

**IMPACT & IMPLEMENTATION OF NEPAL RASTRA
BANK DIRECTIVES ON NON-PERFORMING LOAN**

**(A Comparative Study of the Selected Nepalese Commercial
Banks viz. NBL, SCBNL, NABIL, LBL, NICB and NBB)**

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CHAPTER - ONE

INTRODUCTION

Background of the Study

The Nepalese financial sector is composed of banking sector and non-banking sector. Banking sector comprises Nepal Rastra Bank (NRB) and commercial banks. The non-banking sector includes development banks, micro credit development banks, finance companies, co-cooperative financial institutions, non governmental organizations (NGOs) performing the limited banking activities. Other financial institutions comprise of the insurance companies, employees provident fund, citizens investment trust, postal saving offices and Nepal stock exchange. During the year 2011, Thirty One commercial banks are established with their more than 950 operating branches across the country. Similarly, Eighty Seven Development Banks, Seventy Nine Finance Companies, Thirteen Micro Credit Development Banks are functioning in the country.

The objective of bank supervision in Nepal has always been to promote and maintain the safety, soundness and integrity of the financial system while promoting confidence in the system through the implementation of policies and standards that are in line with the international best practices. The main aim of the directives issued by NRB is to maintain the stability & healthy development of banking & financial system of the country.

Nepal Rastra Bank as the bank of the banks and the government bank has been granted the full authority to regulate and develop the banking sector in Nepal. Commercial banks have to strictly follow the rules and regulations issued by the NRB. The establishment of the NRB was the major step in the evolution of the financial institutions. The commercial banks are supervised by the Bank Supervision Department while the rest of these institutions are supervised by Financial Institution Supervision Department. Initiation of the NRB provided the special impetus for the development of the financial institution.

NRB issues directives to the commercial banks instructing them to fulfill its regulatory requirements of the country. Under the existing structure of Nepal Rastra Bank, the directives applicable to the commercial banks are primarily issued from two departments viz. Bank and Financial Institutions Regulation Department and Foreign Exchange Management Department. The Foreign Exchange Management Department regulates the

foreign currency transactions of the bank while the Bank and Financial Institutions Regulation Department covers the rest.

Statement of the Problem

Nepal is one of the least developed countries of the world with the very lower per capita income. According to the economic survey, more than 38% of the total population is below the poverty line. The major cause of this chronic problem is the lack of economic development or the slow rate of the national economic growth. Nepalese commercial banks have not formulated their investment policy in an organized manner. The implementation of the investment policy is also not effective. The credit extended by the commercial banks to agriculture and the industrial sector is not satisfactory to meet the present growing needs. Granting loan against in deposit, over valuation of goods pledge, land & building mortgaged, risk averting decision regarding loan recovery and negligence in recovery of overdue loan is some of the basic loopholes and the result of unsound investment policy sighted in the banks. Due to this fact, the Non-Performing Loan remains a very serious problem which in turn affects the efficiency of the commercial banks. Therefore, an appropriate investment policy is the basic need of all the commercial banks.

Following are the research questions developed for the study.

1. What is the position of the LLP and Total Loan and Advances of the sample banks?
2. What is the status of Non Performing Loan of sample banks?
3. What are the impact and implications of NRB guideline with respect to NPL on the financial performance of the sample banks?
4. Is sample banks are actually followed the NRB directives in respect to NPL?
5. Whether the implementation of NRB directives are being monitored or not?

Objectives of the Study

The main objective of this study is to analyze the impact and implementation of NRB directives on non-performing loan. The specific objectives are as follows:

1. To evaluate the relationship between loan loss provision and total loan and advances.

2. To analyze the status of Non-Performing Loan of the sampled banks.
3. To analyze the impact of NRB guidelines with respect to NPL on financial performance of the sampled banks.
4. To analyze whether NRB directives are being actually followed or not in respect to the Non-Performing Loan by the sampled banks.
5. To analyze whether the implementation of NRB directives are being monitored or not.

Limitations of the Study

The main limitations of this study are as follows:

1. This study is totally focused on the NRB directives specific to Non-Performing Loan.
2. The study based upon the secondary as well as primary data, information and data are collected through questionnaire.
3. The truth of this study depends on the reliability of the data provided by the concerned banks and respondents.
4. This study depends upon the data and information of a five years i.e.2007 to 2011 A.D.
5. Statistical tools are used in this study wherever needed. Hence, drawbacks and weakness of those tools are also the limitation of the study.

Significance of the study

Nepal Rastra Bank as a bank of the banks issues directives in order to ensure that banks are investing the public deposit in right way. Nepal Rastra Bank issues directives on various aspects to regulate and promote the financial institutions. This study specifically focused on the directives issued by NRB on Non-Performing Loan and its implication, implementation and impact over sampled Nepalese commercial banks namely Nepal Bank Limited, Standard Chartered Bank Nepal, Nabil Bank Limited, Lumbini Bank Limited, Nepal Industrial & Commercial Bank and Nepal Bangladesh Bank. Moreover, this study tries to evaluate the relationship between loan loss provision and total loan & advances. The main aim of the directives issued by NRB is to maintain the stability & healthy development of banking & financial system of the country.

CHAPTER-II

REVIEW OF LITERATURE

Research Gap

Non-Performing Loan has been a very important issue for the entire banking industry in Nepal. Banking sector is backed by the hundreds of research studies but most of the research studies have conducted on the financial performance, dividend policy and in the area of risk and return. Very few studies are related to the Non-Performing Loan and Loan Loss Provisioning of the commercial banks. Going through the material related to the Non-Performing Loan, most of the research studies have found discussing the Non-Performing Loan of the two big government owned banks i.e. Rastriya Banijya Bank and Nepal Bank Limited. It is real fact that these two giant banks carry a huge amount of Non-Performing Loan but the studies done over these banks only couldn't reflect the true picture of overall commercial banks of Nepal. Hence researcher has attempted to fill this research gap by taking reference to Nepal Bank Limited, Nabil Bank Limited, Lumbini Bank Limited, Standard Chartered Bank Limited, Nepal Industrial and Commercial Bank and Nepal Bangladesh Bank.

Keeping this in mind, researcher of this study entitle "Impacts and Implementation of NRB Directives on Non-Performing Loan" has tried to make a comparative analysis of three Nepalese locally promoted banks (including one from government owned) and three joint venture banks. Primary objective of this study is taken to find out the impacts and implementation procedures of NRB directives on NPL comparatively among the sample bank. This study also aims to provide the present issues, information and scenario regarding NPL in the Nepalese banking industry.

CHAPTER-III

RESEARCH METHODOLOGY

Research Design

Basically this study based on descriptive research design. It presents, analyze and interpret the result. All the collected data and information are generalized and conceptualized precisely by achieving insights into phenomenon. To meet the objective of the study a survey with scheduled questionnaire among the professional and individual investors are disturbed. And then firstly, the data represented in table or diagram, secondly, data are analyzed by using various financial and statistical tools and at last analyzed data are compared and interpreted for the conclusion.

Population & Sample

There are thirty one commercial banks in Nepal. They are the population of this study. Conclusion drawn by this study can be generalized to this population. Out of thirty one banks, only six are selected for the study of problem is sample for this study. Meaning that, out of thirty one commercial banks, banks with the higher portion of NPL and banks with the lower portion of NPL are selected for the comparative study. Therefore, rather than random it may be purposive sampling.

Method of Data Analysis

Methods of analysis are applied as simple as possible. The necessary data collected from the different sources are presented and analyzed systematically. To attain the mentioned objectives, the statistical and financial tools are used as required by the study to analyze the secondary and primary data. Data are presented simply and understood able pattern through different charts, diagrams, graphs & tables. For the purpose of analysis of collected data appropriate mathematical, financial as well as statistical tools have been used where necessary.

CHAPTER-IV

DATA PRESENTATION AND ANALYSIS

Major Findings of the Study

From the presentation of data major findings can be drawn as:

1. Nepal Bank Limited, as a government wing bank, its operating result has been affected by the governmental dynamism which is not found satisfactory comparing to other banks in Nepal. Its operating efficiency has been paralyzed likely other enterprises equipped by government. Handover of NBL to foreign management has proven some important improvement in respect to the operating culture of this bank. But even comparing to other private sector and joint venture banks present in Nepal, NBL is still showing some loop holes in its operation. Average NPL figure 29.29% shows bank's incapability in recovery of its interest and principal amount which is absolutely very higher than the international and NRB standards. Similarly, average loan loss provision ratio 32.48% shows a huge profitable amount has been freeze for the creation provision against loan. As well being the largest deposit holder bank of the Nepal, NBL is employing only 42.39% average deposit to the interest earnable locations which shows the banks inefficiency in making loan and advances portfolio.
2. Nabil Bank Limited as a joint venture bank, established as a first private sector bank has shown its smartest operating results from the inception. NABIL also aims to be the lowest NPL bank in Nepal whose current average NPL stood only at 1.67% which is less than the international as well NRB standard. Similarly, its average deposit mobilization rate 68.63% with the CV of 0.07 shows banks efficiency in mobilizing the deposit to interest earnings. Similarly average loan loss provision ratio 2.83% reflects presence of large pass loan in its loan portfolio. Looking into the overall financial indicators of the bank, all indicate a smarter growth in every aspect of the financial parameters.
3. Standard Chartered Bank Nepal, as only bank in Nepal with the global representation, shows its try in rendering a best class banking service. SCBNL's total deposit figure in 2011 stands at Rs. 26,847.02 million where the deposit employed towards loans and advances is only 41.72%. Average deposit mobilization into loans and advances is only 41.72% which figure represents a very smaller amount has been deployed under

the loan portfolio. But on the other hand, average Non Performing Loan ratio 2.60% shows the presence of good quality of loans in its loans portfolio which is much below than the international standards. Also its average Loan Loss Provision ratio 3.10% reflects the availability of the good quality of loans which in turn describes that very smaller amount has been cushioned to meet the required standards and thus profitable earning has also increased.

4. NIC Bank Limited as a locally promoted bank shows its extra efficiency in employing its total deposit in loan and advances. Its average deposit mobilization rate is 81.54% that means Rs. 81.54 has been invested in loans and advances from Rs. 100 deposit. Also average Non Performing Loan ratio only at 2.52% describes availability of good quality of loans in the loan portfolio. Continuously, average Loan Loss Provision ratio 3.33% tells a very smaller amount has been deducted from the profit to cushion the possible loan losses. As well meeting the entire NRB standard, it reflects its seriousness towards the banking operation as per NRB rules.
5. Lumbini Bank Limited, from the locally promoted group shows very weaker position in different financial parameters. Whether a huge sum of money has been employed in loans and advances, presence of bigger level bad loan is resulted the failure of banks operation. Its average deposit mobilization rate is 85.05% where 19.15% of loan is not performing well. This reflects bank's inefficiency in recovering of invested amount. As well average Loan Loss Provision figure 20.51% shows a very big sum of money has been cushioned against the loan loss provision and thus deducted the profit of the bank in contrary
6. Nepal Bangladesh Bank Limited, a joint venture with Bangladesh also shows its weaker position regarding the loans and advances management. Very bigger amount of loan and advances has been availed in loss loan category. And the reason caused failure of the bank hence NRB captured the banks management for the necessary recovery efforts. In its total loans figure, 35.13% (in 2010) of the loan is not performing well amongst more than 70% is loss loan i.e. more than 70% of the loan and advances is overdue more than 1 year that shows the banks incapability in recovering its investment in loan and advances. However, handover of banks management to NRB, has cutlet loan all the bad parameters of the bank to normal standards and that bank is equaling towards profit. Also, recovery of the bad loans is resulting reducing the level of non-performing loan.

CHAPTER-FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

Conclusion

Banks used to collect the funds from idle locations and help to mobilize them into the productive areas that push the entire economy to rise from collecting the deposit and lending them to the enterprise to meet the necessity of commercial funds and which in turn helps in progressive economy of the country through employment, production and export. And the difference of paying interest on deposit and earning interest on lending is the income for the banks. But improper lending management can create headache to the bankers in the form of non-performing loan which is the crucial matter for every financial enterprise.

A non-performing loan not only loses the interest earning of the banks but also creation of necessary provision as per NRB standards deducts the profit of the institutions. Nepalese banking industry is also severely affected by the reason of non-performing loans due to the improper credit appraisal system, ineffective credit management, lack of proper valuation of collateral security, mis-conduction of borrowers and improper credit monitoring and supervision system. Nepalese banking industry especially government winged financial institutions like Nepal Bank Limited, Rastriya Banijya Bank, NIDC have badly affected by the reason of non-performing loans.

Private sector bank like Lumbini Bank Limited and Nepal Bangladesh Bank Limited are also affected by the reason of NPL. NPA in government bank is reason of poor governance and transparency in procedures, poor banking culture, limitations in auditing and accounting, lack of proper regulatory fragmentation and unnecessary political influences.

At present NRB supervision and monitoring system have been tightened, regular follow up and necessary steps for any suspicious and undesirable condition have been formulated by the NRB to prevent the entire banking industry. Timely directives and guidelines have been formulated by NRB to monitor and supervise the banking industry.

Recommendations

On the basis of the analysis of the collected data and the necessary available parameters and facts of the banks following recommendations have been made:

- 1 Nepal Bank Limited as a government winged commercial bank, it has been seriously found affected by the reason of non-performing loan. To overcome the serious situation, proper credit policy should be formulated, credit appraisal system should be improved and the individual accountability of the officials should be raised in the institution.

Due to the huge sum of NPL and the LLP, banks operating profit has been badly hampered. Also as a largest deposit holder bank in Nepal, NBL should try to maximize its credit to deposit ratio to maximize the profit form current level.

- 2 Nabil Bank as a joint venture private sector bank in Nepal is showing its tuff level operating status. But in respect to other parameters of the bank, credit to deposit ratio is not well and hence it should try to maximize the level of this ratio to maximize the operating return.
- 3 Standard Chartered Bank, as an only bank in Nepal with the global representation, it is showing quality in its overall services and financially the same. But looking in the part of credit to deposit ratio, its deposit utilization rate seems very lower comparing to the other financial enterprise.
- 4 NIC Bank as a purely Nepalese invested bank shows its extra level efficiency in its operation. It's all the financial parameters, loan loss provisioning level, non-performing loan status, credit to deposit ratio are looking in perfect level.

However, it holds very smaller level of deposit in overall in comparing to the other successful financial institutions. So, it should try to grow in its total deposit level.

- 5 Lumbini Bank is holding a very higher level of NPL in its loan and advances portfolio than the NRB standard. So, first its NPA should be minimized to overcome the chronic problem of non-performing loan and thus to reduce the level of provisioning which is largely deducting the operating profit of the bank.

Whether a huge sum of money has been employed in loans and advances, presence of higher level bad loans are resulting the failure of banks operating.

- 6 NB bank is also in the serious problem of bad loans. Very bigger amount of loan and advances has been availed in loss loan category.

This means NBBL should step towards the recovering of the non-performing loan level and thus reducing the part of loss loan in its loans and advances portfolio.

Also, its operating profit has been reduced due to the reason of higher amount of provisioning in the loan loss category, hence minimizing the level of loan loss, it should try to maximize the overall return of the bank.