPA is fluctuating in the 5 year period.

The NPA to total lending of this bank is fluctuating which is low in the FY 2069/070 at 0.62. The total lending to total deposit ratio is in the increasing trend which is highest in the FY 2069/070 at 81.74. The total profit to total asset ratio is also in the increasing trend which is maximum in the FY 2069/070 at 2.19.

- The total asset, total deposit, total lending and the net profit all are in the increasing trend of this bank. The total NPA of this bank is fluctuating and has reach to 355 in the FY 2069/070 from 272 in the FY 2065/066. The findings from correlation shows that it has positive relationship between the variables as well as insignificant correlation between the NPA to total lending of banks and between NPA of the bank and total NPA population. But it has negative relationship and insignificant correlation between the NPA to ROA of the bank.
- The total level of NPA was maximum in the FY 2067/068 at 152 which decreased and reached to 75 in the FY 2069/070. The net profit of this bank has also been increased tremendously.
- The correlation analysis shows that there is positive relationship and insignificant correlation between NPA of the bank and total NPA population and between NPA and total lending of banks. The correlation is insignificant and is negative between the NPA to total lending and NP to total assets.

- The NPA to total lending ratio is fluctuating which is low in the FY 2069/070 at 0.50. The total lending to total deposit ratio is also fluctuating which is also low in the FY 2069/070 at 79.45.
- The Net profit to total asset ratio is also in the fluctuating trend which is high in the FY 2069/070 at 1.59. The total asset, total deposit, total lending of this bank is in the increasing trend in the 5 year period.
- The test made for this bank is significant since 6 P.E. is less than the value of 'r'. Similarly, NIBL bank also has a negative relationship between the variables. Only 22% of NIBL bank is affected by the NPA and remaining 65.99% and 78% of the bank is affected by the other factors.
- The value of 6P.E. is 1.4124 of NIBL banks respectively which is more than the value of r. this shows that they have insignificant relationship between them.

CHAPTER- V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter attempts to summarize the whole study and findings, makes general conclusions based on the finding presented in previous chapter and also suggests some recommendations based on the result of the analysis of data.

5.1 Summary

This research is aimed at studying about the non-performing assets and profitability of commercial banks in Nepal. In first chapter the study dealt about basic assumption of the study. Basically it highlights the concept and importance or significance of the study. It also presents research issues, research problems, and basic objectives of the study, rationality of the study, limitation of the study and organizational structure of the study. Second chapter helped to provide knowledge about the development and progress made by the earlier researcher on the concerned field or topic of the study. It also tried to know the some concept used in this study. Moreover, it reviewed and summarized the finding of the previous findings of the study to provide knowledge about the background of the work done by them and to stop the duplicate of previous work. Third chapter of the study discussed about the various research methodologies used for the study. Basically, research methodology here signifies the research design, sources of data, population and sample of data, data collection technique, data collection methods and tools and techniques employed etc. for this purpose descriptive cum analytical research design was adopted. Out of total population of 30 commercial banks, two banks were taken as sample using judgmental sampling method. The two major commercial banks are NIBL and KBL. Secondary data have been used in the study, annual reports and other publications from the basis of secondary data. Beside this newspaper, relevant thesis, journals, articles, related websites etc. are also taken for this research. The data collected from various sources are recorded systematically and presented in appropriate forms of tables and charts and appropriate mathematical, statistical, financial, graphical tools have been applied to analyze the data. The data of five consecutive years of two selected banks have been analyzed to meet the objectives of the study.

Fourth chapter of the study dealt about data presentation and analysis. It first presents the generated data in tabular form of and analyzed them in systematically as per the objectives. The researcher tried to analyze the comparative position of bank in term of non-performing asset and its profitability and its impact on relative variables. Detail of the findings can be presented as follows.

Financial sector have major role to play in the development of the country. A Commercial Bank deals with exchanging currency, accepts deposits, give loans and does other various commercial transactions. Therefore, the major function of commercial bank is to accept deposits and provide loans. There is not so long history of commercial banks in Nepal. Nepal bank limited is the first bank in Nepal, established in 30th Kartik, 1994. But now there are 30 commercial bank as per Nepal Rastra bank, banking and financial statistics, and mid-July 2066 which extend their services in different part of the country. The successful working of the banks depends on ability of the management to distribute the fund among the various kind of investment known as loans and advance. Loan and advance are the most profitable assets of a bank. These assets constitute primary sources of income to the bank. As being a business institution a banks aims at making huge profit since loans and advances are more profitable than any other assets of the banks, it is willing to lend as much as its funds as possible. But bank has to be careful about the repayment of loan and interest before giving loan. If a bank is too timid, it may fail to obtain the adequate return on the fund, which is confined to it for use. Similarly, if the bank is too liberal, it may easily impair its profits by bad debts. Therefore, banks should not forget the reality that most of the bank failures in the world are due to shrinkage in the value of the loan and advances. Escalating level of NPA's has been becoming great problem in banking business in the world. In this context, Nepal cannot be run off from this situation. The level of NPA in Nepalese banking business is very alarming. It is well known fact that the bank and financial institution in Nepal have been facing the problem of swelling non-performing assets and the issue is becoming more and more unmanageable day by day. We are well known from different financial reports, newspapers and news that the total NPA in Nepalese banking system is about 30 Billion (Nepal Rastra Bank, 2005: 45), while it is very worse in case of two largest commercial banks RBB and NBL.

Therefore, this study is concerned to find out the level of NPA and its effects on the return on assets and the other factors of the Nepalese commercial banks. Finally, summary and conclusion and various suggestions were described in this chapter. It drew the conclusion from the findings of the study and explained the summary of research paper. Besides, it also provides various suggestions to give further improvement.

5.2. Conclusion

Nepalese banking industry is faced with variety of serious challenges, the prominent being the management of large volume of non-performing loans and the development of corporate values and ethics among the stake holders in the banking industry. There is already a stiff competition between the market players and the possibility of entry of new players is going to further add to the pressure. So in such a scenario, stakeholders including NRB have to be vigilant that banks do not compromise on the prudent risk management practices in order to survive the competition, which might ultimately lead to the bank failure. At the same time, NRB has to keep tight vigil in the banking industry so as to be take corrective measures in creating and maintaining a stable and a sound banking industry. Among the two sample banks taken under study, KBL has the lowest amount of NPA which is in increasing trend in the 5 year study period.

- KBL and NIBL's NPA is also in the increasing trend. The Correlation coefficient between NPA and ROA mostly came out to be negative except for NIBL. This shows that increase in profitability is affected by the amount on Non Performing Assets.
- These finding supports the theory that, higher the NPA lower will be the ROA and vice-versa. But in the case of KBL higher the NPA higher the ROA will be. The result is insignificant in this which means that there is little or no relation between NPA and ROA in the progression or digression in their values.
- The positive relation shows that when NPA increases the total NPA population also increases and vice-versa. Finally, the test of hypothesis between NPA and Total Lending of the banks is found true. Thus there is a

significance relation between these two variable are significant. On the other hand the test of hypothesis between NPA and that of population is found acceptable.

- This shows that there is a significance relation between two. That is every raise or fall in the NPA of sample banks has also effect in the NPA of the total population.

5.3 Recommendation

Recommendation refers to the suggestive measures derived from the findings of the study. High level of non-performing assets not only decreases the profitability of the banks but also affect the entire financial as well as operational health of the country. If the NPA were not controlled immediately, it would be proved as a curse for the banks in near future. Poor corporate governance and risk management practices are the key reasons for high level of NPL in our banking system. Other causes are economic slowdown, legal hurdles in recovery and poor quality of credit information. Management practices in many banks are still very weak, particularly in the areas of credit analysis, credit administration and risk management and internal control system. Hence, the management of NPL is a great challenge for the Nepalese banking sector. It is high time that we start strengthening and reshaping the reform process. Following are some of the recommendations, which will help to reduce the level of NPA of the Nepalese commercial banks. The NPA of the bank has the direct effect on its profitability. More the NPA of the bank the less will be its profitability. Those banks, which have high level of NPA, should take necessary action towards recovering their bad loans as soon as possible. It is recommended that KBL NIBL make serious action to recover the bad loan and also should make curative action for new loans from turning them into NPA from now. Hiring assets management company (AMC) is recommended to both of them to reduce the current non-performing assets. When bankers give loan, he should analyze the purpose of the loan. To ensure safety and liquidity, banks should grant loan for productive purpose only. Bank should analyze the profitability, viability, long term acceptability of the project while financing. Poor credit appraisal is another factor for the rise in NPA's. 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 NPA's. The increase in

the volume of Total Lending is not the reason in decrease of NPA or increment of the profitability of the banks.

- As seen the case of NIBL and KBL there has been increase in the level of NPA even there Total Lending has increased. This is due the effect of the bad loans provided by the banks.
- Loan must be given only if the banker is satisfied that the borrower can repay money from the cash flow generated from operating activities. However, the banks want to ensure that their loan is repaid even in case of failure of business.
- To protect banks from such happenings, the banks take collateral from the borrower so that in the event of default this collateral is disposed for the recovery of loan. Therefore, banks should take enough collateral so that the Bank at least will be able to recover its principal and interest amount in case of failure of the borrower to repay the loan.
- Being loan a risky asset, efforts should be made to have proper control in every steps of loan management. The banks should establish separate department for credit appraisal, documentation, disbursement, rapport building, inspection and recovery of loan which have possibility of finding mistakes of one department by the others, so that the effectiveness can be achieved.
- Lack of proper financial analysis of the borrower by the banks, is one of the major cause behind increasing NPA of Nepalese commercial banks. Therefore, proper financial analysis should be performed before giving loan to the borrower.
- The banker should always select the borrower very carefully and should take tangible assets as security to safe guards its interests. When accepting securities banks should consider the market ability, acceptability, safety and transferability.
- It is also recommended that banks and financial institution should demand support from government to recover from the bad loans specially created because of willful defaulters. Political influences in the loan disbursement should be avoided as it may lead to worse condition to the bank as it may

increase the non-performing loan of the bank. Regulations must incorporate a contextual perspective (like temporary cash flow problems) and clients should be handled in a manner which reflects true value of their assets and future potential to pay. The top management should delegate authority and back decisions of this kind taken by middle level managers.

- There have been instances of banks extending credit to doubtful debtors (who willfully default on debt) and getting kickbacks for the same. Ineffective Legal mechanisms and inadequate internal control mechanisms have made this problem grow – quick action has to be taken on both counts so that both the defaulters and the authorizing officer are punished heavily. Without this, all the mechanisms suggested above may prove to be ineffective.
- 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. The following factors also play a significant role in controlling the NPA structure of the commercial banks in Nepal. Following the updated directives of NRB and acting upon it also reduce many of the credit risk.
- Beside there are penalty implication and non-compliance of the directives. Hence all the two banks are recommended to follow the directives and they are also suggested to come up with stronger internal audit department to ensure that the directives are properly implemented.
- The banks should be a watch dog of its economy as well as the effect of changes in the international market to its credit customers. The amount involved in non-performing loans may rise considerably as a result of less predictable incidents, such as when the costs of fuel, prices of key export products, foreign exchange rates or interest rates change abruptly. For example fall in the prices of loan collaterals (often real estate) may cause more loans to become classified as doubtful.

- Control mechanism of the bank should be managed properly. Black listed customers should not be given the new loan, as it would lead to the same situation to the bank. Likewise, it is often said “prevention is better than cure”. Hence it is recommended for all the two banks to take preventive measures before the loan goes to default.
- All the banks are recommended to have an information system to gather all the possible information about its borrowers so that necessary precautions can be taken in time. Proper management auditing system should be implemented to monitor the overall performance of the bank. Regular monitoring by both the internal and external (NRB auditors and private Co. auditors) auditors is most. No work can be success without proper management. It is recommended to initiate training and development program for the employees to make them efficient and professional in credit appraisal, monitoring and proper risk management.