CHAPTER- I

INTRODUCTION

1.1 Background

In Nepal banking sector is flourishing in past few decades. Banking sector plays an important role in the growth of the economy. Commercial banks are those financial intermediaries that transfer the fund from surplus unit to deficit unit. Commercial banks are major supplier of fund. Bank act as a interface between borrower and supplier. It accepts deposit from public and supply loan to public. It gathers the scattered fund from the economy and mobilizes in productive sector. In the course of transaction heavy amount is invested in loan by commercial bank. Interest income is the major source of revenue for commercial. Sixty to seventy percent of operating income occupies interest income. In this regard default loan is major threat to commercial bank. Banking sector is exposed to number of risk such as interest risk, market risk, liquidity risk, credit risk, operation risk and so on. Among them credit risk is the major one. The risk of non-payment of loan leads to credit risk.

Non-performing loan is the sum of borrowed money upon which the debtor has not made scheduled payment for at least three month. The delay in payment could be either interest or principle and can be both. Non-performing loan is categorized in three types. They are substandard loan, doubtful loan, and bad loan. The classification is done on the basis delayed time period. Non- performing is the real economic cost for commercial bank because they cannot use the fund in productive sector and repayment of deposit is disturbed. It also result in additional cost for realization of non- performing loan.

Banking sector plays an important role in the economic development of the country. All the economic activities are directly or indirectly channelized through these banks. Commercial banks are one of the vital aspects of this sector. People keep their surplus money as deposits in the banks and hence banks can provide such funds to finance the personal, business and industrial activities in the form of loans and advances. Main stream function of the commercial bank is to mobilize the scattered saving of the public by providing credit to the needy firms, industries and people to get the productive use.

The figure of non –performing loan brings threat for commercial bank.. Heavy chunk of money is utilized in giving loan. As the return from loan is higher commercial banks are more concentrated in loan management.

Any institution offering deposit subject to withdrawal on demand and making loan of a commercial or business nature is a bank. Bank came into existence mainly with the objective of collecting the idle fund and mobilizing them to productive sector causing overall economic development. They constitute an important segment of financial infrastructure of any country. Bank is a financial intermediary between the deficit and surplus of the financial resources which allows the economy to grow. It collects surplus money and grants them to needed person. It enables the flow of money from savers to investors. Without this flow, saving would sit idle in someone's safe or pocket; money would not be available when needed. People would not be able to purchase cars, houses etc and business would not able to build its coverage. Saving is canalized into investment in the productive sectors through banks and financial institution.

But now a days, bank is no longer limited to borrowing and lending of fund. With the passage of time, functions of banks have increased manifold. Recent years have seen banks diversify into new areas to widen their business horizons. They are rendering a wide range of services to people of different walks of life; they have become an essential part of modern society. They work as an intermediary between depositors and lenders and facilitate in overall development of the economy, with major thrust in industrial development. The bankers have the responsibility of safeguarding the interest of the depositors, the shareholders, and the society they are serving. A sound banking system is important because of the key roles in the economy, intermediation and maturity transformation, facilitating payments flow, credit allocation and maintaining financial discipline among borrowers. Banks are the gathers of saving, the allocators of resources providers of liquidity and payment services.

Commercial bank collects deposits from the public and the largest portion of deposited funds is utilized by disbursing loan and advances. Being a profit oriented financial service providing institution, certain percent interest rate is given to the depositor and the bank charges certain percent interest in the loan facility.

Commercial bank has flourished the investment in Nepalese economy. Heavy amount of investment is done by commercial bank. They formulates sound investment policies which support for the growth of the economy. It is vital role of bank to manage the loan so that they can invest properly. The major risk from non-performing loan is credit risk, liquidity risk, operating risk, earning risk, reputation risk, solvency risk, and legal risk.

Loan occupies the greater portion in the assets side of balance sheet .loan is the risky assets. The major reason behind non-performing loan is poorly managed loan portfolio. Non-performing loan reduces the liquidity of bank, credit expansion, and growth of the economic activities and along with performance of bank. Non-performing loan can even erode the existing capital. (Sherpa, 2016)

As per the rule laid down by Nepal Rastra Bank those loan whose payment has not been received for 3 months or more is treated as NPL. As the over dues goes on provision of 25%, 50%, and 100% of loan amount is separated and it is treated as expenses and allocation of loan is reduced from capital. More impact of NPL is that the assets are not able to generate future income. It increases the opportunity loss to the bank. Similarly it increases the economic cost for bank to recover the money. It causes to decrease in employee morale, bank’s image, and shareholder expectation. (Nepal Rastra Bank, 2010)

Non-performing loan carries significant threat to commercial bank as it can erode the capital. NPL management is the top priority of bank. The study is conducted to examine the non-performing loan of commercial bank with reference to Nabil Bank Limited and Everest Bank Limited. There are twenty eight commercial banks and the study is conducted with reference to two banks.

1.2 Statement of the Problems

Commercial bank being the financial institutions plays significant role by collecting deposit and lending these fund in the productive sectors as lending and investment. Economic development of the country is directly related to the volume of investment made and return obtained by the bank. Due to lack of experts to analyze the risk and return of investment and maintain optimum portfolio investment problem has become very serious for the least development country like Nepal.

Due to home war lots of infrastructures had been destroyed. Nepalese commercial banks have been facing the problem of investment in manufacturing sector. The loans are not serviced in time and there is a risk of non-recovery of principle as well, therefore most of commercial banks have switched its portfolio in less risky government securities and non-fund base loan like L/C. This has significant impact in economic growth. This has stopped economic activities in country causing reduction in Gross Domestic Product and declining employment opportunity. It impacts there may be social disorder in the country.

There is increase in the number of commercial bank during the past decade. Different regulatory measure has been made by central bank for the effective performance of the commercial bank. However, actual performances of banks have not been enhanced. The major problem faced by commercial bank these days are competitive environment, limited investment opportunities, inadequate deposits, challenge to maintain authorized capital, non-performing loan and so on. Non-performing loan is increasing in bank's balance sheet. Granting loan against insufficient deposits, loan against undervalued collateral, ineffective credit monitoring and political pressure to the lender are the major reason behind the increasing non-performing loan. Liquidity risk, credit risk, operationrisk, lost investment opportunities are some of the implication of non-performing loan.

The study is conducted to get the answer of the following question

- What is the trend of NPL, Loan and advances of Everest bank limited and Nabil bank limited?

- What is the impact of non- performing loan on profitability?

1.3Purpose of the Study

The major objective of the study is to examine the non-performing loan of Everest Bank limited and Nabil Bank limited. The specific objectives of the study are:

- To analyze the trend of Non-performing loan of selected bank..
- To investigate the impact of non-performing loan on financial profitability of selected bank.

1.4 Significance of the Study

Commercial bank have huge amount of money invested in loan. Loan compromises heavy chunk in the assets side of bank's balance sheet. The source of revenue is generated from loan's interest. In this regard non-performing loan bring prominent threat to bank. Non-productive loan increases the non-performing loan. There can be high probability of loan loss provision. The possible threat from non-performing is credit risk, liquidity risk, operation risk, and overall effect on financial performance. With this regard, this research is conducted to examine the present issue of non-performing loan in selected bank.

This study will be beneficial to the shareholder, depositor, borrower, and other creditor to identify the productivity of their bank in Everest bank and Nabil bank limited. The report will be beneficial to identify the effectiveness of credit department and the selected course of action that bank has undergone to overcome the non-performing loan issues. This report will be helpful for the other organization interested in making these banks as a trading partner. Financial analyst, who is interested in the performance of these banks, would be grateful.

This comparative study will also be helpful to the management of bank to analyze the non-performing assets management and policies of the bank in comparison of these two banks. This study can be helpful in foundation of improved policies. With the help of this report bank can analyze the effectiveness of their credit department. This report could be equally helpful for the central bank for the amendment in policies.

1.5 Limitation of the Study

The limitations of the study are as follows:

- The study covers commercial bank in Nepal and doesn't consider financial intuitions and other sectors to provide a more broad based analysis.
- This analysis is based on the available data and this thesis base on secondary data.

1.6 Chapter Plan

Chapter I: Introduction

This first chapter provides the background information of the study, statement of the problem, objectives of the study, significance of the study, and limitation of the study. Therefore this chapter provides summary of overall study

Chapter II: Review of the Literature

Review of the literature is very important part of every research. This chapter includes conceptual review, review of previous work, and research gap.

Chapter III: Research Methodology

This chapter constitutes the methodology adopted to conduct the study, data analytical techniques, and process. This chapter also contains research design, population and sample, sources of data, data collection methods and statistical tools.

Chapter IV: Result

This chapter is the major part of the study, which is concerned with presentation, data analysis, interpretation of the data and sum up of results.

Chapter V: Conclusion

This chapter includes the discussion, conclusion and implementation for the study.

References and appendix have also been incorporated at the end of this thesis.

CHAPTER II

LITERATURE REVIEW

2.1Conceptual Review

2.1.1Non-performing loan

Non-performing loan is the sum of borrowed money upon which the debtor has not made scheduled payment for at least three month. The delay in payment could be either interest or principle and can be both. In the case of bank, loan is the assets of bank because large portion of deposits are utilized in giving loan. Interests from loan are major source of revenue for bank. Irregular loan can be turned into non-performing loan. Hence, those loans that are not effective in giving interest and principle amount back are non-performing loan.

A study of (Choudhury, 2002) has defined that Non-performing loan is not a single concept and it can be broadly defined. NPL can be classified into three parts such as substandard loan, doubtful loan, and Bad debt according to the time of being default.

2.1.2 Performing Loans

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 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 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 banks are suffering from the non-repayment of loan amount(Choudhury, 2002).

2.1.3 Loan loss provision

There is risk associated in every loan. To minimize the risk from possible losses from loan banks have to allocate some fund as loan loss provision. Loan loss provision is the accumulated fund that is provided as a safeguard to cover possible losses. It is the expected accumulated provisioning fund. The amount required for provisioning depends upon the level of NPAs and their quality. The high quality loan requires low loan loss provision, whereas bad loan requires high loan loss provision. One percent provision of total credit is minimum requirement as every pass/good loans have to be provisioned. However, the ratio of provision may differ from nation to nation. In Nepal, NRB has prescribed 1%, 25%, 50% and 100% provision for pass, substandard, doubtful and loss loans respectively. Loan loss provision made for performing loan is called "general loan loss provision" and loan loss provision made for non-performing loan is called "specific loan loss provisioning"(Nepal Rastra Bank, 2010).

2.1.4 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 etcare 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 (Golcha, 2007).

2.1.5 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.

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 bank. 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. It 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 (Brose, 2016).

2.1.6 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:

1. **Safety**

The main business of banking consists in 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, he has to look to the three C's of the borrower namely Character, Capacity and Capital. Character of the borrower is important because that determines his willingness to repay the loan. His capital and capacity to run the business successfully determines his capacity to pay. The safety of the loan depends on both his capacity to repay and willingness to repay.

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. His endeavor is of course to lend as much of the deposits as possible, without which he will not be in a position to meet his interest obligations and the maintenance of establishment. Therefore, he has to lend with a view to earn interest but lend it safe (Choudhary, 2002).

2. 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 demand and at short notice, he must ensure liquidity also while lending, so that in times of needs, he will be able to convert the assets into cash.

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.

In fact, if one looks at the banker's balance sheet, he finds the assets arranged in the order of liquidity. 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. In such a case as pointed out earlier, he will not be in a position to meet the interest obligations and expenditure of the establishment. From experience, he has learnt that he can safely lend out a substantial portion of the funds. But while lending he should try to ensure liquidity, i.e., in times of need, he must be able to obtain repayment of the money within a reasonably short time. Liquidity also implies that the assets can be sold without any loss. Thus the concept of liquidity has twin aspects namely quick saleability or convertibility of the assets and to risk of loss in such conversion (Shreevastava, 2015).

3.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 will not give undue 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.

4. The purpose of the Loan

Baker 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 (Nsobilla, 2016).

4. Diversification of Loans.

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 to few big firms or concentrates in a certain geographical area, the risk is great. He should diversify lending, so that he 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.

2.2 Review of Studies

Review of NRB Directives

Directive No 2. Provision relating to classification of loan/advances and loan losses

Having exercised the powers conferred by Section 79 of the Nepal Rastra Bank Act, 2002, the following Directives have been issued with regard to classification of credit/advances and provisions to be made for its possible loss by the institutions obtaining licenses from this Bank to carry out financial transactions.

1. **Classification of loans/advances:**
   - (a) Entire loans and advances extended by a licensed institution have to be classified as follows based on expiry of the deadline of repayment of the principal and interest of such loans/advances:-
   - (b) Pass: Loans/advances which have not overdue and which are overdue by a period up to three months.
   - (c) Sub-standard: Loans/advances which are overdue by a period from three months to a maximum period of six months.
   - (d) Doubtful: Loans/advances which are overdue by a period from six-months to a maximum period of one year.
   - (e) Loss: Loans/advances which are overdue by a period of more than one year. The loans which are in pass class and which have been rescheduled/restructured are called as "the performing loan, and the sub-standard, doubtful and loss categories are called non-performing loans.
   - (f) Note: Loans/advances also include bills purchased and discounted.
2. **Additional provisions relating to pass loans:**

   The following loans may be included in the pass loan:-
   - (a) Loans/advances extended against the collateral of gold and silver;
   - (b) Loans/advances of fixed receipts 46

(c) Loans/advances of Government of Nepal securities and loans/advances made against the collateral of Nepal Rastra Bank bonds; Provided that the cases of the loans/advances against the fixed receipts or Government of Nepal securities or Nepal Rastra Bank bond as the additional collateral, such loans and advances shall also have to be classified in accordance with the directive referred to into Point No. 1 above.

The working capital loan having the deadline of up to one year for repayment may be included in the pass loan class. In case the interest to be received from the loans of working capital nature is not regular, such loans have to be classified on the basis of the duration of interest to be due.

3. Additional Provisions Relating to Loss Loans:

In case there seem any of the following discrepancies in any of the following loans, whether or not the deadline for repayment of which is expired, such loans and advances has to be categorized as the loss loan:

(a) The market price of the collateral cannot secure the loans;

(b) The debtor is bankrupt or has been declared to be bankrupt;

(c) The debtor disappears or is not identified;

(d) In case non-fund based facilities such as purchased or discounted bills and L/C and guarantee which have been converted into fund-based loan, are not recovered within ninety days from the date of their conversion into loan;

(e) Loan is misused;

(f) Expiry of six months of the date of auction process after the loan could not be recovered or a case is pending at a count under the recovery process;

(g) Providing loan to a debtor who has been enlisted in the black-list of Credit Information Bureau Ltd;

(h) The Project/business is not in a condition to be operated or project or business is not in operation;

(i) The credit card loan is not written off within 90 days from the date of expiry of the deadline;

(j) While converting the L/C, guarantee and other possible liabilities into a fundbased loan under the regular process, if the said loan is not recovered within 90 days; and

(k) In case of expiry of the deadline of a trust-receipt loan.

Note: For the purpose of clause No. 3(e) of these Directives, "misuse" means non-use of the amount of the loan for the purpose for which it has is taken; the project is not in operation; the amount accrued from the concerned project or business is not used in repayment of the loan but in other activities; and the word also includes the loan which is proved to have been misused by a supervisor in the course of inspection or supervision or by an auditor in the course of auditing.

4. Provision to be maintained for loan loss

For the loans and bills purchase classified according to these Directives, the following loan loss provision shall be maintained based on the remaining amount of principal:

Table 2.1

Loan Classification

Loan Classification	Provision For Loan Loss
Pass	1%
Sub-standard	25%
Doubtful loan	50%
Bad debt	100%

5. Conditions for Adjustment in loan loss provision

No loan loss provision shall be allowed for adjustment except in the following conditions:

a) In case the loan is written off.

b) In the event where repayment of loan is in installment or in partial basis, the loan loss provision made to the extent of the loan so repaid may be written back and adjusted while maintaining loan loss provision according to loan classification; and

c) In the event of the loan is reclassified after loan rescheduling and restructuring, if the repayment of the principal and interest of the loan so rescheduled and restructured is regular for a consecutive period of two years.

6. Loss Provisions and Auction of Non-banking assets

a) In case of the non-banking assets accepted by the licensed institution, cent percent loss provisions shall be made from the date of the acceptance.

b) In the case of sale of the non-banking assets, necessary adjustment in the accounts of loss provision maintained for such property shall immediately be made.

c) While accepting collateral security as non-banking assets by licensed institution, the following provisions shall be applicable while selling the non-banking assets so accepted:

   - While accepting the collateral property of a customer as non-banking assets whose outstanding loan amount is more than 2.5 million, the concerned party shall compulsorily be black-listed.
   - Prior to auctioning the non-banking assets in the name of the institution, it shall have to be evaluated by an independent evaluator. No excessive/less evaluation shall be allowed.
   - Transparent and clear provisions shall be made with regard to auction sale of collateral security/non-banking assets in Financial Administration Byelaws and sales shall have to be carried out in such a manner to serve interest of the bank or financial institution.
   - While accepting the non-banking assets in such a manner, entire property mortgaged as collateral that could not be sold by auction shall have to be accepted and it may not be accepted in part.
   - The property so accepted shall have to be sold at the earliest to the extent possible. In case it is necessary for own purpose of the licensed institution, the same shall have to be approved by the Board of Directors and information thereof shall be made available to this Bank as well.

2.3 Review of Previous Work

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 intermediately 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.

Non-Performing Loans (NPLs) are regressed on three sets of factors in terms of credit, banks size induced risk preference and macroeconomic shocks(NSOBILLA, 2015). The report concluded based on the empirical results that NPLs have a negative statistically significant influence on the financial performance in the selected banks. This signifies that the greater the NPL, the lower the profit of the selected rural banks. The liquidity risk was not statistically significant. The nonperforming loans and cost-income ratio had a negative influence on financial performance whereas total revenue and loan recovered had a positive effect on financial performance.

An article on the study of non-performing loan and its impact on return on assets of major Indian commercial bank(Brose, 2016). The study concluded on the moderately negative correlation between NPL and ROA. This means that increase in NPL negatively affects the ROA. The study concluded that NPL is more affecting the public sector bank in India. Professor Brose says that effective credit monitoring, complying with the rule of monetary policy, computerization, and maintaining database could be the possible solution to reduce NPL.

Shrestha (2006) conducted a study named ‘A study of non-performing loan and loan loss provisioning of commercial banks’ with reference to the Nabil Bank Limited, Standard Chartered Bank and Nepal Bank Limited. Objectives are to find out the portion of no performing loan, relationship between loan loss provision and loan and advances and profitability.

Pointed of the study out the problems of the commercial banks as lack of smooth functioning of economy, different policies and guidelines of NRB, political instability, security problem, poor information system, over liquidity caused by the lack of good lending opportunities, increasing non -performing assets etc.

Neupane (2008) carried out study on ‘Non Performing Loan and Loan Loss Provisioning of Commercial Banks’ with reference to Nepal Bank Limited, RastriyaBanijyaBank and Nabil Bank Limited. objectives is to find out and analyze the guidelines and provisions pertaining to loan classification and loan loss provision and level of NPL in commercial bank, and to find out the impact of loan loss provision on the profitability of the commercial banks.

In this study concluded the ineffective credit policy, political pressure to lend non-viable projects, overvaluation of collateral and even without collateral disbursement are the major causes of mounting non- performing assets in government owned banks. Further add lending factors of accumulating NPAs are poor credit appraisal system, ineffective credit monitoring and supervision system, poor security system and recession, willful defaulter etc.

Pradhan (2006),conducted thesis titled "A study of Non-Performing Assets of Commercial Banks of Nepal" with reference to Nepal Bank Limited, RastriyaBanijya Bank, Nepal Bangladesh Bank, Everest Bank and Standard Chartered Bank Nepal Limited. The main objectives of study are to find out the proportion of non-performing loan and the level of NPAs in total assets total deposit and total lending ,evaluate the relationship between loan and loan loss provision ,present the trend line of the non-performing assets, loan and advances, loan loss provision of selected commercial bank.

Pradhan (2006) concludes, "Improper credit policy and credit appraisal system, lack of supervision and monitoring, economic slowdown, overvaluation of collateral, borrower's misconduct, political pressure to lend for un-creditworthy parties, etc are the major causes of occurring NPAs.

This study concluded that that "Nepalese banks have to remain focused in their efforts to recover their spiraling bad loans, or non-performing assets, to sustain the positive trend of improving asset quality. Better risk management techniques, compliance with the core principles for effective banking supervision, skill building and training and transparency in transaction could be the solution. Removal of non-performing loans from the banking system even through government or quasi government funds at times, is essential. But official assistance should be so structures as to avoid moral hazard. To conclude with, till recent past, corporate borrowers even after defaulting continuously never had any real fear of bank taking any action to recover their dues despite the fact that their entire assets were hypothecated to the banks. This is because there was no legal Act framed to safeguard the real interest of banks. While NPA cannot be eliminated, but can only be contained, it has to be done not a heavy cost of provisioning and increasing the portfolio of credit. Along with recovery fresh inflow of NPA should be brought down at a level much less than the quantum of its exit. If this specific goal is reached, there is an eventual solution for this problem. Good governance is essential for the success in NPA management" Pradhan,(2006).

Non-performing loans are defined as those financial assets from which banks no longer receive interest and/or installment payments. They referred to as non-performing because the loan ceases to generate income for the bank.

Khadka (2004), thesis titled Non Performing Assets of Nepalese Commercial Banks "With reference to Nabil Bank Ltd, Nepal SBI Bank, Nepal Investment Bank, Nepal Bangladesh Bank and Bank of Kathmandu. His main objectives are to examine the level of nonperforming loan/asset in total assets, total deposit and total lending of Nepalese commercial banks, effects of non-performing loans to return on assets (ROA) & return on equity (ROE) and following of NRB circulars by commercial banks.

This studyPointedoutthe problems of commercial banks as "Escalating level of NPAs has been becoming great problem in banking business in the world. In this context Nepal can’t be run off from such situation. The level of NPA in Nepalese banking business is very alarming. It is well known fact that the bank and financial institution in Nepal have been facing the problem of swelling non-performing assets and the issue is becoming more and more unmanageable day by day. He added from different financial reports, newspaper and news, it is understood that total NPA in Nepalese banking system is about 35 billion, while it is very worse in case of two largest commercial banks i.e. RastriyaBanijya Bank(RBB) and Nepal Bank Limited(NBL)" Khadka(2004).

This study concluded that the level of NPA of NBBL seems greater than all other banks. Similarly Nepal SBI Bank and Bank of Kathmandu stands at second and third respectively. The position of NABIL bank Ltd seems quite considerable (satisfactory) because the bank has been reducing its NPA every year .NPA of Nepal Investment Bank stands at minimum than all of other banks. And from this analysis has concluded that the high degree of negative correlation.

Different commercial banks between NPA and ROA and between NPA and ROE indicates that there is inverse relation between NPA and ROA as well as between NPA and ROE. It means the level of NPA effect the return on assets and return in shareholder's equity. Therefore, banks should reduce their level of NPA to increase the ROE and ROA.

A study by Golcha(2007) highlighted the NPA’s of Nepalese finance sector. In his views the NPA’s of three bank (NBL, RBB, NIDC) are highly discussed and published. After analyzing the report we can find that these banks had high figures in Non-performing loan and more amounts has been declared as loan loss provision. These banks are still operating the loan account despite having high figures in non-performing loan. It has led negative impact for business venture to operate transaction with these banks. The reason behind NPA’s behind for these bank are ineffective credit monitoring and careless for credit policies.

Timilsina, (2017) in a study focused about the determinant of commercial banks lending practices. Commercial banks constitute a major chunk of total assets in the banking system in Nepal and extension of credit is one of the major functions of banking institutions. If banks are not efficient in their lending behavior, it may not contribute to economic growth. On the other hand, their inefficient and imprudent banking practices may lead to riskier financial instability. The study has also focused about the lending practices and its effectiveness in lowering the non-performing loan.

Loan occupies the greater portion in the assets side of balance sheet .loan is the risky assets. The major reason behind non-performing loan is poorly managed loan portfolio. Non-performing loan reduces the liquidity of bank, credit expansion, and growth of the economic activities and along with performance of bank. Non-performing loan can even erode the existing capital. (Sherpa, 2016)

'A Study of Loan Classification and Non- Performing Assets Management of RastriyaBanijya Bank' (Niraula,2015) has pointed out the Non- Performing loan as a major problem of Nepalese commercial banks. In this study discloses the factor that the RBB holds the largest portion of Non- Performing loans of the banking sector.

This study concludes that the ineffective credit policies, overvaluation of collateral are the major causes of mounting non-performing assets.Needs to resolve the problems of NPAs by changing the policy and gaining the confidence of borrower to settle loan by way of understanding.

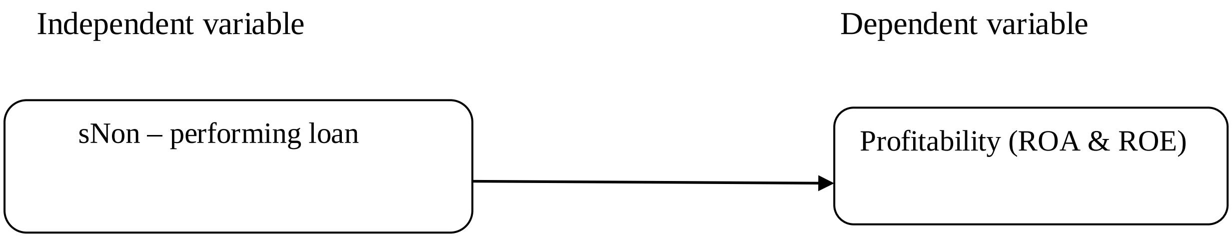
Commercial banks are affected by the vicious circle of non-performing loan. The major factor leading to non- performing loan are improper credit appraisal system, ineffective credit monitoring system, over valuation of collateral and political pressure to lender. Setting up recovery cells, effective laws to recover bad loans, and hiring asset Management Company can be some measure to recover non-performing loan. (Pandey, 2016).

2.4 Conceptual framework

The diagrammatic representation of conceptual framework shows how the variables were related. Loan/advances and loan appraisal system are independent variables; loan default of loan repayment is dependent variable which depends on the occurrences of the said independent variables. The dependent variable of this study was loan default which was influenced by various independent variables.

Figure 2.1

Diagrammatical representation of conceptual framework



Loan policies are believed to influence default of loans to a great extent. Well formulated loan policies are believed to have inversely proportional relationship with loan default. Whereas poor loan policies are believed also to have directly proportional relationship with loan default. Loan appraisal is prepared by credit service official. A credit appraisal deal with the approval of loan to appraisal defines whether the loan will be non-performing or not. Credit department should verify whether the documents given by customer are accurate and confidential. It can be ascertained from the above mentioned that initial loan appraisal includes the core five ingredients of loan appraisal. This comprise of tests on accuracy, collaterals, honesty, capacity and cash flow to determine loan credit worthiness and the probability of loans default.

The duty of credit department does not end after granting the loan. The crucial job starts after the loan sanction. The regular monitoring of loan is necessary to prevent the loan from being default. The monitoring can be done both onsite monitoring and off site monitoring of borrower's performance. NRB's policies also influence the loan default practices. The guidelines of NRB regarding statutory liquid ratio, loan classification, Non-performing loans gives the banks direction to perform their bank and thus they can reduce non-performing loan.

Concrete payment plan is necessary to reduce the non-performing loan. Even the bank is negatively influenced by the loan policies and NRB policies, the concrete payment plan can help bank to reduce the loan default. Regular counseling of customer is necessary because they must be timely reminded the loan amount and interest. Similarly, bank can provide career counseling program to the customer so that they are influence to earn more money.

2.5 Research Gap of the study.

through the review of literature, it has been found that some research in the related topic and have already been reviewed which helps to this study but no research was found exactly in detail research and analysis of non-performing loans on sample commercial bank .Hence this research had attempted to fill this research gap by taking reference of Everest bank limited and Nabil bank Limited and. This study try to show the present issues, latest information on Bank's NPL and their ratios.

CHAPTER III

RESEARCH METHODLOGY

3.1 Research Design

The research design used for this study is descriptive and comparative research design. It aims to explain the non-performing loan of selected commercial bank. The present facts and figure are collected. It uses the scientific method of collecting, classifying, and analyzing of data. Comparative analysis of selected bank helps to compare the result of two bank.

3.2 Population and Sample

The term 'population' for research means all the member of any well defined class of people, event or object. It means that the entire group of people, events or things of interest that a researcher wishes to investigate. As this study is about non-performing assets of commercial Banks, all 20 commercial banks of Nepal taken into account as population, out of the total population, following three commercial banks are selected as samples for this study by using judgmental sampling method.

- NABIL Bank Limited (Nabil Bank)
- Everest Bank Limited

3.3 Sources of Data

The study is based on secondary data. The secondary data are collected both from published and unpublished sources. The sources of data are:

- Annual report of both bank
- Website of both bank
- Other sources include journals, articles, books and research studies.

3.4 Data Analysis Tools

The data analysis has used statistical tools and financial tools.

Financial tools: The financial tools used in the study are trend analysis and ratio analysis.

A. Ratio Analysis

I. NPL ratio

$Non-performingloanratio = \frac{Non-performingloan}{loan} * 100\%$ Return on Assets

$$Returnonaasets = \frac{Netprofit}{Totalassets} * 100\%$$

II. Return on Equity

$$Returnonequity = \frac{Netprofit}{equity} * 100\%$$

B. Trend analysis is used to show the changes in values of non-performing loan, loan and assets in different time period.

Statistical tools

I.Arithmetic mean

$$A = \frac{1}{n} * \sum_{i=1}^{n} xi$$

II. Standard Deviation

$$S = \sqrt{\frac{\Sigma (x-\bar{x})^2}{n}}$$

III. Karl Pearson Correlation coefficient is used under statistical tools.

$$r = \frac{n\sum xy - \left(\sum x\right)\left(\sum y\right)}{\sqrt{n\left(\sum x^2\right) - \left(\sum x\right)^2}\sqrt{n\left(\sum y^2\right) - \left(\sum y\right)^2}}$$

The value of ‘r’ always falls between -1 to +1.

If, r = 0, there is no relation between the variables.

If, r < 0, there is negative relation between the variables.

If, r >0, there is positive relation between the variables.

IV. Regression is the statistical method that is used to predict the value of the dependent variable on the base of the independent variable.

3.5 Data analysis procedure

Correlation analysis

Correlation coefficient is the statistical tool that measures the relationship between the variable. The correlation coefficient ranges from -1 to +1. If the value of correlation coefficient is -1, there is perfectly negative relation between the two variables and when the value of correlation coefficient is +1 there is perfect positive relation between the variables. When the value of correlation coefficient is 0 there is no relationship between the variables.

Regression Analysis

Regression is the statistical method that is used to predict the value of the dependent variable on the base of the independent variable. This statistics is also successful in determining the relationship between dependent and independent variable. It also allows in quantifying the effect of changes in independent variable in dependent variable.

Statistical Methods used in Regression analysis.

$Y = a + bx$

Where, y= dependent variable,

a= y-intercept, b= slope of line, and x= independent variable

Bar Diagram

Bar diagram are one of the easiest and the most commonly used methods of presenting the numerical data. They present the data by means of bars or rectangle of equal with. The length of bar presents the given figures and with may be of any size.

CHAPTER- IV

RESULTS

In this chapter raw data collected from various sources are processed and converted into understandable facts and figure using financial and statistical and financial tools supported by figures and diagrams. The processing of data from raw to useful one is called data presentation and using the statistical tools we can do analysis. Major findings and analysis is done in this part.

4.1Brief Profile of Selected Bank

NABIL Bank limited

Nabil Bank Limited is the nation's first private sector bank, commencing its business since July 1984. Nabil was incorporated with the objective of extending international standard modern banking services to various sectors of the society. Pursuing its objective, Nabil provides a full range of commercial banking services through its 52 points of representation. In addition to this, Nabil has presence through over 1500 Nabil Remit agents throughout the nation.

Nabil, as a pioneer in introducing many innovative products and marketing concepts in the domestic banking sector, represents a milestone in the banking history of Nepal as it started an era of modern banking with customer satisfaction measured as a focal objective while doing business. Operations of the bank including day-to-day operations and risk management are managed by highly qualified and experienced management team. Bank is fully equipped with modern technology which includes international standard banking software that supports the E-channels and E-transactions. There are fifty two branches. The head office is located in Durbarmarg. The ownership structure is explained by the given pie-chart.

CHAPTER -V

CONCLUSION

5.1 Discussion

Non-performing loan are those loan that has been default in the payment of interest and principle. Loan, which payment of interest and principle is not made for more than 3 months is called non-performing loan. In specific contract the term may differ. The rate of NPL in Nepalese banking sector is alarming. The issue of NPL has become unruly day by day. As the Nepalese financial market is dynamic, the risk associated with default payment is difficult to manage. Timely default risk management is necessary for bank. NPL causes the real economic cost for bank and it can even erode the existing capital. Bank requires the heavy amount in collection procedure and bank also has to face opportunity cost. With the increase in NPL, allowance for loan also increases and thus eventually existing capital can erode.

Banking sector in Nepal has expanded substantially in the last one and a half decade, following the financial liberalization policy. People now have several choices in pursuing their banking activities. This sector has gradually embraced modern technologies to deliver value added product and services to its clientele. However, the expansion and adoption of new technologies has brought new types of risk to the fore, the management of which is crucial for the bank and the banking industry in the long run. At the beginning of the 1980s when financial sector was not liberalized, there were only two commercial bank, and development banks performing banking activities in Nepal. After the induction of economic liberalization policy, particularly the financial sector liberalization that impetus in the establishment of new bank and non bank financial institutions. Consequently, by the end ofMay 2018, altogether 153 banks and non-bank financial institutions licensed by NRB are in operation. Out of them, 28 are "A" class commercial banks, 36 "B" class development banks, 25 "C" class finance companies, 64 "D" class micro-credit development banks.

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

Loan to the customer is core assets of any commercial bank. About 80% of deposits are utilized in giving loan to the customer. Commercial bank provides interest on deposits and allows interest on loan. The difference between the interest income and expenses is the net income for bank. Major portion of income is derived from the interest income. When the interest becomes default, there will be threat to the income to the bank. It result in credit risk and eventually leads to the liquidity risk, operational risk, and market risk. To make the system of bank smooth, there is necessary for all loans to be performing. Commercial banks always try to make their loan performing. Pass loans are called performing assets. To make sound, healthy and, profitable operation all the loan needs to be performing. Sometimes due to negligence from customer, change in government policies, and change in macroeconomic variable causes the loan to be non-performing assets.

The study focuses on the study of non-performing loan with reference to Nabil bank ltd and Everest bank ltd. For this purpose descriptive, analytical, and comparative research design is used. Secondary data has been used for analysis. Data are collected from annual report, journals and related thesis article. The data collected from different sources are presented table, graphs, and figures. Statistical and financial tools are used for data analysis. The data of five consecutive years have been taken for analysis. The study overall examines the non-performing loan of commercial bank.

5.2 Conclusion

One of the major bank assets is loan and advances to the customer. Effective management of loan portfolio is challenging task for a banker. The reason behind

NPL is not the inadequate amount of deposits from customer, but poorly managed loan portfolio. Ineffective credit appraisal and change in the credit policy results in the heavy amount of non-performing loan.

Banking sector plays an important role in the economic development of a country. This is mostly pronounced in the realm of financial sector. The increasing trend of NPL in Nepalese sector is creating the less efficiency in the operation of bank. Inadequate credit policy, political pressure, carelessness of customer is some of the reason behind the growing NPL.

The study conducted in NPL analysis helps to find out that there is increasing trend of NPL in commercial bank. The NPL is increasing with higher amount. It is necessary for a bank to take prompt action. The study also shows that there is positive relation between loan and NPL. With the increase in loan and advances, NPL is also increasing. NPL and ROA are also in increasing trend. Classification of NPL can be done in restructured, doubtful, substandard and loan loss. Loan loss amount consist of heavy figure. Substandard and doubtful debt also have significant amount.

NPL’s impact can be seen both on balance sheet and income statement. With the increase in NPL, certain portion of this regarded as a loan loss provision. Loan loss provision is deducted as expenses from operating income. It cause in decrease in the net profit in the bank. Similarly allowance for loan is deducted from the capital. If the trend of NPL goes on increasing in no time existing capital can erode.

Commercial bank is trying to control the NPL by following various major. All the commercial bank complies with the rules and regulation, principles of Basel committee on banking and supervision. Credit and monitoring department is regulated for the pre and post monitoring of credits. Credit officer are accountable by all the credit related documents. Security documents, General Documents, Credit appraisal Report, Collateral valuation report are necessary documents required. Timely monitoring of these documents is necessary.

Commercial bank should give their whole effort in managing the non-performing loan. As there is increasing trend of NPL, there is possibility of major threat to commercial bank. The positive relation between NPL and loan shows that bank should be cautious enough in giving loan. They should make necessary documentation and verification so that the loan will be performing. With the increase in loan, the NPL ratio should be decreased.NPL ratio can be decreased by two ways. Decreasing NPL in given loan can decrease NPL ratio. Similarly, increasing loan and given NPL can decrease NPL ratio. Bank should be able to decrease NPL and increase loan and advances.

Major conclusion from the study can be listed in the following points:

- The ratio analysis of NPL ratio shows, there is fluctuation in the value of NPL. The reason behind the fluctuation in NPL ratio is increase in loan amount. The NPL ratio has decreased in the recent years.
- There is positive relation between NPL and loan. Loan and advances and NPL are moving in the same direction. When the loan and advances increases, NPL also increases. When the loan and advances decreases, NPL also decreases.
- NPL and ROA are tested using the regression analysis. The negative value of coefficient indicates that both are moving in the opposite direction. There is insignificant relation between NPL and ROA.
- NPL and ROE are tested using the regression analysis. The negative value of coefficient indicates that both are moving in the opposite direction. There is insignificant relation between NPL and ROE.
- Classification of NPL is done into restructured loan, substandard loan, doubtful loan, and loan loss. Loan loss covers the major portion of NPL. Substandard and Doubtful debt also covers the significant amount of NPL
- Commercial banks are giving their whole effort in managing the non-performing loan. As there is increasing trend of NPL, there is possibility of major threat to commercial bank. The positive relation between NPL and loan shows that bank should be cautious enough in giving loan. They should make necessary documentation and verification so that the loan will be performing.
- All the commercial bank complies with the rules and regulation, principles of Basel committee on banking and supervision. Credit and monitoring

department is regulated for the pre and post monitoring of credits. Credit officer are accountable by all the credit related documents. Security documents, General Documents, Credit appraisal Report, Collateral valuation report are necessary documents required. Timely monitoring of these documents is necessary.

5.3 Implication

Based on the study and findings, following points can be recommended as an action implication.

- To become successful bank, banker must be able to utilize the deposit effectively. Loan and assets compromise of major assets of bank. It is the risky assets of bank but the profitability generated from these assets are higher. It is necessary for a bank to make their loan as performing assets. Liberal lending policies is necessary for a bank to increase the loan and decrease the non-performing loan.
- The positive relation between NPL and loan shows that bank should be cautious enough in giving loan. They should make necessary documentation and verification so that the loan is performing. With the increase in loan, the NPL ratio should be decreased.NPL ratio can be decreased by two ways. Decreasing NPL in given loan can decrease NPL ratio. Similarly, increasing loan and given NPL can decrease NPL ratio. Bank should be able to decrease NPL and increase loan and advances.
- Bank should review the credit department operation. The staffs need to train and the system of checking and analyzing the loan portfolio should be revised. Any error found in the system operation need to be managed immediately.
- Bank should be sensitive to the external movement such as change in interest rates, exchange rate changes, changes in the policy of NRB, inflation, and other business cycles.
- The major reason behind the NPL is insufficient collateral. Collateral valuation document should be monitored time and again. If the loan amount exceeds to the loaning power, it should be recommended to the immediate

supervisor. Lending policy should be revised time and again. The acts such as pledge and lien need to be done.

- The major reason behind NPL is carelessness from the side of customer. Customer is not using the loan amount for the same purpose that has been borrowed. In rural area, people are taking agriculture loan and utilizing the money in marriage, education, and so on. In doing so people are not able to pay the loan back, as their source of income has not been flourished. This problem can be sort out by giving proper guidance to the customer in utilizing the loan amount. Small seminar can be conducted by the bank in making people aware of investing and utilizing the fund.
- Credit intelligence bureau need to be sound. Timely delivering of information and managed information system is necessary for bank to track the detail information about loan and default loan. Credit department system should be sound and healthy.
- Legal mandatory requirement should be maintained by bank. Proper classification of loan, loan should be extended within the capital and deposit limit. Liquidity ratio should be maintained.

5.4 Recommendation for Further Research

- This study only reveals the trend of non-performing loan few selected commercial banks only. Further researches can be carried out using large sampling to other developmental banks too.
- As this study is limited to the analysis of secondary data future researches can be done using primary data which may yield different result.
- Many researches can be done on importance of NPL for commercial banks.
- As this study covers commercial banks in Nepal, it doesn’t consider financial institutions and other sectors to provide a more broad based analysis. It is also recommended to research NPL of other financial institution of Nepal except commercial banks.

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