CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Financial intermediaries mobilize savings fund from savers to borrowers in order to finance productive activities. Financial intermediaries are essential in the economic prosperity of the nation. There are different types of financial intermediaries or financial institutions such as Commercial Banks, Development Banks, Finance Companies, Cooperatives, etc. Among all those institution, the commercial banks are the key players in the economy of the country. Banks play very important role in the economic life of the nation. The health of the economy is closely related to the soundness of its banking system. Although banks create no new wealth but their borrowing, lending and related activities facilitate the process of production, distribution, exchange and consumption of wealth. Today, modern banks are very useful for the utilization of the resources of the country. The banks are mobilizing the savings of the people for the investment purposes. The savings are encouraged and saving rate increases. Loan facility provided by banks works as an incentive to the producer to increase the production or promote business. If the banking system in a country is effective, efficient and disciplined it brings about a rapid growth in the various sectors of the economy. There are numerous services provided by commercial banks like accepting deposit, providing financial securities, granting loan, money exchanges, financial consultancy, and fund transfer. However commercial banks are facing some challenges such as deposit war, continued need for profit making, Era of fierce competition, customer satisfaction and change in technology.

The commercial bank collects money from the surplus sector and gives to the deficit sector. While collecting money from surplus sector bank gives the guarantee of repayment of money as well as certain amount as interest. On the other hand while giving money to the deficit sector as a loan, it will charge certain percent as interest which is greater than the paid to saver. A loan is an asset for a bank as the interest payments and the repayment of the principal create a stream of cash flows. It is from the interest payments than a bank makes its profits. Success of any bank depends upon the quality of loan. The mushrooming growth of the banks has led them towards cutthroat competition. If the bank fails to collect principal and interest on certain time, there would be created credit risk or default risk. Bank has hard to achieve cash flow. Furthermore, non-performing assets are those loans, which neither pay interest nor repay principal.

There is risk of non repayment of loan. The bank faces number of risk like interest rate risk, liquidity risk, credit risk, borrower risk etc. Such risk in excessive form may sometimes results in the banks inability to make repayment of money to the depositor and return to the shareholders. The risk involved is so high that it can bring bank to a verge of bankruptcy. In this cut throat competition age, amongst many risk that bank faces one of the critical is borrower risk: the risk of non payment of the disbursed loans. Non-performing is the outdated, bad debts and doubtful debts. Nonperforming assets have included non performing loan. Performing loans have multiple benefits in the other hand non-performing assets erodes even capital and profit.

There may be various reasons behind the loans that turn irregular from regular one. The main reason may economic situation of the country which has global and far reaching impact. The smooth operation of the commercial banks is possible only when the economy of the country functions well. Satisfactory level of return on investment is the prerequisite for the financial sector to be groomed. The other contributing factors that turn the good loan into bad are attitude of the borrower, types and quality of security taken and legal hurdles created by the borrower when the recovery action is started. Once the distributed loan is not returned timely by clients and becomes overdue than it is known as NPA for the banks. Banks usually treat assets as non-performing if they are not serviced for some time. If payments are late for a short time a loan is classified as past due. Once a payment becomes really late (usually 90 days) the loan classified as non-performing assets. Reduction of NPA has always been a significant problem for every commercial banks and proper attention for the management of the NPA under top priority. Due to various hurdles on way of management of NPA, commercial banks are now losing their profitability and struggling for their existence. The assets which cannot be used productively regarding the objective is called Non-performing asset. The resources locked up in NPA are borrowed at a cost and have to earn a minimum return to service this cost. NPA bring down the profits, affects the shareholder value and thus adversely affect the investor confidence. Non-performing loan means an outstanding loan that is neither payment interest nor principal. The term NPA means the loans and advances that are non performing well. Thus all the irregular loans and advances can be termed as NPA.

Nepal Rastra Bank has just enacted the debt recovery act approved the long waited regulation on debt recovery to speed up the financial reforms in the financial sector. Under this provision a bank is required to classify their loan and advances on the basis of overdue aging schedule. Affecting internal and external factors for the conversion of NPA shall be another area to be intended to focus under this study. For the analyzing of the cause and impacts of NPA of six private banks shall be taken into consideration.

1.2 Focus of Study

The research is based on the analysis of NPA on profitability of commercial banks. Recently, many Nepalese commercial banks are facing huge amount of Non Performing Assets. Banks should minimize NPA level to achieve their financial mission.

NPA also known as bad debt. However NPA in term of banking sector consists of those loans and advances which are not performing well and likely to be turn as bad loan. Due to adverse economic situation of the country and perception build up among the people that the properties under auction are always over evaluated there is less participation of the bidder during auction. Such situation compels the bank to accept the security on its own name. Continuous acceptance of the ownership has now created another problem by pilling up the volume of Non Banking Assets (NBA). As the major chunk of NBA are fixed in nature the fund supposed to be rolled over are being tied up on fixed assets which is heating the liquidity of the banks.

Government owned banks have huge amount of NPA level with comparison to private banks. This research also focused causes, impact and remedies of burning problem of NPA level with the help of secondary data analysis. In the same way the study will also be focused on non performing assets regarding made in the past five years of six sample commercial banks.

1.3 Statement of Problem

The commercial banks give loans to the deprived sectors and the loan receiver is entitled to pay the interest and the principal amount on time. In reality, all loans are not recovered as per the sanction or within the expiry of repayment period is classified loan as NPA. The study has identified the following research questions regarding to NPA with special reference to six selected bank.

a. What is the trend and level of NPA to the loan and advance of the commercial banks of Nepal?

b. What are the relationship between the profitability and the Non Performing Assets to the Loan and Advances of commercial bank?

c. What are the cause and consequence of NPA on the profitability of the commercial bank?

d. What is the position of NPA of Nepalese commercial banks with compare to international standard?

1.4 Objectives of the Study

The main objective of this research is to analyze and identify cause and consequence of NPA in the loan and advances of the commercial banks of Nepal. The specific objectives of this research are as follows.

a. To study and examine the trend and level of Non Performing Assets to the loan and advance of the Commercial banks of Nepal.

b. To evaluate the relationship between the profitability and the Non Performing Assets to the Loan and Advances.

c. To analyze the cause and consequences of Non Performing Assets on profitability of the commercial bank.

d. To study the position of NPA of Nepalese commercial banks with compare to international standard.

1.5 Significance of the Study

Commercial banks act as a bridge between Savers and users of money. Bank provides loan and advance to the user or investor in different investment purpose. As a business institution, a bank aims at making huge profit through earning interest from loan and advance. Due to mismanagement and economic condition the commercial banks are facing high level of NPA. This has wide spread suspicion on the performance on the commercial banks.

It is also significant to find out whether the Nepalese commercial banks maintain their NPA level in accordance with the current NRB directives or not. This study will give the real picture of the current nonperforming assets which will be significant to bankers, its shareholders, depositor and all general public who are interested on this current affair of banking industry. The shareholders would get information to make decision while making investment on shares of various banks. This study will provide a useful feedback for academic institution, bank employee, trainees and investor, financial person, policy maker bodies and other persons concerned with commercial bank. This study will serve to be a guide to the management of banks, financial institution, related parties, shareholders and general public. Last but not least, it also provides literature to the researchers who want to carry on further research in this field.

The proposed study will make comparison between the NPA of commercial banks of Nepal and global standard. It will also check the NPA level between the commercial banks. It will find out some misconception that general people having about NPA of commercial banks.

This study would be important as it provides theoretical as well as conceptual framework who wants to carry on further research on Non Performing Assets of commercial banks.

1.6 Limitations of the Study

Errors are inevitable but we have to give full effort to minimize them. We have to do many things staying within many types of limitations and boundaries. The study has been subject to the following limitations.

a. This study is concerned only the issue of nonperforming assets in Nepalese commercial banks. It does not consider other aspects of the commercial banks.

b. The study has been based on secondary data most of the data and information provided by commercial banks and published in the report of NRB.

c. The figures are rounded for nearest rupee.
d. This research is based on data and information of only five fiscal years from 2007/08 to 2011/12.
e. The research has been done for only six sample from 32 commercial banks therefore the result of this study cannot be generalized.
f. The study has been conducted in limited time and resources.

1.8 Organization of the Study

The whole research work has been divided into five chapters, namely:

Chapter One: Introduction

The first chapter deals with the subject matter of background of the study, focus of the study, statement of the problem, objectives of the study, significance of the study, limitation of the study and organization of the study.

Chapter Two: Review of Literature

The second chapter deals the review of available literature. In this chapter both conceptual and theoretical review is done. It includes reviews of books, reports, thesis, banking journals, Newspaper, Articles, websites etc.

Chapter Three: Research Methodology

The third chapter provides guidelines and gives a road map to analyze the collected data. It includes research design, source of data, methods of data analysis, populations and samples along with different statistical and financial tool used in this study.

Chapter Four: Data presentation and Analysis

This chapter covers analysis, presentation and interpretation of the acquired data, which was collected through different sources. This chapter provides a shape to facilitate the analysis of relevant data in an attractive way.

Chapter Five: Summary, Conclusion and Recommendations

The last chapter includes summary, conclusion and recommendation that can be useful for academicians as well as for practitioners.

CHAPTER TWO

REVIEW OF LITERATURE

Review of literature is an integral and mandatory process in any research work. Its 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 main reason for the full review of research in the past is to know the outcomes of those investigations in areas where similar concept and methodologies had been used successfully and to avoid investigating problems that have already been definitely answered.

This chapter helps the researcher to develop a thorough understanding and insight into previous research works that relates to the present study. This part of the study explain body of knowledge from related books, report, articles published and unpublished different economic journals, bulletins, magazines, newspapers, yearly published balance sheet of respective banks, NRB directives and guidelines, economic survey, previous thesis on related subject and subject related website search.

This chapter has been divided into the following parts.

2.1 Conceptual Framework

This heading focus the meaning and concept of the term used in the study.

2.1.1 Loan and Advances

A loan is a type of debt, like all debt instruments, a loan entails the redistribution of financial assets over time between the lender and the borrower. Commercial banks collect deposit from depository customer and provide this money as loan to borrowing customers charging some additional interest. In other words, bank play intermediate role in the economy. Bank does so to convert its liability into assets. Thus loans and advances are the assets of the bank. Interest income on such loans is the primary source of income of commercial banks. To spread the depositors fund to the borrowers, banks should have to take in consideration safeties of loan and advances at time of lending but not only on profitability. They have to analyze properly and take adequate collateral for the safety purpose as providing loan is a risky business. Banks have to manage the proper portfolio so that the impact of market failure of any sector will affect least. Loans may be of different types such as : Personal loan, home loan, auto loan overdraft, import loan, term loan etc. The profitability of the bank depends upon extend to which it grants loan and advances to customers. Loans are granted in the form of overdraft, cash credits and direct loans. Loans are granted base on the security. Another way of classifying financial market is to divide them into market for loans and market for securities. Market for loan is negotiated face to face directly between the borrower and lender.

Loan and advances dominates the asset side of the balance sheet of any bank. Similarly, earning form such loans and advances occupy a major space in income statement of the bank. Lending can be said to be the raison of a bank. However, it is very important to be shrinkage in the value of loan and advances. Hence, loan is known as risky assets. Risk of non-repayment of loan is known as credit risk or default risk (Dahal and Dahal, 2002:114).

Performing loans are those loans that repay principal and interest timely to the bank from the cash flow it generates. In other word, performing loan are the productive assets that generate the some profits. Loans have the certain time period to return on its principal with its interest. If anyone repays loan with its interest on time is known as the performing loan. Different country may have different policy to classify the performing loan. Different country may have different policy to classify the performing loans. In the context of Nepal, loans that have fallen under 'Pass' category are treated as performing loan. It is the most profitable assets of banks. Better performing loan are the symbol of success of banks but many are suffering from the non-repayment of loan amount.

2.1.2 Importance of Loan and Advances

Loan and advances are the most profitable of all the assets of a bank. Banks universally seek after the asset. This asset constitute primary source of income to banks. As the business institution, a bank aims at making a huge profit. Since loan and advances are more profitable than any other assets, bank always wants to lend as much as of their fund as possible. Bank has to be careful about the safety of such loan and advances. Bank has impaired their profits by bad debts. If bank is too timid, they may fail to obtain an adequate return on the fund which is confided for use. Loan is also defined as a thing that is lent, especially a sum of money. Debt means a sum of money owned to somebody. However in financial terms loan or debt means principal or interest availed to the borrower against the security.

Loan is defined as a lending. Delivery by one party to and receipt by another party of sum of money upon agreement expressed or implied, to re-pay 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. Loan includes

a. The creation of debt by the lender’s payment of or agreement to pay money to the debtor or to a third party for the account of the debtor;

b. The creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately;

c. The creation of debt pursuant to a lender credit card or similar arrangement;

d. The forbearance of debt arising from a loan:

Regarding debt, Nepal Rastra Bank, Debt recovery Act for bank and financial institution (2058) has defined debt means principal and interest provide to debtor by banks or financial institutions, with the pledge of immovable or movable property or other securities or guarantee or without guarantee and the word also means over dues of the transaction beyond balance or fees, commission and interest incurred in that relation.

Sudir 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 degree or order of any court or otherwise and legally recoverable on the date of the application."

According to Dahal and Dahal, Loan and advances dominate the asset side of balance sheet of any bank. Similarly, earning from such loans and advances occupy major space in the income statement of the bank. However, it is very important to be reminded that most of the bank failures in the world due to shrinkage in the value of loan and advances. Hence loan is known as risky assets, Risk of non-repayment of loan is known as credit risk or default risk.

2.1.3 Types of Loan

A loan-unlike equity-is a fixed payment contract, irrespective of whether there is profit or not. Yet businesses fail and the contractual payments are not honored. If the loan is secured through collateral, the bank can seize and sell the collateral, but in many countries that involves legalities and delays.

Loans and advances are the primary assets of the commercial banks. Most of banks fund are used to acquire earning assets, which provide the bulk of revenue and enable them to cover expenses, including the cost of capital. There are various types of bank loans, according to the way in which the interest payments are calculated. Banks loans can be classified as, (Shrestha and Bhandari, 2004: 263-266).

i. Amortized Loans

Amortized loan refers to the determination of the equal annual loan payments necessary to provide a lender with a specified interest return and repay the loan principal over a specified period, so the loan takes the form of an annuity. In the amortized loans system, first step is to calculate installments to be paid for every period. Suppose the loam amount is Rs. L, the rate of interest is K percent per period, and the number of payments is n, then the installment payment can be calculated as follows.

Periodical Installment= $\frac{Loan\, borrowed}{PVIFA_{K,n}}$

ii. Add-On Loans

The term add-on means that the interest is calculated and then added to the amount received to determine the loans face value. The sum of the principal and interest is then divided over the number of periods to calculate the constant periodic payments.

iii. Discount Interest Loans

In a discount interest loan, the bank deducts the interest in advance (beginning of the period). In this type of loan, the lender receives payments of all the interest that will accrue on the loan at the time the loan is granted. Since the interest is prepaid, the borrower must only repay the principal, usually in equal payments.Furthermore, loan and advances also classified on the base of duration of investment period. The loans provided have both short term and long-term durations depending upon the nature of the loans.

i. Money at Call

This type of loan is usually provided to another bank or financial institution for very short period and the bank can call its money bank at a very short notice of one day to fourteen days.

ii. Cash Credit

These loans are issued to the borrowers against their current assets like shares, stock, bonds etc. Bank opens an account depending upon the policy of the bank and credit the entire loan amount (as per the sanction limit) to the account. The borrower is allowed to with draw money as per his requirement from the limit provide to him. The bank charges the interest on the withdrawal amount.

iii. Overdraft

These loans are provided to those that have high creditability in the business and depending upon their business volume and relationship with the bank, banks provide overdraft facility whereby the borrower can withdraw the amount to certain limit beyond its deposits. The bank charges the interest on the withdrawal amount. It's high interest rate and more risky loan for bank and customer. It is beneficiary for regular cash inflow situation. This facility is given to holders of current accounts only. This is an arrangement with the bankers thereby the customer is allowed to draw money over and above the balance in his/her account. This facility of overdrawing his account is generally pre-arranged with the bank up to a certain limit. It is a short-term temporary fund facility from bank and the bank will charge interest over the amount overdrawn. This facility is generally available to business firms and companies.

iv. Demand Loan/ Short Term Loan

These loans are provided to the borrowers for the purchase of raw material depending upon the situation and the need of the borrower. The loan is provided once the borrower put forward a request letter and depending upon the need the loan sanctioned for a period of ranging maximum from 90 to 120 days. The borrower is allowed to utilize the loan for the stipulated time period with interest rate after which the borrower has to settle the dues including the principal amount.

v. Trust Receipt Loan

This loan is provide against the LC to the borrowers to bring the goods imported from third countries to their stores . The time period ranges from 90 to 120 days and the amount of the loan ranges from 70 to 90 percent of the document value of the LC. The bank charges certain interest rates to the loan provide.

vi. Term Loans

This kind of loan is providing to the borrowers for the purchase of plant and machines and it is usually provided for more than one year. The interest is the highest among all the loans because of longer duration and the risk .The loan is repaid on the monthly, quarterly, half yearly or yearly basis depending upon the terms and conditions of the banks. It includes both demand and term loans, direct loans and advances given to all type of customers mainly to businessmen and investors against personal security or goods of movable or immovable in nature. The loan amount is paid in cash or by credit to customer account which the customer can draw at any time. The interest is charged for the full amount whether he withdraws the money from his account or not. Short-term loans are granted to meet the working capital requirements where as long-term loans are granted to meet capital expenditure.

2.1.4 Loan Management

Loan and advances dominate the asset side of the balance sheet of any bank. Similarly, earnings from such loans and advances occupy a major space in income statement of the bank. Lending can be said to be the raison centre of a bank. However, it is very important to be reminded that most of the bank failures in the world are due to shrinkage in the value of loan and advances. Hence, loan is known as risky assets. Risk of non-repayment of loan is known as credit risk or default risk. (Bhandari, 2003: 114).

Performing loans have multiple benefits to the society while non performing loans erode even existing capital. Considering the importance of lending to the individual bank and also to the society it serves, it is imperative that the bank meticulously plans its credit operations. Sound credit policy, whose objectives are as follows, is a foundation in this direction.

i. To have performing assets.
ii. To contribute to economic development.
iii. To give guidance to lending officials.
iv. To establish a standard for control.

The established credit policy normally speaks about the following components.

2.1.4.1 Loan Volume

The policy should contain the credit deposit ratio (CD ratio) the bank wishes to maintain. CD ratio is very much influenced by the behavior of banks liabilities. The higher the volatile deposit and volatile borrowings lower the volume of loan and vice versa. Moreover, the bank should fix the amount of loan it wishes to give a single borrower. Limit should not be more than the one set by regulatory authorities. In Nepal, a bank can give maximum loan to a borrower as follows.

Funded credit:	25% of banks core capital
Non-Funded credit:	50% of banks core capital

2.1.4.2 Loan Mix

The bank gives loan to various sectors. This is necessary for the long term survival of the bank. Even if any sector is doing very well, the bank does not put its total money in that sector. If the bank concentrates its lending only in one sector, failure of the sector may cause bankruptcy of the bank. Even if two individual borrowing units of two sectors have the same level of risk, the portfolio risk is minimized due to diversification. There is a practice of fixing maximum amount of loan bank wants to give in one sector. Normally, the ceiling is fixed in relation to core capital of the bank. As per NRB, if a bank wishes to have credit exposure(funded + non-funded) in any sector more than 100% of its core capital, the same should be approved by the Board of Directors and should be notified to NRB.

Similarly, the policy should have reference to short term and long term loan mix. This is very much affected by the nature of banks deposits mix and interest rate movement in the market. The bank having short term maturing liabilities go for regular amortizing and self liquidating loans through, normally, the long term gives higher rate of return. However in the scenario of rising interest rate, bank can make more money by having loan portfolio maturing in the short term.

2.1.4.3 Pricing

The policy should have reference to the pricing of loan services. Profitability in loan is calculated as follows.

$$\mathbf{P = I - O - C - D}$$

Where, P= Profitability, I= Interest, O= Operating expenses, C= Cost of fund D= Expected default loss.

There is a practice of fixing prime lending rate. Based, on the risk, percentage is added in the prime lending rate. The higher the risk, the higher will be the rate. Being a custodian of public money, the bank however should not take risk beyond a certain level irrespective of how high the lending is. The policy should speak whether the banks adopts fixed or floating mixed type of interest rate in its portfolio. Credit policy should positively react to interest rate structure in the market flexibility required. However, no concession beyond certain level of interest rate on the borrowers threat that they would shop around.

2.1.4.4 Lending Authority

This is one of the very critical aspects of loan management. Misuse of lending authority puts the bank at a risk. Some banks adopt centralized while some banks adopt decentralized approach regarding lending authority. Under centralized approach, lending authority is not given to branch staff. Under decentralized approach, a certain limit is given to forward to Head Office for approval. Both the approaches have inherent merits and demerits. The apex lending authority in a bank is the Board of Directors but the board has also cap like single borrower limit (one obligor limit) set by NRB. Under both the approaches, some banks fix limit to the official the approving authority. In some banks, lending authority however is not tied up with the level rather it is tied up with the knowledge and experience of lending officials. The latter looks more scientific though it may cause some dissatisfaction in the organization.

2.1.4.5 Securities

The policy should say what types of securities the bank wants to take and does not want to take. Some banks do not take bullions and only personal guarantees as securities. Similarly, the policy should cover about the selection of valuators. Marketability, convenience and transferability should be the guiding factors for selection of securities. Moreover, the policy should talk about different types of documents to be executed for various types of loan so that proper charge can be created on the securities.

2.1.4.6 Risk Analysis

The policy should have reference to the acceptable character of the borrower. Though it should not be like a straitjacket, the policy should specify the acceptable liquidity, leverage, coverage, efficiency and profitability ratios so that there can be consistency in the risks perceived by all lending officials.

2.1.4.7 Loan Administration and Control Mechanism

Structure of loan administration plays a key role in the effective loan management. Being loan a risky assets, efforts should be made to have proper control in the every step of loan management. In certain countries, there is a four eyes concept. A single person cannot do anything. There should be involvement of at least two officials or two departments. If a bank has separate relationship maintenance and inspection, there is possibility of findings mistakes of one department by others. It helps keep non-performing assets (NPA) at low level. This may entail more cost but is peanut compared to the risk it minimizes. Moreover, this helps increase banks business with good customers resulting in more income.

Though the bank expects loan repayment from the cash flow generated from the operation of the borrower, the default of loan cannot be ruled out. To protect bank against such happenings, the bank takes various types of securities so that in the event of default these securities are disposed for recovery of loan. Hence, this policy can have reference to securities disposal and other recovery measures.

2.1.4.8 Loan Classification and Provisioning

Though all loans are good at the time of disbursement, with the passage of time, they show the sign of problem. Based on the health of loan, the loan should be classified and provided accordingly. Provisioning is made as cushion against possible losses and to reflect the true picture of banks assets. Hence, there is a practice of showing net loan (total loan-loan loss provision) in the financial statements instead of gross loan. The bank should comply with statutory regulation relating to loan classification and provisioning.

NRB regulation on classification and provisioning is as follows.

Type	**Criteria**	**Provision Requirement**
Pass	Principal overdue up to 3 months	1%
Substandard	Principal overdue up to 6 months	25%
Doubtful	Principal overdue up to 1 Year	50%
Bad	Principal overdue above 1 Year	100%

Pass loan is called nonperforming and others are called `Non-Performing Assets`. Provision requirement in case of loan given against personal guarantee only is additional 20% for pass, substandard and Doubtful loans. Provision for restructured, rescheduled and swapped loan is 12.5% only. For better management of loan portfolio, the management can have more classifications and can have more stringent criteria than the one fixed by regulating authorities.

According to Dahal B. & Dahal S., loan manage by different actions guidelines should be taken.

i. Pass Loan

Provide "good" service, retain customer. Consider new facilities.

ii. Indicative of Sub- Standard

a. Obtain legal review of all documentation.
b. No new facilities.
c. Frequent contact to gain more information/monitor problems.
d. Suggest ways to strengthen company and protect bank.
e. Consider inter-creditor agreement.

iii. Substandard Loan

a. Service not at issue, move immediately to strengthen Banks position.
b. Seek reduction in facilities and/or increase in security, restructure debt if advantageous to Bank.
c. Take “hard- line” with management, demand specific plan to improve situation.
d. Look for ways to improve management, control management, etc.

iv. Doubtful Loan

a. No interest taken to profit.
b. Look for ways to avoid losses.
c. Take legal action now, sell security if advantageous to bank, force management to repay/ finance.
d. Structure workout agreements with other creditors if necessary and advantageous.
e. Offset where possible, control payments.
f. Monitor weekly, track performance, control all assets and liabilities, if possible.
g. Look for ways to control all cash flows, appoint receivers as appropriate.

v. Bad Loan

a. Loss inevitable, take provision to cover loss and all costs of liquidation.
b. Look for ways to minimize losses, study timing of sales.
c. Be creative, but remember time value of money.

These are general guidelines for managing loans and advances according to its state.

2.1.4.9 Statutory Directives

Management should devise the policy keeping mind the statutory directives. Lending function of a bank is heavily influenced by the directives because the quality of bank’s loan portfolio has to do more with risk and safety than any other banking operation.

Credit facility helps create jobs and income to thousands of people directly and indirectly thereby raising their living standard. Hence, regulatory authorities make efforts to ensure there is no discrimination to any community or any individual on the ground of race, sex, religion, age, education level etc. In USA, the community Reinvestment Act 1977 requires the banks to meet the credit needs of individuals and businesses in their territories. Similarly, Equal Credit Opportunity Act 1974 bars the banks from denying credit facilities to any individual because of their sex, religion, race, age etc.

More regulation of NRB relating lending activities of the banks are as follows.

a. Single borrower limit.
b. Sectoral limit.
c. Directive Credit (priority sector and deprived sector limit).
d. No loan to restricted areas.
e. No loan to directives/employees/shareholders holding more than 1% share of the bank.
f. Interest rate deviation.

2.1.4.10 Quality of Lending Officials

Experience, knowledge, adaptability etc of lending officers should be considered while formulating the policy. Considering all facts, the credit policy should be carefully established, communicated properly to the lending officers and implemented effectively by the lending officers. The credit policy of the bank is established by the board of directors based on the recommendation of Chief Executive Officer or senior loan officer.

2.1.4.11 General Principles of Lending

Banker is essentially a dealer in the funds of others and that too funds mostly repayable on demand. Therefore he follows a cautious policy in the matter of lending and is generally governed by the well known general principles of sound lending which are discussed below:

i. Safety

The main business of banking consists n borrowing various types of deposits such as current, saving and fixed and lending such deposits to needy borrowers in the form of advances and discounting of bills. This obviously implies that safety of such funds should be ensured. Otherwise the banker will not be in a position to repay his deposits and once the confidence of the depositors is shaken, he cannot carry on the banking business. If the banker has to ensure safe lending, they have to look to the five C's of the borrower namely character, capacity, condition, capital and collateral. Normally the banks lend up to 70 % to 72 % of their deposits, because a portion of the deposits are required to meet the withdrawals by customers. Its endeavor is of course to lend as much of the deposits as possible, without which they will not be in a position to meet their interest obligations and the maintenance of establishment. Therefore, he has to lend with a view to earn interest but lend it safe.

ii. Liquidity

By liquidity is meant the readiness with which the bank can convert the assets into cash. As the banker's deposits are subject to the legal obligation of being repayable on the demand and at short notice, it must ensure liquidity also while lending, so that in times of needs, it will be able to convert the assets into cash.
Cash is the most liquid assets and it appears as the first item banker can ensure high liquidity by keeping all deposits in the form of cash only. Liquidity also implies that the assets can be sold without any loss. Thus the concept of liquidity has twin aspects namely quick saleable or convertibility of the assets and to risk of loss in such conversion.

There is yet another reason for paying attention to the liquidity factor. The cost of borrowing from Reserve Bank depends on the net liquidity ratio, which is the ratio calculated by taking the proportion of specified net liquidity assets of the borrowing bank to the bank's aggregate demand and time liabilities.

iii. Profitability

Commercial banks have obtained funds from shareholders and naturally if dividend is to be paid on such shares it can only be paid by earning profits. Even in the case of public sector banks although they are service motivated they will have to justify their existence by earning profits. This is not possible unless the funds are employed profitably. From out of the revenue earned the banker has to pay interest on deposits, salary to the staff, meet other establishment expense, build-up reserves and the balance must permit the payment of dividend to shareholders. However, the banker will not give under importance to this aspect because a particular customer may offer a higher rate of interest but an advance made to him result in a bad debt. Therefore for the sake of profitability, the other two principles, liquidity and safety cannot be sacrificed.

iv. The Purpose of the Loan

Banker should enquire the purpose for which it was taken. If an advance is given for productive purpose, in all probability, it will be repaid. Thus safety is ensured. If an advance is made for speculative purpose, the banker may come to grief. Similarly advances made for wasteful expenditure on social functions etc. are unproductive in nature and as a rule banks avoid such advances. But it is very difficult for the bank to ensure that the advance has been used for the purpose for which it was taken. A person may take a loan obviously for a productive use, but may spend it on speculation. In recent years there is scrutiny of some of the account, as a follow-up measure to see that the end, use of credit is not for some other purpose.

V. Diversification of Loans (Portfolio management on lending)

The familiar saying is 'Do not put all the eggs in the same basket'. Banker should try to diversify loans as far as possible, so that he may minimize his risk in lending. If the banker lends only to one industry or only a few big firms or concentrates in certain geographical area, the risk is great. It should diversify lending, so that it may not be affected by the failure of one industry or the few big borrowers. Where lending is done only in one area, it may be affected by political upheaval or natural calamities (Radhaswami & Vasudevan, 1979:205).

2.1.5 Loan Approval Process

Loan is approved by the approving authority only after being convinced that the loan will be rapid together with interest. There are many processes involved to approve the loan which are as follows, (Dahal & Dahal, 1992:121)

2.1.5.1 Application

A borrower is normally required to submit an application to the bank along with required documents. Respectively, Project Proposal, historical financial statements and documents pertaining to company's legal existence.

2.1.5.2 Conducting the Interview

Though the documents submitted give much information about the borrower; collecting information by interviewing the borrower is of great importance. Normally, such an interview takes place at the bank premise.

<u>What to learn during Interview</u>

a. Loan Purpose.
b. Loan Amount.
c. Repayment Source.
d. Repayment Schedule.
e. History of the Business.
f. Banking Relationship.

2.1.5.3 The Credit Analysis

Historical analysis refers to analysis of past financial statements and business risk. The former is quantitative while the latter is qualitative analysis. The financial analysis exhibit the financial performance of the management and business risk analysis helps to the major risk factors (supply, production, demand, collection, management) observed in the past and how management mitigated them. The underlying purpose of historical analysis is to know the major factors in borrower's present condition and past performance which foreshadows borrower's likely success or failure in repaying the debt in future.

There is a practice of analyzing 5Cs of Credit (Character, capacity, Condition, Capital, and Collateral) by the financial institutions.

i. Character

It refers to the personal traits i.e. ethics, honesty and integrity of borrowers which is very important for lending decision. Serious purpose, truthfulness in answering the queries, responsibility and seriousness in making all the efforts to repay loan make up what a lending official call the character. Dishonest borrower always finds a way to avoid the restrictions imposed through the loan agreement. No further credit analysis is made if the lending official feels the borrower lacks character.

ii. Capacity

Capacity is being used in two senses.

1. Legal Capacity to borrow money.
2. Capacity to generate enough income to repay loan or through liquidation of assets.

iii. Condition

Condition refers to the general economic condition beyond the control of the borrower that affects the business of the borrower. This is basically security, political and other social conditions under which the business has to operate. Loan is given to the borrower if lending officials feels general condition is favorable for that type of business.

iv. Collateral

Loan is given if the banker is satisfied that the borrower can repay money from the cash flow cash flow generated from operating activities. However, the bank wants to ensure that their loan is repaid even in case of default. In such cases, the banker asks for additional securities. Collateral can be fixed in nature land, building, machinery or working capital like inventories and account receivables.

v. Capital

Capital refers to the net worth of the borrower. This is covered under capacity above while analyzing the leverage ratio. Leverage ratio will be high if the borrower has low capital. A bank gives loan only when it finds leverage ratio acceptable to it or if the borrower has enough capital.

2.1.5.4 Forecast and Risk Rating System

Based on the findings of historical analysis, and in light of present and foreseeable future environment, the analyst has to forecast impending major risks. The analyst should also highlight to what extent inherent risks will be mitigated and how unmitigated risks can be covered.

Analysis of credit information attempts to answer the question "How risky would it be to lend to this applicant?". Most commercial loans are risky to some degree. Up to a certain risk level, a lender may justify granting a particular loan and attempt to compensate for the relatively high risk by charging a high rate of interest and adequate securities. Above a certain risk level, loans will not be granted. Thus, it can be said that credit analysis: (1) determines which loans will be made and which will not and (2) provides a ranking from low risk to high risk for those loans that are made, thus helping determine the rates of interest to be charged and the value of securities to be obtained.

2.1.5.5 Return

The amount of loan has got inherent cost as it is obtained from either shareholder or depositor or creditor. The analysis should be made to calculate total return (interest, fee and commission) and compare whether it meets banks standard.

2.1.5.6 Liquidation

The analyst should ascertain banks ability to recover loan in case of liquidation of the borrower. If liquidation analysis reveals insufficient security, additional security may be asked for.

2.1.5.7 Creditworthiness and Debt Structure

If the analyst finds the borrower creditworthy and decides to extend loan, he should structure the debt facility to be extended.

2.1.5.8 Collateral

Bank analyzes various financial statements like Balance Sheet, Profit and Loss Account, and Cash Flow Statement of borrower for financial appraisal and for the assessment of borrower’s credit-worthiness. Bank decides to sanction the loan mainly relying on the borrower and his proposition. However, it proves very costly for the bank in the event the borrower and his proposition fails. To safeguard banks interest, bank asks for security which proves to be cushion in cause of default. There are two types of securities:

i. Primary Security

The security deposited by the borrower himself is known as primary security. This includes promissory note and tangible securities offered by the borrower.

ii. Collateral Security

Collateral means “additional” or “secondary”. If the bank feels that primary security is insufficient, the borrower is asked to provide additional security. Thus, collateral security means security deposited by the third party to secure advance made to the borrower. This includes guarantee and tangible securities offered by the third party.

2.1.6 Meaning of Nonperforming Assets (NPAs)

An asset is classified as non-performing assets (NPAs) if the borrower does not pay dues in the form of principal and interest for a period of 180 days. However with effect from March 2004, default status would be given too a borrower if dues are not paid for 90 days. If any advances or credit facilities granted by bank to a borrower becomes non performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status (http:www.indianinfoline.com).

The assets which cannot be used productively regarding the objective is called Non-performing asset (NPA). In general, NPA is the sum of following terms.

NPA = NPL + NBA + RNPL + SI + UA

Sub-standard, doubtful and loss loans are called non-performing loan (NPL). In other words, all loans which are dues but not paid for two quarters are called NPL. On the process of collection of debts, remaining amounts of loan after realizing the collateral are called non banking asset (NBA). Outstanding interest and other amounts from the loans which are due called remaining non-performing loan (RNPL). The amount which bank and financial institution cannot get from their capital investment are called suspend interest (SI). The movable and immovable assets which cannot be used in bank's own transaction and the asset which have no contribution for the value addition in the bank and financial institutions are called unutilized assets (UA).

Non-performing assets (NPAs) could wreck bank’s profitability both through a loss of interest income and write of the principal loan amount. It tackles the subject of entire starting from the stage of their identification till the recovery of dues in such account (S.N. Bidhani, 2003:1).

To define NPA first of all meaning of assets should be understood. Asset means the property of a person or a company. This indicates that assets are the property of a company accumulated with the help of sources. Moreover, Non-performing loan means an outstanding loan that is not repaid i.e. neither payment on interest or principal are made. In case of the banks the loans and advances are the assets as the banks flow loans from the funds generated through shareholders equity, money deposited by the people and fund having through the borrowings. Hence the term NPA means the loans and advances that are non performing well. Thus all the irregular loans and advances can be termed as NPA. Nonperforming Assets can be defined as the non productive assets of the banks. An asset is known as non-performing assets (NPAs) if the borrower does not pay the dues in the form of principal and interest in time. In other words, loan which are not performing as per the prescribed time of the bank are called non-performing loan. The payment period varies from nation to nation. In some country it is longer period where as in other it is shorter past due period. However a common feature of NPA is past due that have not been served. In Nepalese context, if the loans are past due since three months, it should be reported an non-performing Assets. In other words, loans classified under substandard, doubtful and loss category are regarded as non-performing Assets.

The NRB directives require banks to create loan loss provisions on the gross value of all outstanding loans. Therefore, the public banks with large volumes of Nonperforming loan maintained higher provisions, while that of private banks was lower. The growth rates of all variables mentioned above were higher in private banks relative to the public sector banks in the review year. Nepal's public sector banks control a sizable chunk of deposits, loans and advances and total assets of the banking industry. They have continued to expand their branches despite the growth of private banks. In the same two decades the world witnessed the maximum number of banking crises. The consequences of such crisis are far-reaching. Against this backdrop, it can be said that there is always a need for effective, sound and forward looking regulatory and supervisory authority to ensure the financial stability.

NPA create problems for the banking sector's balance sheet in the asset side. They also create a negative impact on the income statement as a result of provisioning for loan losses. Ultimately a riskier portfolio combined with lower net income makes new lending more difficult, often resulting in slower credit growth. In the worst scenario, a high level of NPLs in a banking system poses a systemic risk, inviting a panic run on deposits and sharply limiting financial intermediation and subsequently investment and growth in the economy. Banks and financial institutions always try to have almost all the financial assets as performing assets to make them sound, sustainable, profitable and healthy within the system. Sometimes, unfavorable internal economic shocks and other discrepancies affect quality of such assets. Deterioration in the quality and other assets, give birth to non performing loans and ultimately invites the financial crisis. The non performing loan is a problem which cannot be eliminated. However it can be controlled and managed to minimize it and to minimize its effect. The Non Performing Loan has many negative effects to the organization such as affects adversely on the profitability, good will and reputation of the organization, decreases the loadable fund.

2.1.7 Causes of NPA

One of the potential factors responsible for increasing non performing assets of the commercial banks is lending policy of the banks. Similarly ineffective credit policy, weak monitoring, lacking of portfolio analysis, shortfall on security, weak credit concentration, mismanagement within the banks, inability to identify borrowers bad intention etc are loopholes in the side of banks and economic and industrial recession, insufficient legal provision for the recovery of dues, inconsistency on government policy, lack of monitoring and supervision from central bank, high and conservative provisioning requirement are some external factors responsible increasing NPA of banks.

From various studies and from the experts of Banking and Economics of Nepal, the researcher concludes following are major important causes for of NPA in Nepalese commercial banks .

2.1.7.1 Undue Pressure

The main causes of increase of NPA and NBA in commercial banks are due to undue pressure and influence from the political parties, promoters, Bureaucrats and other influential people to sanction loan to low credit profile and overvaluation of the collateral. Especially willful defaulters take help of such pressure group to sanction loan.

2.1.7.2 Lack of Credit Policy

Only few banks are found having proper credit policy. The concentration of loan to a single sector also helped to increase the NPA. The banks should be clear where to invest and how much to invest. The condition of the industry should also be analyzed properly before lending that industry. NPA increase due to lack of proper policy and act to return the expired loan.

2.1.7.3 Political Instability

Due to political instability and the violence many industries were closed turning their loan Bad. Regular strikes and undue demands from the worker union deteriorate the environment for conducting business and trade. The political instability affects every sector of the nation adversely.

2.1.7.4 Government Inactivity

The Government of Nepal is found unwillingness towards punishing willful defaulters. The Government has not made any law to control the banking crime. It is because most of such defaulters are often the major donor for the political parties for their campaign.

2.1.7.5 Managerial Inefficiency

In most of the banks the Non performing assets grow not only due to the willful defaulters but also by the inefficiency of the management to manage the loan and advances. Due to improper planning and incorrect maintenance of the loan even the good loan turn into bad. The management should also be able to find out new sectors to lend and produce to products. The bank should regularly revise the creditor's performance and classify accordingly. There are other causes also but these are found playing major role in increasing the Non Performing Assets.

2.1.7.6 Cut Throat Competition

The number of commercial banks is growing rapidly. It is nearly saturated. But the market size is very small and the economic situation is not improving. In such situation, the commercial banks have very less option to invest. Due to this, there is unfair competition exercised by the banks to attract the customer. In such situation, NPA may increase due to sanctioning the loan without studying and analyzing the client properly.

2.1.7.7 Lack of Vision

The success of any organization lies on the ability to think and have long term vision. Creativity is very essential thing for the managers to drive the whole organization to success. The managers should be able to create new products. In Nepal, there is a culture of copying others product. Lack of Vision results in investment in those areas which will turn the loan into NPA. (Bidhani, 2003:12)

2.1.7.8 External Factors

There are many external factors that turn a good loan to bad. Economic condition of the country, political situation, technological change, etc. also plays a key role in turning a good loan to bad. This closer of the factories, result in inability to repay loan taken by the organization although the business man do not intend to be a defaulter. NPA increased suddenly due to depression of the economy of the country cause of the insecurity and instability of the business environment.

(Source: National Daily Newspapers and Business Magazines).

2.1.7.9 Other Factors

There are various causes to increase the NPAs such as lack of transparent and clear policy to mobilize the assets productivity, supervision, monitoring and control, lack effective forecasting or deviation between expectation and actual outcomes of the business, lack of information and communication between banks and customer, lack of proper information about the situation and transaction of the customer at the time of rendering loan, lack of trainings and seminars to build the smart human resources, wrong valuation of accepted collateral and business project by the bank to the loan.

2.1.8 Classification of NPA

As per the NRB directives NPA are said as classified loans and this includes substandard, doubtful and loss categories as defined by new NRB Directives (NRB Circular 2057) . As per the circular no BP.BC.79/21-043-92 dated April 27, 1992 and Circular No. B.B.BC.59/22.04.943-92 dated December 17, 1992 the RBI has identified the NPA as an account of loan where on the Balance sheet date in respect of,

a. Term Loan interest remains “past due” for more than 180 days, overdraft and cash credit account remain out of order.
b. Bills purchased or discounted remain overdue or unpaid for more than 180 days .
c. Other accounts receivables remain past due for 180 days.

The circular further says a NPA is a credit facility in respect of which interest has remained unpaid for two quarters. According to the circulars the loans are classified based on weakness and dependence on collateral securities into four categories and prescribed the provisioning rate as follows.

Table 2.1

Classification of Non Performing Assets

Categories of Loan	Criteria of Classification	Provisioning required
Standard	Not disclose any problem and not carry risk (actually a performing asset)	1% of outstanding loans.
Substandard	Overdue for not exceeding 2 years	10% of outstanding loans.
Doubtful	Uncollectible/ unrecoverable loans, continuance as a bankable asset is not warranted	a. 100% provision on unrealizable value of the security. b. 20% if the asset has to remain doubtful up to 1 year. c. 30% if the asset has remained doubtful up to 3 years. d. 50% if the asset has remained doubtful for more than 3 years.
Loss		Entire amount should be written off. If assets are permitted to remain in the books for any reason, 100% outstanding should be provided for.

Source: NRB, Unified Directives, 2005/06

In our country the previous circular of NRB had classified the loans into six categories; however as per new circular issued and effective from F/Y 2058/059. Commercial banks and development banks are required to make provision against loans and advances as follows.

Table 2.2

Classification of loans and advances

Classification of loans and advances	Criteria for provisioning	Provision Rate
Pass	Not past due and past due for a period up to 3 months. (performing loans)	1%
Substandard	Past due for a period of 3 months to 6 months	25%
Doubtful	Past due for a period of 6 months to 1 year	50%
Loss	Past due for a period of more than 1 year or advance which have least possibility of recovery.	100%

Source: NRB, Unified Directives, 2005/06

Nepal Rastra Bank has issued Unified Directives to banks and financial institution for implementation effective from 2062/4/1 B.S (16 July 2005 A.D.). This also contains new directive concerning classification of loan portfolios and provisioning. Except a few important changes, this directive has retained most of the previous provisions. The classification criteria are representing on above table.

The assets are also classified in the following broad groups:

a. Standard assets:

It is one, which does not disclose any problems and which does not carry more that normal risk attached to the business. Such as assets is not a NPA for e.g.. if any account is regular and there is no problem of repayment, then the collateral placed for that loan is standard asset.

b. Sub-standard assets:

It is one, which has been classified as NPA. In such cases, the current net worth of the borrower/guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the bank in full. In other words, such as assets has well defined credit weaknesses that jeopardize the liquidation of a debt and is characterized by the distinct possibility that the bank will sustain some loss if deficiencies are not corrected. However, in respect of accounts where there are potential threat of recovery an account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers, it will not be prudent for banks to classify them as sub-standard and then as doubtful after expiry of specified years from the date the account has become NPA. Such accounts should be straightway classified as doubtful or loss assets as appropriate, irrespective of the period for which it has remained as NPA.

c. Doubtful assets:

A doubtful asset is one, which has remained NPA for a period exceeding 2 years. In the case of term loans, where installments of principle has remained overdue for a period exceeding 2 years should be treated as doubtful. A loan classified as doubtful has all the weaknesses inherent that has been classified as sub-standard with the added characteristics that the weakness makes collection or liquidation if full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

d. Loss assets:

A loss asset is one where loss has been identified by the bank or internal or external auditors or the central bank's inspectors but the amount has not been written off, wholly or partly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable assets is not warranted although there may be some salvage or recovery value and where no security is available.
(Source: http/www.nrb.org.np)

2.1.9 Effects of NPA

Under the circumstances assets that do not earn any income to the bank affect the profits in a number of ways. Here are some examples of the impact of NPA on bank. These are the effects of NPA on Profitability impact of commercial banks.

a. The resources locked up in NPA are borrowed at a cost and have to earn a minimum return to service this cost.

b. NPA on the one hand do not earn any income but on the other hand drain the profits earn by performing assets through the claim on provisioning requirements.
c. Since they do not earn interest they bring down the yield on advances and the net interest margin or the speed.
d. NPA have a direct impact on return on assets and return on equity, the two main parameters for measuring profitability of the bank.
e. 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.
f. Return on equity is also affected as provisioning eats more and more into profits earned.
g. The cost of maintaining these assets includes administrative costs, legal costs and cost of procuring the resources locked in.
h. NPA bring down the profits, affects the shareholder value and thus adversely affect the investor confidence.

According to S. Athmanathan and R. Venkatakrishnan, NPA has impact of NPA can be assessed with the following:

a. Lower ROE and ROA
b. Lower image and rating of bank
c. Disclosure reduces investors’ confidence
d. Increases costs/difficulties in raising capital
e. NPA do not generate income
f. They require provisioning
g. Borrowing cost of resources locked in
h. Opportunity loss due to non recycling of funds
i. 100% risk weight on net NPA for
j. Capital gets blocked in NPA
k. Utilize capital but does not generate income to sustain the capital that is locked.
l. Recapitalization by government comes with string.
m. Administration and recovery cost of NPA
n. Effect on employee morale and decision making

2.1.10 Treatment of NPA

According to Subramanyam V. on Treatment of Non-Performing Assets in Macroeconomic Statistics, its conclusion are explain,

Part A : Policies and Practices

i. Classification of loans and off-balance sheet items

There is no uniform system of classifications of loans and off-balance sheet items. Many countries have adopted, mainly through regulatory and supervisory framework, a three- tier approach towards classification of Non Performing Assets (NPAs), corresponding to 'substandard', 'doubtful' and 'loss' categories, using delinquency period as the main bench mark. Thus, 'substandard' assets are those where principal and/or interest are more than 90 days past due; 'doubtful' assets are those where principal and/or interest are at least 180 days past due; and 'loss' assets are those where principal and/or interest are at least 1 year past due. This classification category is also applied to contingent accounts or Off-Balance Sheet items, since they are treated the same way as loans. The delinquency period is applied for classification of various 'on-balance' sheet assets and 'off-balance' sheet items, so as to provide, among others, an objective criterion for appropriate classification, depending on the possibility of collectability. However, if, in the bank's judgment, an asset is impaired to such an extent and its collectability is in serious doubt that it should straightaway be classified as 'doubtful' or 'loss', waiting for the delinquency period. The delinquency period varies across countries and it differs in relation to the types of accounts. Also, in some countries, banks themselves classify the loans, on the basis of judgmental factors. In view of the varied practices followed, primarily depending on the structure of the banking system, credit delivery systems, and socioeconomic conditions, it will not be advisable to prescribe a set of definition of Non-Performing Assets. One may rely on the approach adopted by the national authorities.

ii. Provisioning Requirements

The practices of provisioning differ among countries, following the asset classification system adopted. Most of the counties have adopted the standard requirements of provisioning- 20 percent of the outstanding balance in respect of 'substandard' category of asset; 50 percent in respect of 'doubtful' category; and 100 percent in respect of ‘loss’ category. While some countries have imposed lower percentages, yet some others have adopted the system of provisioning, in a phased manner. Recognition of collateral- fully or partially in assessing the provisioning requirements, as applicable in some countries, has great impact on provisioning. Also, tax deductibility of specific provisions towards loan losses, as extended by tax authorities in some countries, constitutes a strong positive incentive for banks to make adequate provisions. It is, therefore, necessary that banks should be required to fully explain the policies and procedures adopted in making provisions towards NPAs.

iii. Recognition of Income on Non-Performing Loans (NPLs)

Stricter regulations have been laid down by supervisory authorities in many countries with regard to income recognition on Non-Performing Loans (NPLs). The suspension of interest payments is required on loans that are classified as ‘non-performing’ (‘substandard’, ‘doubtful’ and ‘loss’). Any uncollected interest payment on NPL is considered non-accrued interest. Previously accrued, but uncollected interest is reversed out of income. Failure to do so would overstate income. Uncollected interest is normally put in a memorandum account. NPLs are restored on an accrual basis only after full settlement has been made on all delinquent principal and interest.

iv. Criteria for ‘write-off’ of bad loans

The policy with regard to ‘write-off’ of bad loans by banks is set by the Board of Directors, depending, among others, on the repayment culture and legal system prevalent. It will be inadvisable for the regulatory authority to lay down specific guidelines as to when a loan could be considered as ‘non-recoverable’ and written-off. The banks may, however, be exhorted that balance sheets would need to be cleansed, as early as possible.

Part B : Reporting Requirement

i. Interest Income

Ideally, interest income should reflect only interest income realized and should exclude interest accrued on NPLs, so as to avoid overstating of income. The banks may be required to report the balance of uncollected interest on NPLs, as a memorandum item. It would be useful, if additions and deletions during the preceding specified period are also reflected.

ii. Loans

It will be appropriate to record the "specific provisions" as a contra item, thus reducing the total loan outstanding, so as to reflect the recoverable value of the loans. Thus, while specific loan loss provisions are reported as contra asset, nonetheless, provisions, other than for loan losses, should, however, appear under "liabilities".

iii. Non-Performing Assets (NPAs)

The banks may be required to report Non-Performing Loans (NPLs), preferably under various categories, as a memorandum item. It is important that the amount of outstanding NPLs should not include interest not realized. The additions and deletions during the preceding specified period may also be reflected. The total of on-balance sheet assets, other, other than loans, and off-balance sheet items, classified as 'non-performing may be reported separately, under various categories. Additions and deletions during the preceding specified period should also be reported.

iv. Provisions

"General" provisions may be required to be reported as a separate item under 'capital and reserves'. The "specific" provisions may be required to be reported, so as to facilitate arriving at provision-adjusted NPLs i.e.; Net NPLs. Additions and deletions during the preceding specified period may also be required to be reported.

Part C : General

i. Cross Country Comparison of Financial Soundness

If the policies and practices followed in the matter of classification of assets, provisioning, income recognition etc., are fully explained, it will be possible for the analysts to make meaningful cross country comparison of financial soundness.

2.1.11 NPA Management

Banking sectors are the backbone of a country. The motto of the commercial banks is to mobilize the resources by investing the same in a profitable manner. The resources may include capital funds consisting the shareholders equity, Money deposited by the people, borrowing and profit capitalization. Though the activities of them are guided by some social obligations but some profit has always been desirable for existence.

Big chunks of resources are being utilized on loan and advanced by commercial banks. They follow the principle of higher return higher risk. On one hand the mushrooming growth of banks has led them towards cut throat competition on the next hand economic condition of the country is more or less stagnant. Result is no new area could be explored. The competition among bank is just to share the small size of the cake on the other hand quality of the loans and advances could not be maintained result is increased on Non performing Assets of bank. Increasing NPA has the direct effect to banks, investors and customer.

Internal Effect: Due to NPA the banks have to make loan loss provision from their profit and other sources. That's why the profit of the banks decreases or may occur losses. As a result share capital also becomes capital erosion and capital inadequacy. If the provision for doubtful debts crosses 5% of the total loan amount, the bank have to pay income tax as profit. So it has direct effect to the cash flow of bak. As a result the profit of the bank has affected.

External Effect: When banks accept deposits from the public and provide loan to the operation of business and other purposes. When the loan does not return with its interest, it becomes non-performing assets and banks will not able to return the deposited amount to their customers. The banks unable to return the deposited amount the banks are loosed public supports and faiths. Not only that much but also, the banks have to take loan at a higher rate to pay deposit, which directly affects the profitability of the banks and which lead the bank bankruptcy and dissolved.

Likewise, NPA adversely effect profitability and the reputation of the banks hence they concentrate on management of loan and advances. Classification of loan and advances, loan rescheduling and restructuring, LLP are measures of NPA management. Nepal Rastra Bank has been issuing Directives for the NPA management of commercial banks to cope up with the increasing level of NPA.

Loan classification is basis for loan loss provisioning. Loan classification is based in aging factor of loan. Sometime for the maintenance of the commercial relation and going through the viability of project or by evaluating the borrowers financial viability often back up by additional personal and corporate guarantee or additional collateral security loans are restructured or rescheduled. Restructure and rescheduled loan on its aging factor and interest and principal payment criteria is again classified underperforming and non performing loan. Loan loss provisioning is done to curb up the financial loss that occurred due to Non performing loan/assets. Inefficiency in part of bank and country's economical and political instability, prevailing cut-throat competition among bank are some factor responsible for increasing NPA of banks. Banks deal in public money so they must be responsible to the general public. In this regard bank has to do loan loss provisioning is made to safeguard the interest of stakeholders of bank. Loan loss provisioning set aside for performing loan is defined as "General Loan Loss Provisioning" and Loan loss provisioning set aside for Non Performing Loan is defined as "Specific Loan Loss Provision". For restructured and rescheduled loan additional loan loss provisioning is made. In this regard it has to follow NRB directives. NPA management aims for reduction of the risk aroused through NPA by classifying the loan and advances on the basis of aging factor. There by making loan loss provisioning every year out of operating profit so when loan finally turns into loss loan there is no heavy financial burden at that time. Hence, mitigating the risk by doing proper planning of loan loss provisioning.

2.1.12 Policies Initiated By NRB to Control the Level Of NPA

Various initiatives have been taken by the NRB to address the high risk assets such as: NPL, non-banking assets, monitoring of high risk exposures. These steps include strengthening of capital, monitoring risk, enhancing the capacity absorbing identified risk, strengthening credit management and implementing best credit policies.

i. Directive on good governance:

NRB has issued a separate directive in order to enhance the level of corporate governance in the banks and financial institutions. This comprise of setting the minimum acceptable level of code of conducts for Directors, CEO, employees. Similarly, provision of fair dealing with borrowers, prohibition to work in conflict with organization, maintaining of proper records, maintaining of confidentiality, timely submission of returns, qualification of CEO and reporting of compliance of code of conduct, requirement of audit committee, and responsibility of audit committee are also incorporated in it.

ii. Adequate capital in relation to risk weighted assets:

Generally, unidentified credit risk should be covered by the capital fund of the bank and financial institutions. Therefore, in order to absorb this type of risks, two types of measures have been prescribed by the NRB. The first is the minimum paid up capital which is Rs. 1 billion for the banks and it would vary for financial institutions as per their categories. The second is the risk based capital which is prescribed as 12% of total risk weighted assets. Out of total capital fund the requirement of core capital is at least 6%.

iii. Prudent loan classification and provisioning:

For the identified risk, the loan loss provisions are 25% for substandard, 50% for doubtful and 100% for bad loan categories.

iv. Requirement to monitor the concentration of assets:

As per NRB guidelines loans should be at least classified under 14 categories and monitored whether any exposures in the sector are within the 100% of core capital or beyond that limit. Exposure up to 100% of core capital should be monitored by the management and beyond it should be monitored by the Board of Directors.

v. Maintaining of a good loan portfolio and establishing proper system for the collection of interest and principal:

It has been a motivating task for the banks and financial institutions to recognize the interest in cash basis and classification of loans on the basis of overdue periods.

vi. Compulsion for formulating and implementing Credit Policy Guidelines (CPG):

NRB regulations require the bank and financial institutions to prepare and implement prudent credit management procedures. For this purpose CPG needs to be formulated and implemented by each bank and financial institutions. Credit management aspects needs to be specified by the CPG.A standard CPG should address all the area that cover all aspects on credit risk management policies and procedures.

vii. Strengthening the credit information system and blacklisting procedures:

In order to strengthen the financial discipline a system for obtaining credit information needs to be developed. For this purpose, the directives of blacklisting was issued by NRB almost one decade ago. This has been amended and strengthened in order to improve the credit information system and dealing with willful defaulters in a scientific way. This has facilitated to restore a good credit culture among bankers and the borrowers.

viii. Provisioning of loan write-offs:

Each bank and financial institution should have its own loan write off policy. Generally, write offs are charged against reserves made for loan losses. Top management, normally, with the concurrence of legal and audit department makes decision to write off the loans. It will be prudent to write off a loan when the amount of loan is less than that of the amount to be spent to recover the loan or while proceeding to the legal steps, there will be still an excess outstanding amount than that of the liquidation value of the loan securities or if a loan is considered as uncollected under various possibilities and circumstances of recovery.

ix. Strengthening of consortium loan management:

The consortium loans disbursed in the past were turning into problematic loan due to lack of adequate procedures for risk management in the bank. To fill this gap NRB issued policy directives to guide such exposures. It is observed that there is still a huge exposure in the consortium NPL in the Nepalese banking system.

x. Refinance facility to sick industries:

NRB has provided refinance facility for the rehabilitation of sick industries since 2001/02. During the last five years a sum of Rs. 3 billion has been disbursed to 151 hotels and 41 industries. NRB still has allocated Rs. 2billion in current fiscal year to facilitate them. If the loan is performing and fulfill the criteria, then these industries can benefit from this facility. The provision has also helped to make the loan as performing for difficult time. Working with government to deal with big defaulters of this system: It has been observed that the credit culture among the borrowers have not improved to desired level. It is international practice that either the loan should be repaid by the borrower (or by his collateral) or needs to be declared as bankrupt.

Nepal government has constituted a high level committee under the vice chairmanship of NPC, in order to suggest the measures to build financial discipline in the financial system. This committee has recommended several long term and short term measures for implementation.

xi. Other measures:

Other measures focused for maintaining a good asset portfolio comprised various prudential norms. These measures are enhancing the eve if corporate governance, limitation to investment (such as unlisted shares and debentures) and deduction in capital for such activities, monitoring of liquidity gap through asset and liability mismatch, monitoring of foreign exchange exposure etc. (Source: NRB directives, 2062)

2.2 Review of Relative Studies

2.2.1 NRB Directives to Commercial Banks

It's all about rules and regulation for commercial banks related to credit and loan from NRB, Unified Directives, 2006/07. This directive is dealt in detail as follows:

2.2.1.1 Directive Credit

Banks have to extend a certain percentage of loan and advances in the deprived and priority. Currently, deprived sector lending should be at least 0.25% to 3 % depending on the banks and priority sector lending at least 12% inclusive of deprived sector lending to their total credit portfolio. However, monetary policy of FY 2059/2060 B.S. announced by NRB has pledge to phase out priority sector credit program in next five years but to continue with deprived sector credit program. In case of shortfall in any sector, the concerned bank has to pay penalty at the highest lending rate of the bank during the shortfall period which is monitored quarterly.

2.2.1.2 Single Borrower Limit

Single borrower's limit refers to the maximum credit limits that can be extended to a customer, firm, company or companies of the same group. Such limit is currently as under:

a. Funded: 25% of Core Capital.
b. Non-funded: 50% Core Capital.

The bank, where, a single borrower enjoys credit limit more than above should bring it within the limit. If above limit is not observed by a bank, 30% additional risk weight is assigned to such credit portfolio warranting additional capital.

Interest Spread

Weighted interest spread between lending rate and deposit rate should not exceed 5%. Such rate is calculated as under:

$$\text{WALR} = \frac{\textit{InterestIncomeForSixMonths}}{\begin{array}{l}\textit{AverageInterestEarningAssets}\\ \text{Outstanding on the month - end of 6 months}\end{array}}$$

$$\text{WADR} = \frac{\textit{InterestExpensesForSixMonths}}{\begin{array}{l}\textit{AverageDepositOuts}\tan\textit{ding}\\ \textit{ontheMonthendof}\ 6\textit{months}\end{array}}$$

WALR= Weighted Average Lending Rate.

WADR= Weighted Average Deposit Rate.

Interest Spread= WALR – WADR.

Interest in move in excess of 5% spread on bi-annual basis (mid January and mid-July) should be retained in the bank as Interest Spread Reserve and no dividend can be given out of this fund. However, this fund is treated as supplementary capital.

Interest Spread limit of 5% was scrapped on 25th July 2002.

Interest Rate

Banks are free to fix interest rate on deposits and loans. Interest rates on all types of deposits and loans should be published in the local newspapers and communicated to NRB minimum on a quarterly basis and immediately when revised. Deviation of 0.50% from the published rate is allowed on all types of loans and deposits.

2.2.1.3 Loan Classification and Provisioning

A bank is required to classify their loan on the basis of overdue aging schedule and provide on a quarterly basis as follows:

Type	Criteria	Provision Requirement
Pass	Principal overdue up to 3 months	1%.
Substandard	Principal overdue up to 6 months	25%.
Doubtful	Principal overdue up to 1 Year	50%
Bad	Principal overdue more than 1 Year	100%.

Pass loan is called 'performing' and others are called 'Non-Performing Assets'. Provision requirement in case of loan given against personal guarantee only is additional 20% for pass, Substandard and Doubtful loans. Provision for restructured, rescheduled and swapped loan is 12.5%. Provision for Pass Loan made up to 1.25% of total risk weighted assets is treated as supplementary capital. Investment portfolio of the bank should be accounted at market value or cost whichever is less. If investment securities have not been listed in the stock market, 100% provision should be made against such an investment and deposited at 'Investment Adjustment Reserve'.

2.2.1.4 Sectoral Credit Limit

Credit concentration in one sector increases the risk of a bank. Hence, NRB requires banks to monitor its credit portfolio in following ways:

a. Level I: Sector where credit of a bank ranges from 50-100% of core Capital.

Bank has to devise a proper Credit Information System to monitor such credit at least quarterly.

b. Level II: Sector where credit of a bank is above 100% of Core Capital. Board of Directors of the bank should decide annually whether it wants/does not want to have credit exposure more than 100% in any sector. Decision of the Board should notify to Banking Operations Department and Supervision and Inspection Department of NRB.

2.2.1.5. Prohibition

Banks are prohibited to do following activities:

i. Purchase and sale of goods with transaction motive.

ii. Purchase of fixed assets not for own use.

iii. Extending credit facilities against the security of own share.

iv. Extending credit facilities to the director or the member of his undivided family.

v. Extending credit facilities to the shareholder holding more than 1% share and to his undivided family.

vi. Extending credit to the company where the director or the members of his undivided family have 10% stake.

vii. Acting as the managing agent.

viii. Declaration/distributed of dividend to shareholder before complete amortization of preliminary expenses accumulated loss and before appropriation of fund for capital adequacy, reserves and provisions.

2.2.1.6 Letter of Credit and Guarantee

If non-funded facilities such as letter of credit, guarantees and other liabilities turn into funded liabilities and have to pay by the financial institution, these credits have to categorized into 'pass' loan up to 90 days day then treated as 'loss' loan.

2.2.1.7 Rescheduling and Restructuring of Loan

Financial institutions may reschedule or restructure loans and advances upon receipt of written plan of action from the borrower citing the following reason:
a. Evidence for adequate collateral and documentation regarding loans.
b. Financial institutions have confidence that loans can be recovered after rescheduling.
Note:
i. Rescheduling means to extend the loan payment period that have been borrowing by the customer.
ii. Restructuring means to change the loan type, terms and conditions and including change in loan payment period.

To reschedule or restructuring the loans, it is mandatory that at least 25 % of past due interest up to rescheduled or restructuring date should be paid by the borrower. If all interests have been recovered before renewal of loans, it can be categorized in to 'Pass' loan.

2.2.2 Review from Related Articles

Professor Bishwambhher Pyakuryal (2001) has stated in his article entitled 'Our Economy is in a Volatile Stage' that the banks have not able to collect their overdue due to the increasing cumulative NPAs in Nepalese commercial banks. There is no additional demand of the investment due to the higher risk and present uncertainty. According to his article, revenue collection was negative and regular expenditure was higher than the revenue during that time which indicated volatility of the economy. Even before the declaration of emergency, the government didn't have surplus revenue to pay for the remuneration and benefits of retired civil servants. Up to 65% of the country’s development expenditure was being financed by foreign aid. He also predicted that if Nepal couldn’t meet the regular expenditure through its revenue, it would be very difficult to convince the donor community. This could push the society toward what is called a 'mass unrest society.' He also added the need to establish some kind of Asset Management Company to take over the non-performing assets (NPAs) of the government-owned banks.

"Asset Management Companies (AMCs) have a mixed outcome everywhere. In many countries AMCs are the vehicle to shift headache from the government to the institutions created by itself or in association with the private sector. Besides, AMCs would be successful if the loan is backed by safe collateral and if the collateral has marketability. No doubt, the transfer of the NPAs from the banks to the AMCs would help restructuring the balance sheets of the banks and make them viable entities. There are threats of monopoly pricing and moral hazards also. Despite this , if the large non-performing loan portfolio of some of the banks in Nepal is to be cleaned, there is no alternative. To ensure that the property of the government (owned by the banks) is not disposed at a throw away price or the asset management company does not exercise undue monopoly power to exploit the banks, government involvement in the proves has become essential in Nepal"(Khatiwada, Yuba Raj, Executive Director, NRB and Management Association of Nepal, Giving interview with the New Business Age, November, 2002).

"You Perhaps unwittingly omitted to mention another measure taken to reduce the NPA- that is the setting up of a special judicial court or Tribunal to hear the loan recovery cases. So, now before filing a case in the regular courts, the first step from the bank will be to file it with the Tribunal. This law was passed after lot of follow up by us bankers. But even after the bank wins the case from the court and takes the collateral into its possession the bank may find it difficult to sell the property, as is the case even today. The buyers simply do not come forward. When they come they are very few and often they join hands and offer a very small amount. There is a sort of a buyers' market here. So, the AMC was proposed. At this moment I cannot say whether this AMC will or will not work well in Nepal. Globally, there are mixed reports. As I have heard, AMCs could not do well in Latin America while they did very well in Thailand, Philippines and Malaysia. Our central bank people have gone there and studied how the AMCs functioned there and they are trying to model the proposed AMC of Nepal accordingly. But I think the success of AMC depends on the leadership of the AMC "(Rana Himalaya SJB, Chairman, Himalayan Bank Limited, Giving interview with the New Business Age, December 2003).

Prashanth K. Reddy (2003), in his study "“Treatment of Non-Performing Assets in Macroeconomic statistics” has stressed on the importance of a sound understanding of the macroeconomic variables, systemic issues pertaining to banks and the economy for solving the NPA problem along with the criticality of a strong legal framework and legislative framework. Furthermore, A Comparative Study of Non Performing Assets in India in the Global Context – Similarities and Dissimilarities, Remedial Measures issues has addressed. He gave following suggestions:

a. Don’t eliminate-manage. Banks should focus on management of NPA rather than elimination.

b. Foreign experiences must be utilized along with a clear understanding of the local conditions to create a tailor made solution which is transparent and fair to all stakeholders.

c. He further argues that changes required to tackle the NPA problem would have to span the entire gamut of Judiciary, Policy and the bureaucracy to be truly effective.

Ghimire, B.R. (2003) in his titled "Credit sector reform and NRB" has tried to highlight the effects of change or amendment in NRB directives regarding loan classification and loan loss provisioning." Although the circumstances leading to financial problem or crisis in many Nepali banks differ in many respects, what is common across most of the banks is the increased size of NPAs. To resolve the problem of the losses or likely losses of this nature facing the industry, Nepal Rastra Bank has, as the central bank, amended several old directives and issued many new circulars in recent years".

As opined by him, since the majority of the loans of most of the commercial banks of the country at present falls under sub-standard, doubtful and even loss categories, loan loss provisioning now compared to under the previous arrangement would be dramatically higher. The new classification and provisioning norms are very laudable as they help to strengthen banks financially. But, he added that we also must remember that the old system remained in force from 1991 to 2001 and this was probably the most volatile decade for business operation of the country as there were frequent boom and bust cycles. He has indicated that total loan loss provisioning as a percentage of total credit. He has also stated that tightening provisioning requirements on non performing loans is essential to ensure that banks remain liquid even during economic downturns.

In the conclusions he has mentioned that in the recent years NRB has worked for the management and reform of credit of the financial institutions more seriously and NRB has adopted reforms aimed not just at dealing with problem banks but also which is more important, at strengthening banking supervision to reduce the likelihood of future crises. All prudential directives of NRB in connection to credit sector reform have been made/ revised on or after April 2001. To adapt to such a sudden change, there can be some difficulties. For a better and harmonized reform, NRB should continue to be supportive, proactive and also participative to take opinions of bankers for a change in regulation/policy taking place in the future.

In the article by Regmi, Yogendra (2006) titled Non-performing Assets Management" the writer stated about the management of NPAs in the commercial banks. He writes, the NPAs includes the non-performing loan, non-banking assets, remaining non performing loan, suspend interest and unutilized assets. The increasing NPA are the emerging problem in commercial banks, which is the main factor of failure of banks.

NPAs caused by investment of assets in non-performing sectors, lack of future prediction, lack of proper supervision, monitor, control, lack of information and failure of recovery of loan and their interest on time. He also added the low quality of collateral of loans failure of projects and lack of appropriate rules and regulations to punished the bad loan takers. He added that increasing NPAs directly affects to the banks, investors and human resources. Not only that but also it affects the customer, economy of country and business activities. Increasing NPA has impact on banks. It affects directly on profitability and human resources and in external, it affects to customers, investors, management and country's economy.

He concludes that it is like a cancer of banks. Thus, it is necessary to control this cancer in time; otherwise it becomes a big issue for bankruptcy. NPA have to need microanalysis to protect the banks, investors, customer, human resources and country's economy. For this a clear 'Road Map' is required. To success the laws and policies, all the stakeholders should take responsibilities.

Narayan Sapkota (2004) in his article published on 19thMay 2004 in Rajdhani National Daily entitled "Portion of NPA in Commercial Banks – High in Public, Low in Private", has highlighted the fact of NPA as being less in private banks in comparison to public banks. He has mentioned that the NPA of two big nationalized banks (NBL and RBB) was about 60% and the loans were in very serious situation. He further added that in order to improve this situation and to make healthy banking environment, financial reform program had been brought; as its consequences, the management of these two big banks was handed to foreign company on a contract but the ratio of NPL was not reduced.

While most of the privately owned banks had NPA within international standard, some had it above that standard. As per international standard 5% NPA was acceptable during 2004. He also mentioned the average NPA of the Nepalese banking sector to be 30% which is very high.

2.2.2 Review of Related Dissertations

For the purpose of this study, relevant thesis works regarding several aspects of banking sectors conducted by different intellectuals and students are discussed below:

In the study of Rajesh Bhandari (2004) titled "Analysis of Non Performing Assets of Commercial Banks of Nepal", he found following major findings and suggested following major recommendations.

Major Findings:

a. There is negative correlation exists between NPA with ROA and ROE.
b. The external factors are major contributing for the growth of NPA in any banks. Political and economic situation of the country and borrower related factors were found most crucial in the conversion of good loans into bad.
c. Lack of asset management company, Execution of the court proceedings and cumbersome legal procedure and economic recession and political instability are major problems associated with the management of NPA.

Major Recommendations:

a. Formulation of NPA management committee and reviewing of its performance on monthly.
b. Approaching to loan recovery tribunal for dispose off bad loans from loan portfolio.
c. All banks should make initiative towards the establishment of Asset Management Company so that bad loans of the banks could be removed from the Balance Sheet.

Govind Ghimire (2005) in his research, "Non Performing Assets of Commercial Banks: Cause and Effect" found following major findings and advised following major recommendations:

Major Findings:

a. Non Performing Assets on overall profitability of the bank tend to have inverse relationship. Profitability is affected due to provisioning requirement.
b. There is some relationship between credit extend and increment on Non Performing assets.
c. It may be significant in case of aggressive credit expansion. Findings showed that Non Banking Assets is created due to having Non Performing Assets.

Major Recommendations:

a) Float loan on business position, viability and business need. Proper attention of personal integrity of borrowers should be taken.
b) Strong follow up system in commercial banks for recovery of due loans. It is required to have general proactive of follow up before the loans turn into bad.
c) Avoid Credit Concentration to a single sector and project.
d) Strong Legal system should be created. Government should be create necessary laws and take necessary actions. The tribunal constituted under Bank and Financial Institutions loan recovery Act 2058 should pay special attention while translating the provision of the act into practice. Bank should be empowered to proceed to arrest the will defaulters.
e) Formation of Assets Management Company.
f) Avoidance of Undue Pressure.

He concludes that profitability of commercial banks has been affected due to increasing level of Non Performing Assets. Bad intensions, weak monitoring and mismanagement were found the major responsible factors for NPA growth. He further suggested the bank to analyze the loan proposal properly before extending any loan and conduct all feasibility study do the project. The banks should also act immediately to collect the bad loans.

In the research conducted by Dirga Narayan Kafle (2005) on “Non Performing Loans of Nepalese Commercial Banks”, devised following major findings and suggested following major recommendations to be adopted in order to decrease the level of NPA and increase the efficiency of the commercial banking industry.

Major Findings:

a. The return on assets (RoA) and return on equity (RoE) of the bank somehow depend upon Non Performing Loan. The bank should reduce its NPL to increase RoA and RoE of the bank.
b. Management inefficiency is one of major cause behind high level of NPA of Commercial banks.

Major Recommendations:

a. Those banks having high level of NPL should take immediate action. The bank should dispose off the collateral taken from the borrower and recover principal and interest amount.
b. Corporate structure of the banks play key role in the effective loan management. There should be separate department for credit appraisal, documentation, disbursement, relationship maintenance and inspections.
c. Maintenance efficiency should be enhanced. Hence necessary trainings should be given to the managers and staffs.

Saroja Poudyal (2006) in her research “A Study of NPA of Commercial Banks of Nepal” came across following major findings and gave following major recommendations:

Major Findings:

a. In recent years Nabil has shown significant decrease in Non Performing Assets, which is the result of banks effective credit management and its efforts in recovering bad debts through establishment of recovery cell.
b. High degree of negative correlation exists between NPA and ROE of Nabil Bank. The banks should reduce there level of NPA to increase ROE and ROA and profitability.
c. Loan loss provision for Doubtful loan seems to be higher in case of both banks Nabil and SCBNL.

Major Recommendations:

a. Create credit appraisal department to receive application and gather necessary information and give approval for lending.
b. Credit administrative department to disburse loans transaction, the repayment of principal and interest and provide information regularly to executive level.
c. Legal department to properly execute necessary legal documents for the safeguard of bank. Update the documents and its validity.
d. Credit control Department (Recovery Cell) to regularly follow up the borrowers about their installment dues and remind them their due dates in case of default.

She concludes that ineffective credit policy, political pressure to lend to low credit profile borrowers, overvaluation of collateral are major causes of mounting NPA of the banks. Other factors lending to accumulation of non performing assets is weak loan sanctioning process, ineffective credit monitoring and supervision system, economic slowdown, borrowers' misconduct, etc. He further suggests continual review and classification of loan enables banks to monitor quality of their loan portfolios and to take remedial action to counter deterioration in credit quality. In addition to this establishing recovery cell, hiring Assets Management Company are also measures to resolve the problem of non performing loan.

Niranjan Shrestha (2007) in his research, "Non Performing Assets of Commercial Banks" made following major findings and advised following major recommendations:

Major Findings:

a. The result shows significant difference in NPA of commercial banks and international standard of 4%.
b. High degree of negative correlation exists between NPA with RoA and RoE. The banks should reduce their level of NPA to increase RoA, RoE and profitability.
c. Management in efficiency is one of the major causes behind high level of NPA of commercial banks.

Major Recommendations:

a) Follow the regulation of Nepal Rastra Bank
b) Those banks having high level of NPA should take immediate action. The bank should dispose off the collateral taken from the borrower and recover principal and interest amount.
c) Formation of assets management company is necessary.

Kapil Mani Gyawali (2007) in his study titled "Impact of NPA on Profitability of Commercial Banks" found following major findings and gave following major recommendations.

Major Findings:

a. The low ratio, i.e., total assets ratio of SCBL is the indication of risk averse attitude of the management or they have the policy of investing low in the risky assets like loan & advance. They have the higher proportion of their investment in risk-free assets like treasury bills, national saving bonds etc.

b. The average ratio of nonperforming assets to total loan & advance indicates the proportion of non- performing assets to total loan & advance. RBB has significantly higher proportion of the non performing loan in the total loan portfolio & this ratio, which exhibits the critical condition of the bank.
c. NPA to total assets shows how much NPA is there in total assets. SCBL has the lower ratio of NPA to total assets & it can be seen that it provides less amount of loan & advance, where as RBB has the highest ratio of NPA to Total Assets because it provides the higher amount of its resources as loan & advances.
d. High negative correlation of NBL is the result of high non- performing loans in the total loan portfolio.

Major Recommendations:

a. SCBL has low loan & advances to total deposit ratio, i.e., lower than the standard range. Therefore they should utilize the deposited fund efficiently.
b. RBB has high level of NPA total assets ratio with comparison to rest banks which reduce the profitability of the banks. Therefore they should reduce the portion of non- performing assets.
c. Negative return on loan & advances ratio which indicates they are ineffective to employee its resource in the form of loan & advances. Therefore, they should pay attention on the efficiency of their credit department.
d. Commercial banks should hire Assets Management Co. to resolve the problem of NPA.

The study conducted by Anjana Guragain (2008) “Analysis of Nonperforming Assets of Commercial Banks of Nepal” found following major recommendations.

Major Finding :

a. The NPA proportion of total Loan and Advances of whole commercial banking industry is in decreasing trend. Among the banks selected for this study, Himalayan Bank has highest level of NPA where as the lowest is NIC.
b. The Non Performing Assets have inverse relationship with Return on Equity and Return on Assets. That NPA decreases the RoE and RoA of the organization. Hence it decreases the profitability of the organization.

Major Recommendations:

a. Those banks, which have high level of NPA, should take necessary action towards recovering their bad loan as possible. In case of doubtful to repay loan, the bank should dispose off the collateral taken from them and recover the principal and the interest amount there of.
b. The bank should take proper valuation of collateral so that it can at least recover its principal and interest amount in case of failure of the borrower to repay the loan.
c. 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.

Gyawali (2010), in his study, "Scrutinizing Non Performing Assets in Commercial Banks (with special reference to SBI, NIC and MBL)", has the main objective to make scrutiny of non performing assets of commercial banks, especially of Nepal SBI Bank Ltd, Nepal Industrial and Commercial Bank Ltd. and Machhapurchhre Bank Ltd. The specific objectives are explained to measure to what extent does the non performing asset adversely affect the profitability of banks, to measure the credit risk of the banks and to measure the relationship between non performing assets and total deposit.

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

2.3 Research Gap

All of the above research is based on the quantitative analysis and has ignored the qualitative analysis. In other words, it has been observed that the previous studies have neglected the factors that augment the chances of the turning good loans to non performing assets. Further, the aforementioned studies have not considered the opinions of the borrowers on the loan management procedures of the banks, the internal reasons for the nonperforming assets and other aspects that can alleviate the nonperforming assets . The present study attempts to fill all these research gaps by taking reference of Nabil bank Ltd., Himalayan Bank Ltd., Standard Charted Bank Ltd., Bank of Kathmandu Ltd., Everest Bank Ltd. and Nepal Industrial and commercial Bank Ltd. along with the analysis of the secondary data related to the nonperforming assets.

From the study of previous thesis it has been found that increasing Non-performing assets is one of the major challenges faced by Nepalese commercial banks in the present context. There are many research conducted on this topic. In other research, most researchers used correlation between the Nonperforming assets with Net Profit, Return on Equity and Return on Assets.

In this research, ANOVA test has been used to test significant difference between the levels of NPA among the commercial banks, which has not been done in other research. In this research six commercial banks are taken into consideration which is the largest sampling than previous research. The recommendations are given regarding pre sanction period and post sanction of loan and after loan being turned into non performance. Its finding compare with international standard.

The NPA is in decreasing trend from 2007/08 to 2010/11. It's increasing in high level in 2011/12. Most of the banks have been found to have uncontrolled NPA where as they are facing strict housing loan rules by NRB. However, all commercial bank has already provided huge long term housing loan. Inverse relations were found between the NPA and RoE and NPA and RoA. The level of NPA among the banks showed no significant difference. Non Performing Assets adversely affected the profitability of the bank.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Background

Research Methodology is a way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. In it we study the various steps that we generally adopted by a researcher, studying his research problem among with the logic behind them.

Furthermore, research is a systematic inquiry of any particular topic and methodology is the method of doing research in well manner and human nature's get satisfied with the same thing that regularly takes place for a long time. For this they gather the information and analyze them to achieve their goal. The method that applies during this knowledge gaining research is known as research methodology means the analysis of specific topic by using a proper method. In other words, research methodology is a systematic study of the research problem that solves them with some logical evidence. The population and sample, source and data collection techniques, and data analysis tools and the hypothesis to be tested, which are associated with the study, have been discussed in this chapter.

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. In other words research design is the frame work for a study that helps the analysis of data related to study topic. Research design is specification of methods and procedures for acquiring the information needed. It is the plan, structure and strategy of investigation conceived so as to obtain answer to research question and to control; variances. It is the overall operational pattern of framework of the projects that stipulates what information is to be collected from which sources by what purpose.

The main objective of research design is to make analysis in non-performing assets of commercial banks in Nepal and provide valuable recommendation. In other words, this research is aimed at studying the non-performing assets of commercial banks.

This will follow analytical and descriptive research design. And it also analyzes the composition of trend of non-performing assets, loan recovery and profitability condition of commercial banks. The design for this research is made by financial statistical tools. So it can be also called roadmap for Research study or blueprint of the study. The Research Design is the overall operational pattern of frameworks of the project that stipulates what information is to be collected, from which source, by what procedures, how to conduct analysis, etc. The research design of this study is analytical as well as descriptive. This study is the evaluation of Non Performing Assets of commercial banks of Nepal.

3.3 Population and Sample

A representative part of population selected from it with the objection of investigation its propertied is called sample. The census of the population is neither feasible nor desirable for the study of this nature that is why a sample from the population has therefore selected for the purpose of this study. For purpose of study, the random sampling had been used to analysis about total member number and inters group number.

The commercial banking industry is the population of this research. Recently, there is all together 32 commercial banks operating in Nepal and out of them, six banks are taken as sample for this study. Six commercial bank cover Approximately 19 % of population of commercial banks. Since profitability is a major factor related to NPA of banks, it was taken as the basis for taking sample. Profitability was linked with the market share value of the banks. Some of the banks in the sample have high market share value whereas some have moderate and low value. This variation was taken into consideration in order to make the study representative to the extent possible to the commercial banking industry of Nepal. Following are the commercial banks currently operating in Nepal. For the purpose of study only six banks are taken as sample for the study. The total collection of commercial banks is the population. The sample commercial banks are as follows:

Table 3.1

List of Commercial Banks in Nepal

S.N.	Commercial Bank Name	Operation Date	Head Office	Selected Bank
1	Nepal Bank Limited (NBL)	1937/11/15	Kathmandu	
2	Rastriya Banijya Bank (RBB)	1966/01/23	Kathmandu	
3	NABIL Bank Limited (NABIL)	1984/07/16	Kathmandu	1
4	Nepal Investment Bank Limited (NIBL)	1986/02/27	Kathmandu	
5	Standard Chartered Bank Nepal Ltd. (SCBN)	1987/01/30	Kathmandu	1
6	Himalayan Bank Limited (HBL)	1993/01/18	Kathmandu	1
7	Nepal SBI Bank Limited (NSBI)	1993/07/07	Kathmandu	
8	Nepal Bangladesh Bank Limited (NBBL)	1993/06/05	Kathmandu	
9	Everest Bank Limited (EBL)	1994/10/18	Kathmandu	1
10	Bank of Kathmandu Limited (BOK)	1995/03/12	Kathmandu	1
11	Nepal Credit and Commerce Bank Ltd. (NCCBL)	1996/10/14	Siddharthanagar	
12	Lumbini Bank Limited (LBL)	1998/07/17	Narayangadh	
13	Nepal Industrial & Commercial Bank Ltd. (NIC)	1998/07/21	Biratnagar	1
14	Machhapuchchhre Bank Limited (MBL)	2000/10/03	Pokhara	
15	Kumari Bank Limited (KBL)	2001/04/03	Kathmandu	
16	Laxmi Bank Limited (LXBL)	2002/04/03	Birgunj	
17	Siddhartha Bank Limited (SBL)	2002/12/24	Kathmandu	
18	Agriculture Development Bank Limited Nepal	2006/03/16	Kathmandu	
19	Global Bank Limited (GBL)	2007/01/02	Birgunj	
20	Citizens Bank International Limited (CBIL)	2007/06/21	Kathmandu	
21	Prime Commercial Bank Limited (PCBL)	2007/09/24	Kathmandu	
22	Sunrise Bank Limited (SRBL)	2007/10/12	Kathmandu	
23	Bank of Asia Nepal Limited (BOA)	2007/10/12	Kathmandu	
24	DCBL Bank Limited (DCBL)	2008/05/25	Kathmandu	
25	NMB Bank Limited (NMB)	2008/06/02	Kathmandu	
26	Kist Bank Limited (Kist)	2009/05/07	Kathmandu	
27	Janata Bank Nepal Limited (JBNL)	2010/04/05	Kathmandu	
28	MEGA Bank Nepal Limited	2010/07/23	Kathmandu	
29	Commerz and Trust Bank Nepal Ltd.	2010/09/20	Kathmandu	
30	Civil Bank Ltd.	2010/11/26	Kathmandu	
31	Century Commercial Bank Limited.	2011/03/10	Kathmandu	
32	Sanima Bank Limited.	2012/02/15	Kathmandu	

(Source: Banks and Financial Institution Regulatory Department of NRB in 2011/12)

3.4 Profile of Selected Banks

In this research, the total number of commercial bank increased to 32 with 1245 branch in fiscal year 2011/12. Brief profile of selected six commercial banks is presented below.

3.4.1 Nabil Bank Ltd.

Nabil bank is a first foreign joint venture bank and it is one of the most successful banks in Nepal. It was established in 16th July, 1984 A.D. in joint venture with United Arab Emirates Bank. Its current share capital is Rs.491, 654,400 and Total Assets Rs 27,253,393,008. It has 36 branches currently in operation throughout Nepal.

3.4.2 Himalayan Bank Ltd.

Himalayan Bank Ltd was established in 18th January, 1983 A.D. in joint venture with Habbib Bank Ltd of Pakistan. It is very aggressive in lending. Among private banks operating in Nepal, Himalayan bank Limited has the highest loan portfolio. Its current share capital is Rs.810,810,000 and Total Assets is Rs. 33,519,141,111. It is currently supplying its services through 31 branches.

3.4.3 Bank of Kathmandu

Bank of Kathmandu Limited (BOK) has today become a landmark in the Nepalese banking sector by being among the few commercial banks which is entirely managed by Nepalese professionals and owned by the general public. BOK started its operation in 12th March, 1995 A.D. with the objective to stimulate the Nepalese economy and take it to newer heights. It's current share capital is Rs. 603,141,300 and Total Assets Rs.14, 570,098,804. BoK is currently operating 37 branches.

3.4.4 Standard Chartered Bank Ltd

Standard Chartered Bank Nepal Limited has been in operation in Nepal since 30th January, 1987 A.D. when it was initially registered as a joint-venture operation. Today the Bank is an integral part of Standard Chartered Group who has 75% ownership in the company with 25% shares owned by the Nepalese public. Its current share capital is Rs.41, 32, 54,800 and total assets Rs.28,596,689,451 .It is currently providing service through 15 branches.

3.4.5 Nepal Industrial and Commercial Bank Ltd.

Nepal Industrial & Commercial Bank Limited (NIC Bank) commenced its operation on the year 21st July, 1998 A.D. The bank was promoted by some of the prominent business houses of the country. NIC is the first to be ISO 1901:2000 certified for quality management. It's current share capital is Rs. 660,000,000 and total assets Rs.11, 678,834,055. It is currently providing service through 26 branches.

3.4.6 Everest Bank Ltd.

Everest Bank Limited is established on 18th October, 1994 A.D. a joint venture with Panjab National Bank Ltd of India. Punjab National Bank (PNB), it's joint venture partner (holding 20% equity in the bank) is the largest nationalized bank in India. With its presence virtually in all the important centers at India and over 5600 ATM counters, Punjab National Bank offers a wide variety of banking services which include corporate and personal banking, industrial finance, agricultural finance, financing of trade and international banking. For its excellence in banking services, it was recently awarded the "Best Bank Award 2011"amongst all banks in India by the leading corporate magazine, Business India. Everest Bank Limited (EBL) provides customer-friendly services through its Branch Network and all it's the branches are connected through Anywhere Branch Banking System (ABBS), which enables customers for operational transactions from any branches. The bank has 45 Branches, 55 ATM Counters and 21 Revenue Collection Counters across the country making it a very efficient and accessible bank for its customers, anytime, anywhere.

3.5 Types and Sources of Data

Without any data, nothing can be studied. For the purpose of analysis in this research, mainly the secondary data will be used. The facts and figures provided by the banks will be taken into consideration. But some data which are not published will be directly collected from the bank as a primary data. The bank professionals will also be interrogated wherever needed. Collection of relevant data is essential for correct and important decisions.

The main source of data is the annual reports published by the banks. The statistical reports of the NRB are also the main source. Following are the secondary sources of data are used.

i. Annual reports, newsletter, brochures of the concerned banks,
ii. Relevant laws guidelines and directives of NRB,
iii. Text books regarding the subject matter,
iv. Articles published in Newspaper, Journals, magazine etc,
v. Unpublished thesis and dissertation related to subject matter,
vi. Various reports published by NRB, CIB etc,
vii. Websites of related field

3.6 Data Collection Techniques

In order to collect the data annual report published by the commercial banks and Nepal Rastra Bank (NRB), Economic report and other published statistical are collected. Data from such reports are used in this study and to obtain the additional information, informal talk made with bank personals. Similarly information is collected from Newspapers, Magazines, Web sites, bulletin, booklets and journal published from relative banks.

After the identification of sources of data, the required data for the study have been gathered through the following procedures:

a. First of all nature of data have been identified

b. For the collection of secondary data yearly annual report of the sampled banks have been taken for the period of five fiscal years i.e. during fiscal year 2007/08 to 2011/12 A.D.

c. For the collection of primary data the official from sample banks have been identified as the respondent and questionnaire have been distributed and required information are collected.

3.7 Data Processing Procedure

Data collected from various sources were in raw form. They were classified and tabulated as per the nature of the study and in accordance of the data. Simple percentage tool was used as arithmetical tool and Karl Pearson Coefficient of correlation was also used as a statistical tool. Financial data of the sampled bank have been put aside and the primary data collected through questionnaire have been tabulated as per the need of calculating financial and statistical tools.

3.8 Data Analysis Tools

For the fulfillment of the study objectives various financial tools as well as statistical tools have been employed. The description of financial tools as well as statistical tools is described below.

3.8.1 Financial Tools

Financial analysis is the process of identifying the financial strength and weakness of the firm by properly establishing relationship between the item of balance sheet and profit & loss account. While adopting financial tools, a ratio is used as benchmark for evaluating the financial position and performance of any firm. Furthermore, "Financial analysis is the use of financial statement to analyze a company's financial position and performance and to assess future financial performance," (Subramanyam, 2003: 13)

3.8.1.1 Technical (Trend) Analysis

In this analysis the past trend is analyzed of any data and future movement is predicted. Technical analysis presents the past data in the charts and predicts the patterns of future. It shows where the organization is going in that particular matter of analysis. In the technical analysis different charts and picture are used which makes it simple to understand. It is used to analyze the data as well as to present the data.

3.8.1.2 Ratio Analysis

Ratio analysis is the most effective tool of financial analysis. It is the widely used tool in financial analysis. A ratio simply shows the relationship between the two variables or one another. It presents the relative strengths and weakness of any firms or organization and financial performance of the organization. It summaries the financial figurer and make quantitative judgment about the financial performances and positions. The relationship between two accounting figures expressed mathematically is known as financial ratio. To make analysis, we can use various ratios. But only those ratios have been calculated which are related to the subject matter.

Net profit to Loan and Advance Ratio

a. Net Profit to Loan and Advances = $\frac{Net\ Profit}{Loan\ \&\ Advances} \times 100\%$

NPA to Loan and Advance Ratio

b. NPA to Loan and Advances = $\frac{NPA}{Loan\ \&\ Advances} \times 100\%$

It is the percentage of Non Performing Loan and Advances. It shows how much of the total loan and advances are not performing well.

Return on Equity

This ratio assesses the effectiveness of the management with respect to both its operating and financing decisions. (Pradhan, 2004: 59)

c. ROE = $\frac{NetIncome}{CommonEquity} \times 100\%$

Return on total Assets (ROA)

This ratio measures the return on total assets after interest and taxes

d. ROA = $\frac{NetIncome}{TotalAssets} \times 100\%$

These three net Profit Ratio, ROA and ROE are used to check the profitability of the firm. It measures the efficiency and effectiveness of the firm's management.

3.8.1.3 Test of Hypothesis

As per objective of the study, following hypothesis are formulated.

T test statistics:
These are the process of T test calculation;

Sample Mean ($\bar{x}$) = $\frac{\sum X}{n}$

$S^2 = \frac{1}{n-1} \sum \left(X - \bar{X} \right)^2$

Test Statistics under Hypothesis

$$t_{cal} = \frac{X - «}{\frac{S}{n}}$$

Whereas, $\sum X =$ Sum of Variable ‘X’

« = Population Mean

Hypothesis 1

There is no significant different between the NPA level of commercial banks of Nepal and international Standard of 4%.

Hypothesis 2

There is no significant difference between the NPAs of commercial banks of Nepal.

3.8.2 Statistical Tools

Statistical tool is the mathematical technique used to facilitate the analysis and interpretation of the performance of the organization. It helps to compare the performance, strengthen, weakness of the organization. It also helps to present the data, show the relation and deviations or differences of variables of organizations. In this study, the following statistical tools are used:

3.8.2.1 Mean (Average)

Mean is defined as sum of observations divided by their number in the selected sample. It is the popular measure for representing the entire data. It is the average of the data. It is further used in many statistical and financial analysis tools

$$\text{Mean } \bar{X} = \frac{\sum X}{n}$$

Where, $\sum X$ = Sum of Variable ‘X’

n = No. of observation

3.8.2.2 Correlation Analysis

Correlation coefficient is defined as the association between the dependent variable and independent variable. It is a method of determining the relationship between these two variables. If the two variables are so related change in the value of independent variable cause the change in the dependent variable then it is said to have correlation coefficient.

The most widely used in practice for calculating correlation coefficient between two variables is "Karl Pearson's correlation coefficient." The correlation coefficient between two variables X and Y, usually denoted by r (X, Y) or r_{xy} or simply r, is a numerical measure of linear relationship between them and is defined as

r_{12} = Correlation coefficient between X_1 and X_2

$$= \frac{n\sum X_1 X_2 - \sum X_1 \sum X_2}{\sqrt{n\sum X_1^2 - \left(\sum X_1\right)^2}\sqrt{n\sum X_2^2 - \left(\sum X_2\right)^2}}$$

Where, r = correlation co-efficient

n = Total no. of year

X = Dependent Variable

Y= Independent Variable

The value of r lies between -1 and + 1 symbolically,

$$-1 \leq r \leq +1$$

The correlation coefficient is systematic in two variables, i.e. $r_{xy} = r_{yx}$ (It can be verified by exchanging X and Y in the formula). It is a pure number independent of the unit of measurement.

Interpretation of correlation coefficient

i. When r = +1, there is perfect positive correlation.
ii. When r = -1, there is perfect negative correlation.
iii. When r = 0, there is no correlation.
iv. When r lies between 0.7 and 0.999 (– 0.7 to – 0.999) there is a high degree of positive (or negative) correlation.
v. When r lies between 0.5 and 0.699 (– 0.5 to – 0.699) there is a moderate degree of positive (or negative) correlation.
vi. When r is less than 0.5, there is low degree of correlation.

3.8.3.3 Analysis of Variance (ANOVA)

Analysis of Variance often abbreviated ANOVA is a powerful statistical tool for tests of significance to evaluate differences among the parameters of several groups. It is specially designed to test whether the means of more than two quantitative populations are equal. It consists of classifying and cross classifying statistical results and testing whether the means of a specified classification differ significantly. (Sharma, Chaudhari, 2003: 330).

There are two types of ANOVA; One way ANOVA and Two way ANOVA. In one factor ANOVA only one factor is considered at a time and we may conduct the experiment through a number of sample studies. The main objectives of one way ANOVA is to analyze difference among the group means by considering one factor (one variable). Through an analysis of the variation in the data, both among and within the several groups, we are able to draw conclusions about possible differences in group means.

F-test statistics:

$$F = \frac{MSC}{MSE}$$

Where,

MSC = Mean sum of squares within samples (columns) = $\frac{SSC}{K-1}$

MSE = Mean sum of squares within samples (errors) = $\frac{SSE}{n-K}$

There are many situations where the response variable of interest may be affected by more than one factor. Under Two-way ANOVA, the effect of two factors (two variables) is studied simultaneously. The data are classified according to two different factors. The effect of one factor is studied through the column wise figure and totals and of the other through the row wise figures and totals.

The Two-way ANOVA F- test statistics are:

$F = \frac{MSC}{MSE}$ …………… (1) With d.f. is [(C – 1), (C – 1) (r – 1)]

And $F = \frac{MSR}{MSE}$ .... (1) With d.f. [(C – 1), (C – 1) (r – 1)].

Where, MSC = Mean sum of squares of variations between columns

MSR = Measn sum of squares of variations between row

MSE = Mean sum of squares of variation due to error (residual)

In order to find MSC, MSR and MSE, we need to find SSC, SSR, SST and SSE.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

In this chapter, efforts have been made to present and analyze the collected data. Data collected from various sources were classified and tabulated as requirement of the study and in accordance to the nature of the collected data. It is the body of the report. Data collected from various sources were classified and tabulated as requirement of the study and in accordance to the nature of the data. To make easier and clearer to the understanding of the study, data are presented in the table and figures also. Different arithmetical and statistical tools are used to analyze the data. To make easier and clearer to understand, data are presented in the required figure also. Simple percentages are used to analyze the date as arithmetical tools. Karl person's correlation co-efficient is also used to analyze data as statistical tools. This chapter presents the secondary data analyses that are collected from the annual reports of the sample banks. For the purpose of study five years data from fiscal year 2007/08 to 2011/12 of all sample banks have been taken into consideration. In this chapter, two type of analysis have been carried out, i.e., description analysis and inferential section of analysis.

Descriptive Analysis

Descriptive analysis is carried out to assess the NPA level and its relationship with other key factor in the firms under study. Five years data relating to NPA, operating profit, net profit and loan loss provisioning position and NBA ratio to all the sample banks have been obtained. For the analysis of trend of NPA with other related variable this has been subdivided into three parts:

Firstly, for the analysis of the trend of NPA, operating profits, net profit and loan loss provisioning increment level compared to previous year has been computed. Then trend of NPA with operating profit, net profit and loan provisioning is compared to assess whether the increment ratio of NPA is similar to increment ratio of operating profit, net profit and loan loss provisioning. In second part, trend of loan portfolio and NPA increment level on the basis of previous year positions have been computed. The purpose of assessing the trend is for finding the relationship of loan expansion and growth of NPA.

Third part of the analysis is for assessing trend of NPA and NBA, since NBA is created when the security either current of fixed kept in the banks custody auctioned after the borrower defaults. Situation arises when banks has to accept the ownership of the security in its own name then NBA has significant relationship with NPA.

4.1 Loan & Advances, Net Profit and NPA of Nepalese Commercial Bank

As at mid July 2011, the numbers of commercial banks in Nepal were thirty-two. The public sector banks, which are three in number and have large branch networks 6 throughout the country, have still got substantial share in the total assets of the industry. The assets that are taken over by the bank in course of the recovery in respect of the default by the borrowers are classified as non-banking Assets. The share of these banks on total deposits, loans, and total assets has been increasing gradually. Banks are becoming efficient in terms of capital, technologies, products and services and overall management. The competition in the market is getting tougher as the number of these institutions is increasing rapidly and the market size being the same. Banks are always faced with different types of risks that may have a potentially negative effect on their business. Excessive and poorly managed risk can lead to losses and thus endanger the safety of a bank's depositors. Nepal Rastra Bank laid significant emphasis on the adequacy of a bank’s management of risk. Nepal Rastra Bank regulate the commercial banks for the purpose of providing guidelines to risk management systems that are expected to be in place.

Table 4.1

Loan and Advances, Net Profit and NPA of Commercial Banking Industry

(In millions)

Year	2007/08	2008/09	2009/10	2010/11	2011/12
Loan & Adv.	229363.91	306638.13	384315.13	469160.83	528023.14
NPA	24215.85	18648.50	13574.64	11223.34	16871.58
Net Profit	10.56	6.08	3.53	2.39	3.20

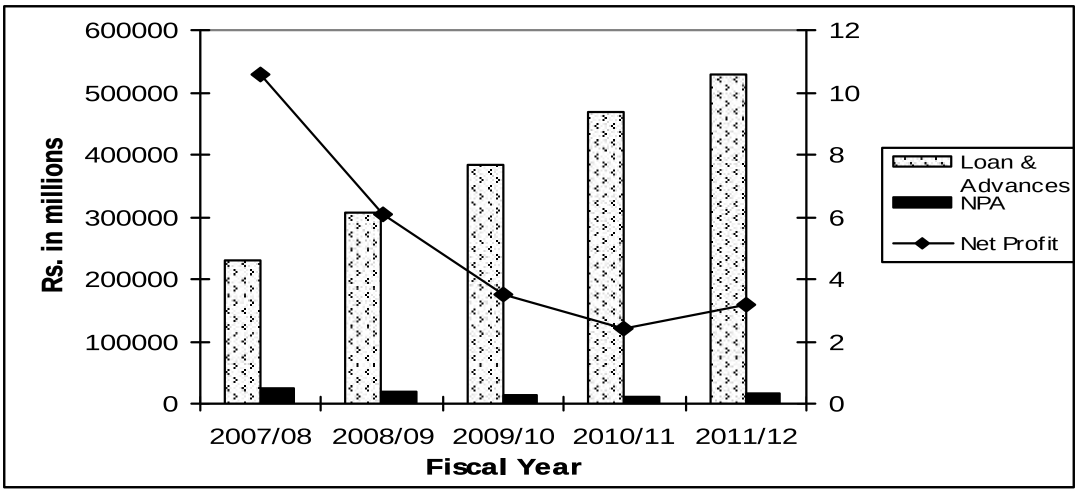
(Source: NRB, Banking and Financial Statistics, 2011/12)

The Loan and Advances of the whole commercial banking industry is growing significantly. Furthermore, every new fiscal year has been increasing trend of the loan and advance. However net profit of the commercial bank industry has decreased 2.39 million in FY 2010/11. The net profit of bank industry has increased by 34 percentages in FY 2011/12 than previous fiscal year. At the same time the NPA of the whole commercial bank industry is also decreasing slowly but steadily up to FY 2010/11. The ratio of nonperforming loan of the commercial banks has been improving after the implementation of financial sector reform program. The NPA of the whole commercial banking industry is decreased to 16871.58 million in FY 2011/12 from 24215.85 million in FY 2007/08.

Moreover, the net profit of the whole commercial banking industry was decreasing trend until FY 2010 but it's sudden increased Rs. 3.2 million in FY 2011 with increasing Loan and advance. Increasing profit shows the very encouraging for the industry. The NPA to Loan and advance ratio of the Commercial banking industry is 3.20% in FY 2011/12 which is proper standard ratio on NPA to Loan and advance compare with international banking industry(3.2%<4%). But the discouraging aspect is the NPA level of commercial banks industry is increased in 2011/12 than previous fiscal year. The NPA of private commercial banks need to do a lot to bring the NPA to a minimum level. All figure shows that the amount of Left hand side Loan and Advances and NPA whereas Right hand side shows the amount of Net profit.

Figure 4.1

Loan and Advances, Net Profit and NPA of the Commercial Banking Industry



(Source: Table No. 4.1)

All figure shows that the amount in millions on Left hand side Loan and Advances and Non performing Assets whereas Right hand side shows the amount of Net profit in millions. The above figure 4.1 shows the Loan & Advances is in increasing trend. NPA of banks is in decreasing trend up to 2010 after that it's increased in FY 2011/12. However, Net profit is in decreasing trend up to 2010/11 then it has increased sudden in 2011/12. Overall, Loan and Advance, NPA and Net profit all are growing in FY 2011/12 than previous fiscal year 2010/11. It is a positive and prosperity signal of the nation's economy but commercial banks would conscious on increasing NPA.

4.2 Loan & Advances, Net Profit and NPA of Selected Banks

4.2.1 Nabil Bank Ltd.

Table 4.2

Loan & Advances, Net Profit and NPA of Nabil Bank

(In millions)

Year	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
L & A	15903.00	21769.80	27589.93	33030.93	38922.74
NPA	178.30	171.40	220.72	45.58	689.85
Net Profit	673.96	746.47	1031.05	1141.05	1337.75
NPA / L& A (%)	1.12	0.79	0.80	0.14	1.77

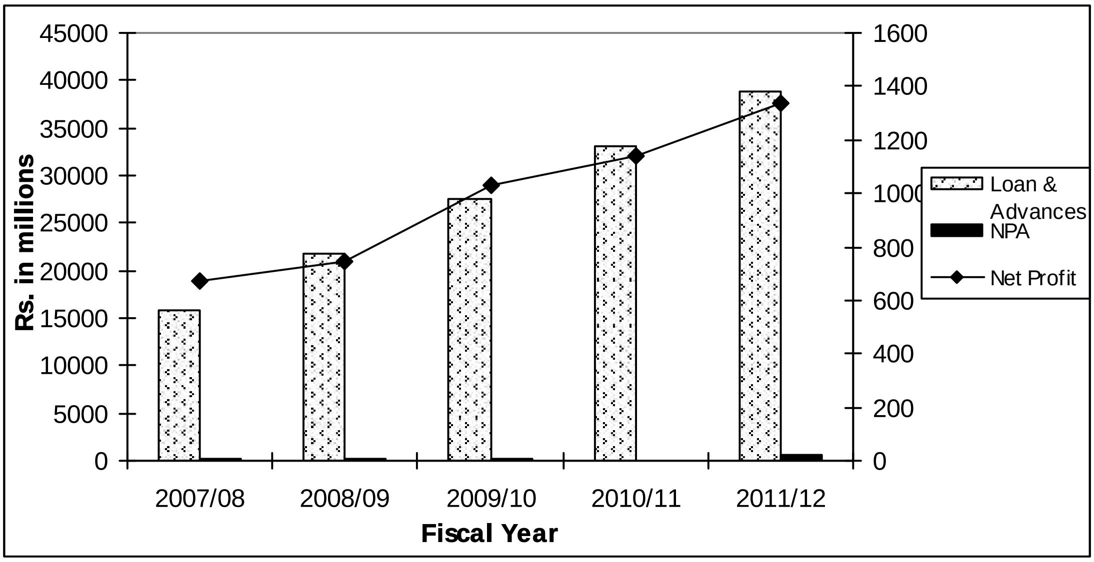
(Source: http://www.nabilbank.org.np)

In above table 4.2 we see that the Loan and advance , Non performing Assets (NPA) and Net Profit (NP) of Nabil Bank Limited in FY 2007/08 to 2011/12. Nabil Bank has increasing trend in the Loan and Advance as well as Net profit. Where as it has fluctuating trend in NPA. It has improved a lot in the quality of loan and advance . The NPA ratio to total Loan advance has dropped to 0.14% in the FY 2010 from 1.12 % in the 2007/08. However the NPA was increased up to in fiscal year 2011/12. The loan doubled form 15,903 millions in 2007/08 to Rs. 38,922.74 millions in FY 2011/12. Nabil Bank is showing the quality of management by providing large loan with low Non performing loan. Finally, NPA has increased up to 689.85 million as progressive trend.

The Net profit of Nabil Bank has earned 1337.75 millions in FY 2011/12 which is 17.24% higher than previous fiscal year. Nabil Bank has highest Net profit among Nepalese commercial banks which is Rs.1337.75 millions in FY 2011/12. The growth of profit increment is considerably high. With in five years annual profit of Rs. 673.96 millions to 1337.75 millions proves that it has been doing its business very well.

Figure 4.2

Loan & Advances, Net Profit and NPA of Nabil Bank



(Source: Table No. 4.2)

The above figure 4.2 depicts the level of Loan and advance, the level of Nonperforming Assets and the trend of the Net profit of the Nabil Bank Ltd.

4.2.2 Himalayan Bank Limited

Himalayan bank has increasing trend in the Loan and Advances. It is one of the highest lending in commercial banks of Nepal . It has aggressive policy in the sanction of loan. There is The NPA ratio has increased from 3.61 % in 2007/08 to 3.92% in FY 2011/12 . There is a lot improvement in the Loan and advances. The Loan amount was 17,793.70 millions in FY 2007/08 and it was 32968.27 millions in FY 2011/12 . However, the Non performing assets (NPA) was fluctuating trend in beginning fiscal year then it has increased simultaneously. At last, the level of NPA was increased slightly up to 3.92% in fiscal year 2011/12.

Table 4.3

Loan & Advances, Net Profit and NPA of Himalayan Bank

(In millions)

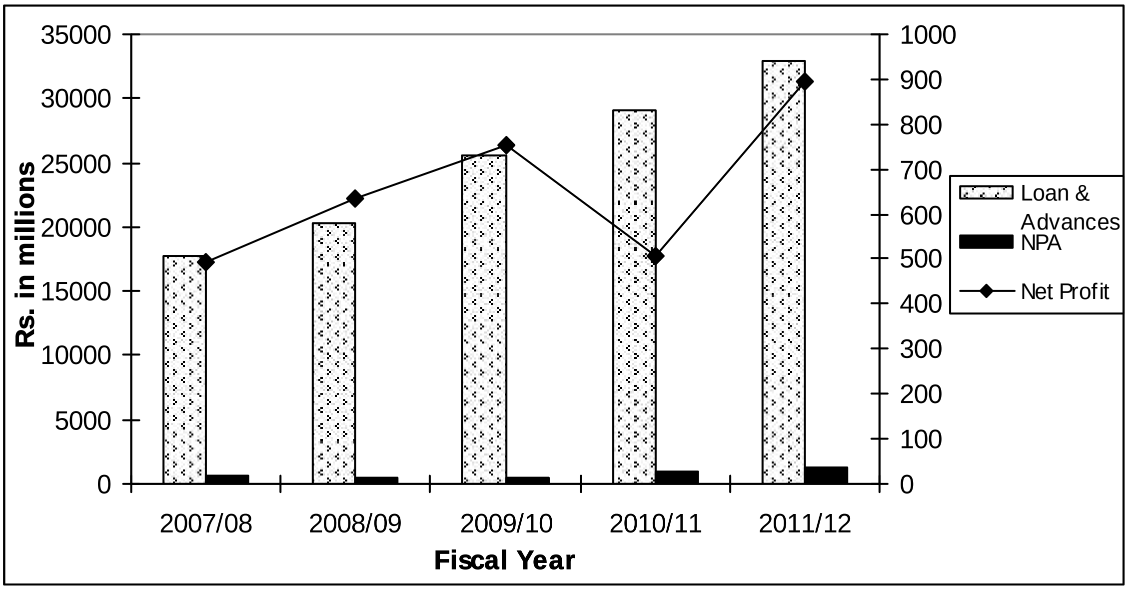
Year	2007/08	2008/09	2009/10	2010/11	2011/12
L & A	17793.70	20233.90	25519.14	29123.76	32968.27
NPA	641.60	475.80	551.21	920.29	1293.38
Net Profit	491.82	635.87	752.84	508.80	893.31
NPA / L& A (%)	3.61	2.35	2.16	3.16	3.92

(Source: http://www.himalayanbank.org.np)

The Net profit of Himalayan Bank Ltd. has been continues growing significantly up to Nrs. 893.31 million in FY 2011/12 from Nrs. 491.82 million in FY 2007/08. The net profit has 75.58 percentage improvements in FY 2011/12 than previous fiscal year 2010/11. Furthermore, Himalayan Bank is the one of the good earner bank which net profit is continuous running on increasing profit.

Figure 4.3

Loan & Advances, Net Profit and NPA of Himalayan Bank



(Source: Table No. 4.3)

The above figure 4.3 depicts that level of the Loan and Advances, Net profit and NPA are increasing trend smoothly.

4.2.3 Bank of Kathmandu Ltd.

Bank of Kathmandu has increasing trend in the Loan and advance. The Loan and advance amount is nearly doubled from 9694 million in 2007/08 to 17956.95 million in 2011/12. Its NPA is in decreasing trend up to FY 2010/11 but in the FY 2011/12 the bank's NPA ratio increased slightly compare to previous fiscal year which is 1.82% in FY 2011/12.

Table 4.4

Loan & Advances, Net Profit and NPA of BoK

(In millions)

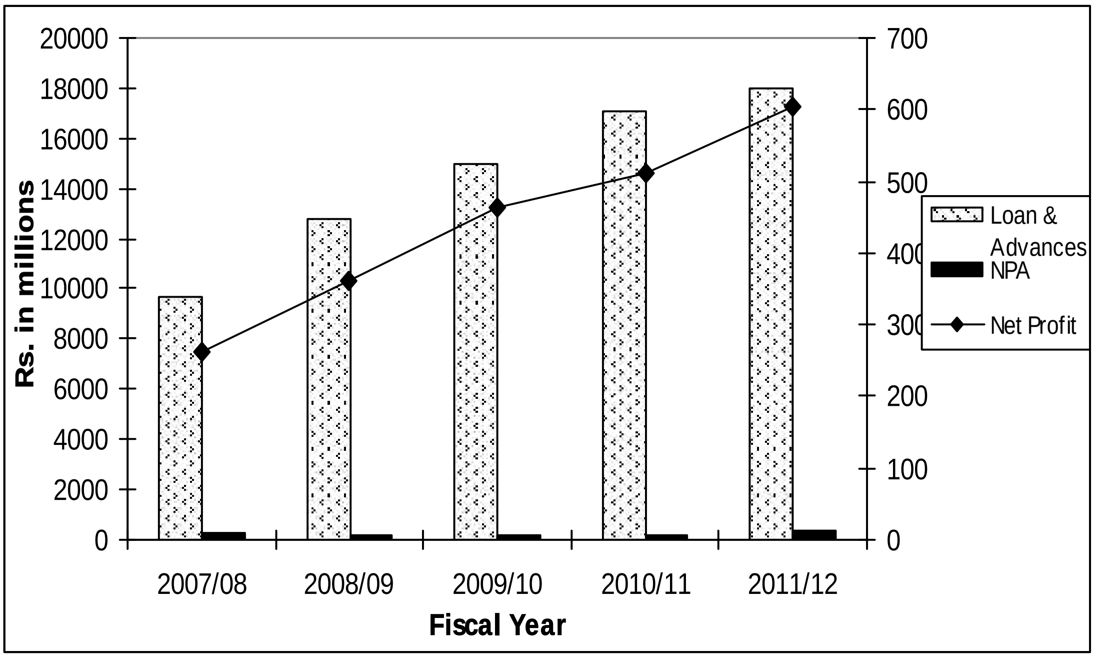
Year	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
L & A	9694.00	12747.80	14945.72	17113.33	17956.95
NPA	243.29	223.80	189.81	202.08	326.33
Net Profit	262.39	361.50	461.74	509.26	605.00
NPA / L& A (%)	2.51	1.76	1.27	1.18	1.82

(Source: http://www.bok.com.np)

The Net profit of BOK has progressive trend. BOK earned 605 million in FY 2011/12 which is 18.80 % higher than previous FY2010/11. In FY 2007/08 the Net profit was only 262.39 million which is 130.57 % drastically improved in FY 2011/12. The growth rate of profit margin increment is considerably high. Within five year the Net profit of BOK proves that it has been doing its business very well.

Figure 4.4

Loan & Advances, Net Profit and NPA of BoK



(Source: Table No. 4.4)

The above figure 4.4 depicts that the Loan and Advances is in increasing trend. NPA is in decreasing trend. Net profit is in increasing trend. The NPA ratio to total loan and advances is also in decreasing trend.

4.2.4 Standard Chartered Bank Ltd.

Table 4.5

Loan & Advances, Net Profit and NPA of Standard Chartered Bank

(In millions)

Year	2007/08	2008/09	2009/10	2010/11	2011/12
L & A	10790.10	13964.40	13679.76	16176.65	18662.48
NPA	197.10	128.70	90.29	87.17	115.80
Net Profit	691.67	818.92	1025.12	1085.87	1119.17
NPA / L& A (%)	1.83	0.92	0.66	0.54	0.62

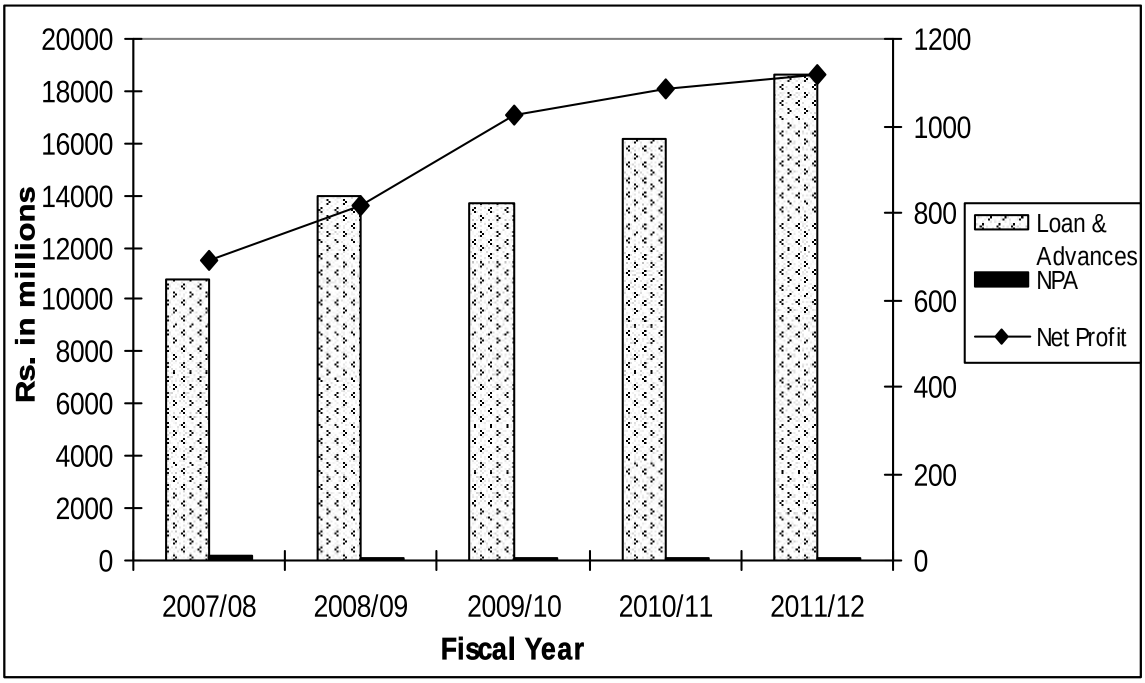
(Source: http://www.standardchartered.com.np)

Standard Chartered Bank has significant improvement in the distribution of Loan and advance as well as in maintaining the quality of the loan. It has increasing trends in the loan and advance. It has improved a lot in the quality of the loan and advance. The NPA has dropped to 0.62% in FY 2011/12 form 1.83% in FY 2007/08. After that it grew 2.22% sudden in FY 2011/12. The Loan amount grew rapid form 10,790.10 million in 2007/08 to 18662.48 millions in FY 2011/12.

The net profit of Standard Chartered Bank's growing significantly in the last five fiscal years. It has earned Rs. 1119.17 million in FY 2011/12 which is 3.07 % higher than previous fiscal year.

Figure 4.5

Loan & Advances, Net Profit and NPA of Standard Chartered



(Source: Table No. 4.5)

The above figure 4.5 depicts that the Loan and Advances is in increasing trend. NPA is in decreasing trend. Net profit is in increasing trend. The NPA ratio to total loan and advances is also in decreasing trend.

4.2.5 Nepal Industrial and Commercial Bank Ltd.

Table 4.6

Loan & Advances, Net Profit and NPA of NIC Bank

(In millions)

Year	2007/08	2008/09	2009/10	2010/11	2011/12
L & A	9128.70	11465.46	13679.39	12929.30	15165.52
NPA	1001.10	98.30	123.11	72.40	90.36
Net Profit	158.48	243.06	317.43	449.84	496.00
NPA / L& A (%)	1.11	0.86	0.90	0.56	0.60

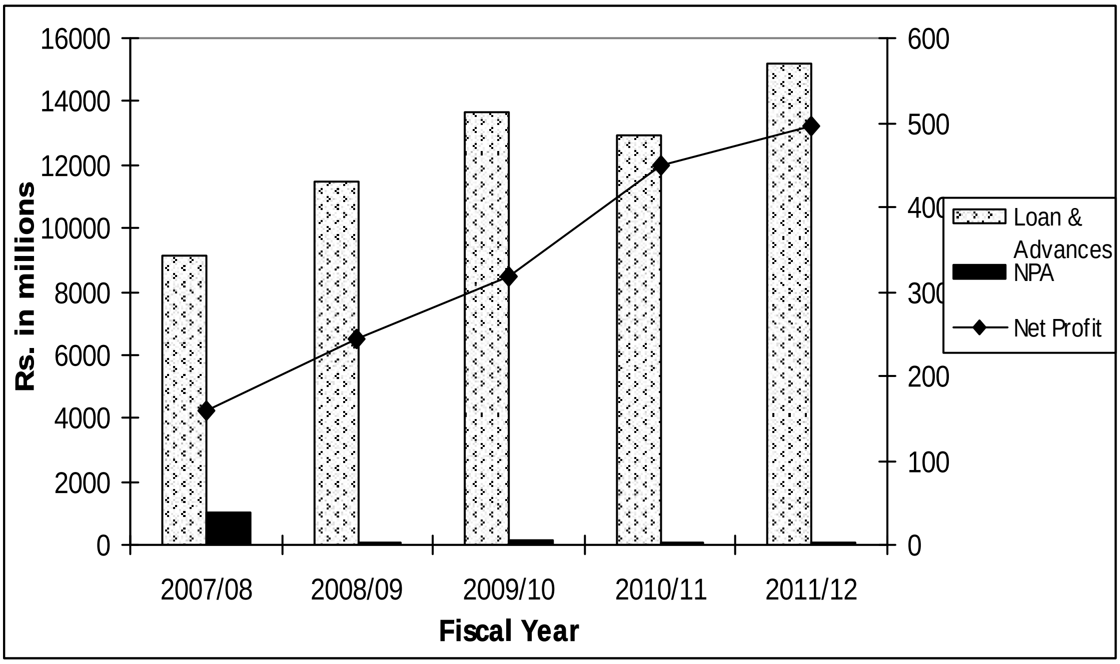
(Source: http://www.nicbank.com.np)

Nepal Industrial and Commercial (NIC) bank has increasing trend in the Loan and Advances. However, it's NPA is in decreasing trend. It is a positive signal of a good commercial bank. It has improved a lot in the quality of the loan and advance. The NPA has dropped to 0.60 % in the FY 2011/12 from 1.11 % in the FY 2007/08. The NPA ratio is lowest than others selected commercial banks. Moreover, the loan and advance amount is also grew significant from 9128.70 million in 2007/08 to 15165.52 million in 2011/12. Furthermore, the NPA of NIC bank decreased up to 2010 but in the FY 2011/12 the bank's NPA increased slightly compare to previous fiscal year.

The net profit of NIC bank grew significantly from 158.48 million in FY 2007/08 to 496 million in FY 2011/12. Which is approximately 10 % higher than previous FY and 213 % higher than base fiscal year 2007/08. It's continuous growing revenue show that positive signal for improving trend of commercial bank.

Figure 4.6

Loan & Advances, Net Profit and NPA of NIC Bank



(Source: Table No. 4.6)

The above figure No. 4.6 depicts that the Loan and Advances is in increasing trend. NPA is in decreasing trend. Net profit is in increasing trend. The NPA ratio to total loan and advances is also in decreasing trend.

4.2.6 Everest Bank Ltd.

Table 4.7

Loan & Advances, Net Profit and NPA of EBL Bank

(In millions)

Year	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
L & A	14082.68	18836.40	24469.56	28156.40	31661.84
NPA	113.17	121.00	117.45	43.71	108.40
Net Profit	296.40	451.20	638.70	831.80	931.30
NPA / L& A (%)	0.80	0.64	0.48	0.16	0.34

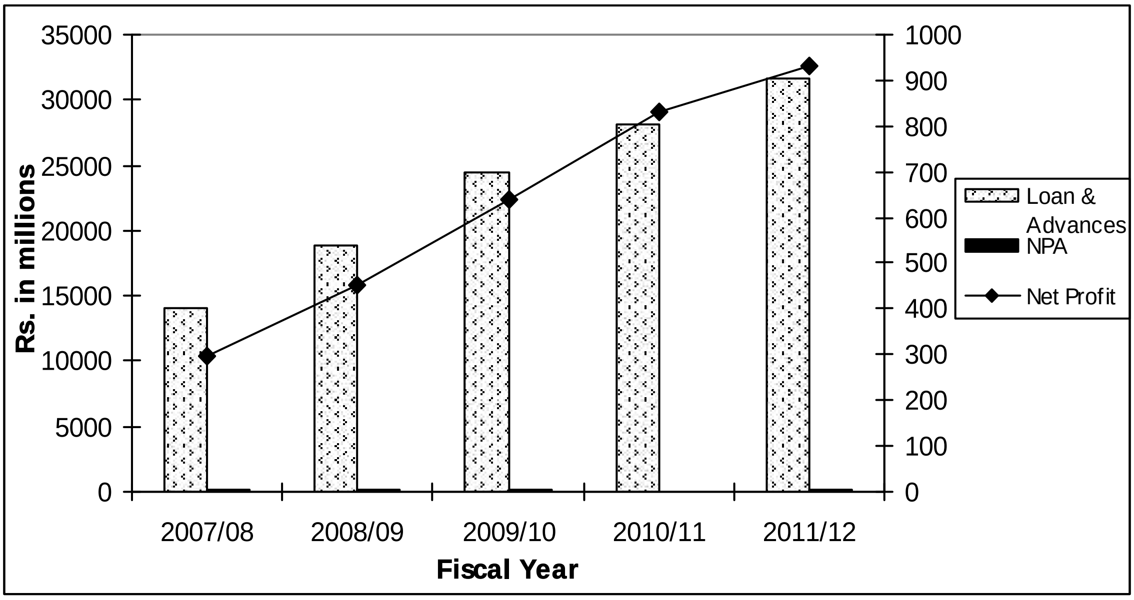
(Source: http://www.everestbankltd.com)

Everest Bank Ltd. has increasing trend in loan and advance. However, it's NPA is in decreasing trend 0.16% up to FY 2010/11 but in the FY 2011/12 the bank's NPA increased slight compare to previous FY. As a whole, it's NPA was lower than other commercial banks. The Loan and advance amount is more than doubled from 14082.68 million in FY 2007/08 to 31661.84 million in FY 2011/12. It shows that the bank is exhibiting the quality of management by providing loan and advance with very low Nonperforming loan.

The net profit of Everest bank Ltd. has progressive trend. Everest Bank Ltd. earned Rs. 931.30 millions in FY 2011/12 which is more than triple from 296.40 million in 2007/08. Comparatively, Everest Bank Ltd. has been performing outstanding up to current years. The rate of profit increment is considerably high within five fiscal year 214.20 % change in annual profit proves that it has been doing its business very well .

Figure 4.7

Loan & Advances, Net Profit and NPA of EBL Bank



(Source: Table No. 4.7)

The above figure No. 4.7 depicts that the Loan and Advances is in increasing trend. Moreover, Net profit is in growing. NPA and it's ratio to total loan and advances are in decreasing trend from 2007/08 to 2010/11. However, the NPA level and it's ratio are increasing in mid 2011/12.

4.3 Correlation Analysis

Inferential analysis is based on the sampling and statistics. It helps to estimate a good estimator of population parameter. Attempts are therefore made to estimate the population parameters to predict the future outcomes i.e. to establish relationship between NPA and other factor in case of different banks under study. For this purpose, ratio analysis concerning other class of loan and other balance sheet terms and correlation coefficient have been computed between loan and NPA as well as NPA and NBA.

In this section the relation between Non Performing assets and Net Profit, Return on Shareholder's Equity and Return on Assets are analyzed and the data and information are depicted.

4.3.1 Correlation between NPA and Net Profit

The correlation between the ratio of NPA to L&A and ratio of Net Profit to L&A is analyzed to find out what type of relationship does exist between these two entities of individual banks.

Table 4.8

Correlation Coefficient between NPA and Net Profit

Banks	Nabil	HBL	BoK	SCB	NIC	EBL
Correlation Coefficient	0.1367	-0.3598	-.4254	-0.1948	-0.9743	-0.9677

(Source: Annex 1, 2, 3, 4 ,5 and 6)

The correlation coefficient between the NPA and Net Profit of Himalayan Bank Ltd, Bank of Kathmandu, Nepal Industrial and Commercial Bank, Standard Chartered Bank and Everest banks are negative. It means the NPA and Net Profit have inverse relationship, that means when the NPA is high the Net Profit will decrease and when the NPA decreases the Net Profit increases. Whereas the correlation coefficient between the NPA and Net Profit of Nabil Bank is positive. It means the NPA and Net Profit have direct relationship, that means when the NPA is high the Net profit will increase and when the NPA decreases the Net Profit decreases.

The Nepal Industrial and Commercial Bank has the highest degree of inverse correlation between the NPA and the net Profit. The Standard Chartered Bank has the lowest degree of inverse correlation between the NPA and the Net Profit.

4.3.2 Correlation between NPA and ROE

Table 4.9

Correlation Coefficient between NPA and RoE

Banks	Nabil	HBL	BoK	SCB	NIC	EBL
Correlation Coefficient	-0.1369	-0.4767	-0.2265	0.8983	-0.9511	-0.5841

(Source: Annex 1,2,3,4, 5 and 6)

The high degree of negative correlation of different commercial banks between NPA and Return on Common Equity (RoE) indicates towards the inverse relation between NPA and RoE. The NPA of all commercial banks found in to have inverse correlation with the RoE .

The inverse relationship between the NPA and RoE, shows the increase in Non Performing Assets will decrease the return on equity capital of bank or it means the level of NPA effect on return on equity. Therefore bank should reduce their level of NPA to increase the RoE.

4.3.3 Correlation between NPA and RoA

Table 4.10

Correlation between NPA and RoA

Banks	Nabil	HBL	BoK	SCB	NIC	EBL
Correlation Coefficient	0.2553	-0.2498	-0.6163	-0.7745	-0.9512	-0.9540

(Source: Annex 1,2,3,4, 5 and 6)

From the table 4.10, the correlation coefficient between the Non Performing Assets to Return on Assets shows that there is negative relationship between these two variables. The established theory also states that the Profit and Non Performing Assets flow in the opposite direction. The NPA of all commercial banks found to have inverse correlation with the RoA. The banks are found to have high degree of negative correlation. The Everest Bank Ltd has the highest degree of inverse correlation between the NPA and RoA.

From the above correlation analysis of Non Performing Assets with Net Profit, Return on Share holder's equity and Return on Total Assets, it is found that NPA has inverse relationship with Net Profit, Shareholders equity and Total Assets. These three ratio exhibits the profitability of the business. Hence, Non Performing Assets reduces profitability of the banks and return to the share holders and employment of assets.

4.4 Comparative Performance of Sample Banks

Table 4.11

Comparative Performance of Sample Banks

(In millions)

FY	2010/11					2011/12				
Bank	L&A	NPA	Net Profit	NBA	L.L Provision	L&A	NPA	Net Profit	NBA	L.L Provision
NaBL	**33030.93**	**45.58**	**1141.05**	**0**	**752.20**	**38922.74**	**689.85**	**1337.75**	**0**	**941.0**
HBL	**29123.76**	**920.29**	**508.80**	**29.9**	**1093.3**	**32968.27**	**1293.38**	**893.31**	**14.1**	**1347.8**
BoK	**17113.33**	**202.08**	**509.26**	**0**	**387.1**	**17956.95**	**326.33**	**605**	**0**	**488.8**
SCB	**16176.65**	**87.17**	**1085.87**	**0**	**217.9**	**18662.48**	**115.80**	**1119.17**	**0**	**234.00**
NIC	**12929.30**	**72.40**	**449.84**	**0**	**196.5**	**15165.52**	**90.36**	**496.00**	**0**	**231.6**
EBL	**28156.40**	**43.71**	**831.80**	**0**	**600**	**31661.84**	**108.40**	**931.30**	**0**	**604.2**

(Source: Annual Reports of Corresponding Banks)

In the fiscal year 2011/12, among the selected banks, Nabil Bank earned the highest net profit followed by Standard Chartered Bank, Everest Bank, Himalayan Bank, Bank of Kathmandu and Nepal Industry and commerce Bank simultaneously. The net profit of all selected banks has also increased.

Nabil Bank and Standard Chartered Bank are better than other banks. Both have nil Non Banking Assets (NBA) where as Himalayan Bank has highest NBA on fiscal year 2011/12.

Loan loss provision is the fund set aside to minimize the effect of possible loan losses of the banks. The loan loss is directly related to NPA. Among the sample banks NIC has the lowest NPA hence it has lowest provision for loan loss. The HBL which has the highest Loan and advance with NPA has highest loan loss provision. Due to high NPA, large sum has to be set aside for provision, due to which the banks' loanable fund decreases affecting its revenue. From profit and NBA, Nabil Bank and Standard Chartered Bank are the best among the sample banks. From NPA and Loan loss provision NIC is the best. HBL is very aggressive. It has highest loan and advances and its profit is high but at the same time its NBA, NPA and loan Loan Loss Provision is also very high.

4.5 Hypothesis Test

4.5.1 Hypothesis 1

There is no significant difference between the NPA levels of commercial banks of Nepal and the international standard of 4%.

Tabulated Value	Calculated Value	Result
$T_{tab} = 2.132$	$T_{cal} = 3.4126$	$T_{cal} > T_{tab}$

(Source: Annex VII)

Since $T_{cal} > T_{tab}$,

$\therefore H_0$ is rejected.

$\therefore$ There is significant difference between the NPA level of commercial banks of Nepal and international Standard of 4%.

4.5.2 Hypothesis 2

There is no significant difference between the NPA levels of commercial banks of Nepal.

Tabulated Value	Calculated value	Result
F_{tab} =2.87	F_{cal} =1.62	$F_{tab} > F_{cal}$

(Source: Annex VIII)

Since $F_{tab} > F_{cal}$,

$\therefore H_1$ is rejected.

$\therefore$ There is no significant difference between the levels NPA among the six commercial banks.

In Fiscal year 2011/12, HBL has the highest level of NPA (3.92%) where as the lowest is EBL (0.34%).

4.6 Major Findings

As per the analysis of data, following major finding major have been obtained.

1. The loan and advances of all commercial banks are in increasing trend every year. However, the net profit of the commercial banks is decreasing up to 2010/11. Furthermore, whole index of Loan and Advance, Net Profit and Nonperforming Assets are increased in fiscal year 2011/12. The total loan disbursed by the whole commercial banking industry reached to 229.36391 billion in F.Y. 2007/08 which was only 528.02314 billion in F.Y. 2011/12.

2. The NPA proportion of total Loan and Advances of whole commercial banking industry is in decreasing trend up to 2010/11 after that it is increasing trend . It decreases to 11,223.34 million in F.Y 2010/11 . However, it is increased up to 16,871.58 million in fiscal year 2011/12. The net profit has decreasing rs. 2.39 million in 2010/11 from 10.56 million in 2007/08. At last, The whole industry net profit has significantly improved in FY 2011/12. It was Rs. 3.20 million in FY 2011/12 which was only Rs. 2.39 in previous fiscal year.

3. Nabil Bank has increased its Loan and Advances to Rs. 38,922.74 million in F.Y 2011 from Rs 15,903.00 million in 2007. It is the highest lending bank. There is fluctuation of NPA. It increased to Rs. 689.85 million from Rs. 45.58 million in current fiscal year. Its profit has significantly improved. It was Rs. 1337.75 million in FY 2011 which was only Rs. 673.96 million in FY 2007.

4. Himalayan Bank has increased its Loan and Advances to Rs. 32,968.27 million in FY 2011/12 from Rs. 17793.70 million in 2007/08. Furthermore, its NPA increased to Rs. 1293.38 million from Rs. 641.60 million in five years. Its profit reached Rs. 893.31 million in FY 2011/12 which was only Rs.491.82 million in FY 2007/08.

5. Bank of Kathmandu has increased its Loan and Advances to Rs. 17,956.95 million in FY 2011/12 which was only Rs 9,694.00 million in FY 2007/08. Its NPA is Rs. 326.33 million in FY 2011/12 which was Rs. 243.29 million in 2007/08. Net Profit increased significantly in five years time and reached to Rs. 605 million from Rs 262.39 million.

6. Standard Chartered Bank has also increased its Loan and Advances to Rs 18,662.48 million in F.Y 2011/12 which was only Rs 10,790.10 million in F.Y 2007/08. NPA of Standard Chartered Bank has decreased . Moreover, its NPA is Rs 115.80 million in F.Y 2011/12 which was Rs.197.10 million in 2007/08. Its profit reached Rs 1,119.17 million in F.Y 2011/12 which was only Rs. 691.67 million in F.Y 2007/08.

7. Nepal Industrial and Commercial Bank also improved in loan and advances. Its Loan and Advances reached Rs 15,165.52 million in FY 2011/12 from Rs. 9,128.70 million in FY 2007/08. Its NPA is comparatively low. It achieved net profit of Rs 496.00 million in FY 2011 which was only Rs 158.48 million in FY 2007/08.

8. Everest Bank Ltd. has increased its Loan and Advances to Rs. 31,661.84 million in FY 2011/12 which was only Rs 14,082.68 million in FY 2007/08. Its NPA is Rs. 108.40 million in FY 2011/12 which was Rs. 113.17 million in 2007/08. Net Profit gained significantly in five years time and reached to Rs. 931.30 million from Rs 296.40 million.

9. Among the sample banks Nabil Bank Ltd has the highest Loan and Advances amounting Rs. 38,922.74 million and Nepal Industrial and Commercial Bank has the lowest Rs. 15,165.52 million. All six commercial banks have increased its Loan and Advances and Nonperforming assets as well as Net profit in Fiscal year 2011/12 than previous fiscal year 2010/11. The loan and advances of all six banks were gradually increasing every year for five fiscal year. Their Net profit also increasing continuously but Himalayan bank's fluctuation net profit previous four fiscal year than last year it's also grow up. The NPA of each six banks fluctuated in previous four year from 2007/08 to 2010/11 but NPA increased in 2011/12.

10.
11.

12. Among the selected banks for this study, Himalayan Bank has highest ratio of NPA to Loan and advances where as the lowest level of Everest Bank Ltd. According to the higher to lower ratio of NPA and Loan and advances are HBL, BOK, NABL, SCBL, NIC and EBL.

13. Positive correlation was found between NPA and the Net Profit of Nabil Bank. While other remaining five commercial banks were negative correlation between Nonperforming assets and Net profit.

14. Standard Chartered Bank Ltd. only found positive correlation between NPA and ROE however other five banks have negative correlation. Nabil only found positive correlation between NPA and ROA however other five banks have also negative correlation.

15. The Non Performing Assets have inverse relationship with Return on Equity and Return on Assets. That Non Performing Assets decreases the RoE and RoA of the organization. Hence it decreases the profitability of the organization.

16. The Non Performing Assets level of the commercial banks of Nepal lies within the international standard of 4%. All the sample banks have maintained their NPA level, it would be good for them to maintain at present level.

17. There is no significant difference in the NPA level between the commercial banks of Nepal. Among the banks selected for this study, Himalayan Bank has highest level of NPA (3.92%) where as the lowest is 0.34% of Everest Bank Ltd.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter is the important for the research because this chapter is the extract of all the previously discussed chapters. This chapter consists of mainly three parts: summary, conclusions and recommendations. In summary part, revision or summary of all four chapters is made. In conclusion part, the result from the research is summed up and in recommendation is made for improving the presence situation to the concerned partied as well as further research. Furthermore, Summary is the main crux of finding of a research. This part also contains the conclusion of the study and the recommendations to overcome the problems found by the researcher.

5.1 Summary

This research is aimed at studying about the analysis cause and impact of nonperforming assets of commercial banks. In first chapter the study the concept and significance of the study. It also presents research problem identification, objective of the study, rationality of the study, limitation of the study and organization of the study.

Second chapter helped to provide knowledge and information about the development and progress made by the earlier researcher on the concerned field or topic of the study. It reviewed and summarized the finding of the previous findings of the study to provide knowledge about the background of the work done by other resources and to stop the duplicate of previous work.

Third chapter of the study discussed about various research methodology used for the study. Research methodology signifies the research design, sources of data, population and sample of data, data collection procedure, data collection technique, data collection methods and tools and techniques employed etc. For this purpose descriptive and analytical research design was adopted. Out of the total population of 32 commercial banks, six banks were taken as sample using random sampling method. The data of five consecutive years of the six selected banks have been sanalyzed to meet the objective of the study.

Fourth chapter of the study dealt about data presentation and analysis. It first presented the generated data in tabular form and analyzed them in systematically as per the objectives. The researcher tried to analyze the comparative position of bank in terms of Nonperforming assets and impact on relative variables. The whole banking industry is growing significantly, which is a good signal for nation economy. The NPA levels of the commercial banks industry's decreasing up to 2010/11 then it's increasing overall in 2011/12. It is negative signal for progressive commercial banks. The commercial banks should be alert during lending. The NPA had inverse relation with profitability and performance of the banks.

All selected six banks had increased its Loan and Advances and Nonperforming assets as well as Net profit in Fiscal year 2011/12 than previous fiscal year 2010/11. The loan and advances of all six banks were gradually increasing each and every year up to five fiscal year. Their Net profit also increasing continuously but Himalayan bank's fluctuation net profit previous four fiscal year but last year it also grow up. The Nonperforming Assets of each six banks fluctuated in previous from 2007/08 to 2010/11 but NPA increased on each six bank in 2011/12. Among the sample banks Nabil Bank Ltd. the highest Loan and advances and Nepal Industrial and commercial Bank has lowest. Positive correlation was found between NPA and the Net Profit of Nabil Bank. While other remaining five commercial banks were negative correlation between Nonperforming assets and Net profit. The Non Performing Assets level of the commercial banks of Nepal lies within the international standard of 4%. Among the banks selected for this study, Himalayan Bank has highest level of NPA (3.92%) where as the lowest is 0.34% of Everest Bank Ltd.

Finally, summary, conclusion and various suggestions were described in fifth chapter. It drew the conclusion from the findings of the study explained the summary of the research paper. Besides, it also provides various suggestions to give further improvement. In Nepal the increase of NPA is especially due to funding on large loan and advances on housing, plotting and such as ideal business sector with the willful defaulters. Big house's company loan is the major source of NPA of commercial banks by misusing their reputation, connection to political parties and make unhealthy influence. Some of the causes of NPA are lack of credit policy in the bank. The banks have not been able to handle influence and pressure from various factors like promoters, political parties etc, while cut-throat competition, political instability, lack of far-sightedness and lack of systematic management and strategy have increased the opportunity for NPA. Government unwillingness to punish defaulters also plays vital role in increase of NPA in Nepal. Willful defaulters should be banned any kind of economic activities by the society and government. Unfortunately, it comes in papers and news that such defaulters get shelter from political parties.

5.2 Conclusion

Present research is very much important to analyze cause and effect of NPA. The growth of loan and advances is increasing very slowly. They are much more concerned about the problem of NPA and giving required concentration need to make good loan, there are close relationship of loan and advances, Net profit and NPA of commercial banks that means there is a inverse relationship between profit and NPA. Nonperforming loans epitomize bad investment reduce profit. The NPA levels of the commercial banks industry's decreasing up to 2010/11 then it's increasing overall in 2011/12. It is negative signal for progressive commercial banks. The commercial banks should be alert during lending.

All selected six banks had increased its Loan and Advances and Nonperforming assets as well as Net profit in Fiscal year 2011/12 than previous fiscal year 2010/11. The loan and advances of all six banks were gradually increasing every year for five fiscal year. Their Net profit also increasing continuously but Himalayan bank's fluctuation net profit previous four fiscal year and last year it's also grow up. The NPA of each six banks fluctuated in previous four year from 2007/08 to 2010/11 but NPA increased in 2011/12. Among the sample banks Nabil Bank Ltd. the highest Loan and advances and Nepal Industrial and commercial Bank has lowest. Positive correlation was found between NPA and the Net Profit of Nabil Bank. While other remaining other five commercial banks were negative correlation between Nonperforming assets and Net profit. Standard Chartered Bank Ltd. only found positive correlation between NPA and ROE however Nabil only found positive correlation between NPA and ROA. The NPA level of the commercial banks of Nepal lies within the international standard. Among the banks selected for this study, Himalayan Bank has highest ratio of NPA to Loan and advances where as the lowest level of Everest Bank Ltd. According to the higher to lower ratio of NPA to Loan and advances are simultaneous HBL, BOK, NABL, SCBL, NIC and EBL. Nepalese Commercial banks are found conscious regarding the Non Performing Assets. They have been giving full effort to decrease and minimize the level of NPA which have been accumulated for years. They have not got significant achievement in this regard. All the sample banks have try to maintain their NPA level. There is no significant difference in the NPA level between the commercial banks of Nepal.

The Non Performing Assets is the double edge sword which decreased the revenue and profitability of the bank in one hand and in other hand it decreases the loanable fund due to the necessity to keep fund aside in the form of Loan Loss Provision. The NPA also decreases the efficiency of the bank. It decreases the goodwill and reputation of the bank. It decreases the confidence level of the shareholders as well as the customers. In the worst case the Bank can be bankrupted. Since, the NPA has many unpredictable effects not only to the lending bank but also to the whole society and economy of the nation. The NPA germinate from analysis of time period during the lending process. Hence to decrease level of Non Performing Assets, the banks should be aware from the time of lending and the project should be analyzed carefully for its validity. The lending team should be given necessary training, full authority and should also be made responsible. There morale should be raised. They should not be enforced or make them to sanction loan in pressure. The bank should also visit the customer regularly, analyze their performance, there status should be revised in periodic basis and should also give financial guidance if necessary. The Non Performing Assets consumes the capital and assets and destroys the whole system. The defaulters or the clients who do not repay the loan back should be punished. Recently Nepal Rastra Bank has followed the strict rule and law for housing and plotting and such as idle sectors. Thus, all commercial bank have tried to reduce their loan and advance on housing, plotting and such as idle sectors.

Finally, Almost bank have increased their Nonperforming Assets with loan and advance. Which is shows the signal of very risky economic situation. Some of the banks have been found to have uncontrolled NPA however strict housing loan rules are needed for apply whereas all commercial bank has already provided huge long term loan. Thus, Increasing NPA reduce the revenue and profitability of the bank due to the necessity to keep fund aside in the form of Loan Loss Provision. There is needed a special effort for suitable rule and regulation from Government, Nepal Rastra Bank and from private sector to minimize the NPA and recover the bad loans.

5.3 Recommendations

The non performing loan is a problem which cannot be eliminated. However it can be controlled and managed to minimize it and to minimize its effect. Defaulting borrower should prove to the bank that they made every possible effort to pay the debt. A good co-ordination and healthy environment should be created by banker and borrower. High level of non-performing assets not only decreases the profitability of the banks but also affects the entire financial as well as operational health of the country. If the NPA were not control immediately, it is the cause of bankruptcy of bank. Most of commercial bank have increased their NPA in fiscal year 2011/12 than previous fiscal year 2010/11. Therefore following are some of the recommendation, which will help to reduce the level of NPA of Nepalese Commercial Banks in near future.

1. Corporate structure of bank plays key role in the effective management. Loan being 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, inspection and recovery of loan which have possibility of finding mistakes of one department by the others creating system effectiveness.

2. 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. The bank should take proper valuation of collateral so that it can at least recover its principal and interest amount in case of failure of the borrower to repay the loan.

3. 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.

4. 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. They should be followed regularly to recover interest and principal of loan.

5. Those banks, which have high level of NPA, should take necessary action towards recovering their bad loan as possible. In case of doubtful to repay loan, the bank should dispose off the collateral and securities such as land, building, stock etc. taken from them and recover the principal and the interest amount.
6. Diversification of loan should be managed by the individual banks. In the context of Nepal, it is provided to the borrowers who often go to the bank and that too not in the new sector. Default by older borrowers can be found, which should be avoided.
7. The credit staff team should be given special educational training, technical training, management development training for more competitive and updated regarding the current issues and practices. Therefore, indoor and outdoor training programs to make employees efficient and professional in credit appraisal, monitoring and proper risk management.
8. 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.
9. Every commercial bank should maintain loan loss provision as per NRB's directives regarding nonperforming assets.
10. The bank should use the state- of- art computerized information system to maintain the information of credit and creditors for effective management of the bank.
11. Bad intension, weak monitoring and mismanagement at top level are the major internal reasons turning good loan into bad loan therefore commercial bank should take corrective action immediately.
12. Establishment of Asset Management Company. Focused institutions such as Assets Management Company could be helpful to manage the high risk assets and reduce the level of NPL.
13. The accounting policies must be transparent and must follow best auditing practices.
14. NRB is the supervisory body responsible to maintain sound, stable and competitive financial system. Therefore, the capacity, professionalism and skill of

the staffs of these institutions should be enhanced to cope up with the development in the financial system. NRB rules and regulation should be followed simultaneous by commercial bank and their loan able customer with in fixed time period.

15. Most of the commercial bank must be conscious on their provision for loan able fund, credit limit, recovery system and costing, impact on profitability and their assets. They should be reduced their idle and long term risky loan such as housing loan, plotting loan and many personal useless loan.

16. NPA increased cause of inadequate study of loan proposals, bad intention, week monitoring, mismanagement, lack of portfolio analysis, ineffective credit policy, shortfall security, poor recovery system , negligence in taking information from credit information Bureau and external factors. So, banker should aware the cause and improve their system as a strategically. Bank should be advisor of their credit customer.

17. Commercial banks should accept the portfolio management. Lending towards the single sector of economy creates higher risk. So, other remaining sectors of economy may function well and fruitful but single lending sector impacts on the whole commercial banks.

18. Government has to formulate strong legal system and framework to support the loan recovery process of commercial banks. Willful defaulters should be empowered to proceed to arrest the debtors who do not have any property to pay the dues to the bank. Thus, never protect and support those defaulters by politician.

19. It is often said that "Prevention is better than Cure", hence it is recommended that make sound information system to gather all the possible information about its borrowers so that necessary precautions can be taken in time. This is an age of information so bank should update with various business related knowledge and information. For this, following Directive of NRB of Know your customer (KYC), seems important and necessary.

20. Formulate the separate credit and NPA control department team to credit appraisal, documentation, disbursement, recovery, relationship maintenance and inspections for systematic credit and minimize NPA.