NON-PERFORMING ASSET AND ITS EFFECTS ON PROFITABILITY OF NEPALESE COMMERCIAL BANKS
(With reference to GlBL, NIBL, ADBL, EBL and NIC Asia)

A Thesis Proposal

By

SHIVJEE KUMAR MAHATO

CENTRAL DEPARTMENT OF MANAGEMENT

Roll No. : 823

TU Regd. No: 7-1-13-1422-2007

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1. Background of the Study

Banks and financial institutions are the backbone of country's economic development. It's failure and success will have huge impact on financial as well as economic health of overall sectors of country. BFIs are classified under four categories according to their scope of operations and capital requirements. As according to NRB in its monthly statistics, there are four categories of BFIs in Nepal. They are (i) 27 class ‘A’ commercial banks, (ii) 20 class ‘B’ Development Banks, (iii) 22 class C' Finance Companies, (iv) 85 class 'D' microfinance financial, and institutions. Among them commercial banks are the largest financial institutions as it performs largest activities than other in terms of scope of operations, required capital, number of the branches and financial services etc. The total commercial bank of the Nepal 5068 on 2021. The Covid-19 Continuously increase non-performing loan in Nepal due to lockdown overall financial institution.

Banks have statement of sources and uses of the funds as other non-financial institutions are also known as balance sheet. Liabilities are a source of funds and assets as a uses of funds. As they deal with the money its assets and liabilities and capital both are in forms of money or other instruments equivalent to money. Most of assets reflect the loan and advances providing to different individual, corporations and government by applying different conditions and covenants due to various reasons comes from lenders and borrowers side, loans and advances can't collected by banks in timely manner. Those loans and advances that becomes due beyond the specified period as required by law will create blockade in earning profit hence it will also ceases the inflow of cash in banks that will leads to liquidity crisis at bank due loan and advances is known as Non Performing Loan NPL.

Concept of non-performing Assets

Nonperforming Assets (NPA) means the amount of loan that the individual commercial banks had provided and the customer has not paid in until the time already matured. The distributed loan is not returned timely by clients and becomes overdue then, it is known as non-perforeming assets for the banks. Generally, bank treats its loan as assets from which it can earn profit by charging higher borrowing rate than a lending rate called interest spread. Bank counts its loan as non performing when client or borrower does not make payment of installment of principal and interest within prescribed time period.

The standard period of loan to be classified as non-performing loan may differ from country to country as accordance to their regulatory bodies.

A performing asset is an advance which generates income to the bank by way of interest and other charges. A non-performing asset in the banking sector may be referred to an asset not contributing to the income of the bank or which does not generate income for the bank. In other words, an advance account, which ceases to yield income, is a non-performing asset. A common meaning of a NPA is an investment that does not contribute to production, value addition or capital formation or advance has ceased to yield any income to the bank. NPL can be defined as a failed credit, a service product that has turned into scrap.

According to the International Monetary Fund, a non-performing loan is any loan in which interest and principal payments are more than 90 days overdue; or more than 90 days' worth of interest has been refinanced, capitalized, or delayed by agreement; or payments are less than 90 days overdue but are no longer anticipated. Another definition of a non-performing loan is one in which the maturity date has passed but at least part of the loan is still outstanding. The specific definition is dependent upon the loan's particular terms (Fares Financial Dictionary, 2017)

The well accepted threshold for classifying a loan as non- performing is when Obligation related to the loan become over 90 days past due. Multilateral organizations define non-performing along the same lines. The BCBS defines default for capital calculation purposes as follows: “A default is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place:

(i) The bank considers that the obligor is unlikely to pay its credit obligations to the banking to actions group in full, without recourse by the bank such as realizing security.

(ii) The obligor is past due more than 90 days on any material credit obligation to the banking group." The IMF Financial Soundness Indicators (FSIs), which are vastly used for cross country comparability, also establishes as criteria for defining a loan as non performing past due of principal or interest over 90 days.

Basing the criteria only on the number of days past due would pose challenges for balloon payment loans or overdraft type credits. Moreover, information can be available that the borrower is likely to default, even if the loan is not yet past due. Thus, in general, a loan is considered to be non performing when the probability of full repayment is considered to be low or when a loan is in default or highly likely to default. Criteria for classifying a loan as non performing are thus number of days past due, as well as the overall financial performance/creditworthiness of the borrower, sometimes even combined with the assessment of collateral (Hulster and Letelier, 2017).

A Non-Performing Asset refers to a classification for loans on the books of financial institutions that are in default or are in arrears on scheduled payments of principal or interest. In most cases, debt is classified as nonperforming when loan payments have not been made for a period of 90 days (Kumar, 2017).

There are two types of non- performing assets. They are gross non- performing assets.

(i) Gross NPL

Gross NPA is a term used by financial institutions to refer to sum of all the unpaid loans which are failed to recover from the customers within stipulated period of time.

(ii) Net NPL

Net NPL is refers to the sum of NPL less provision for bad and doubtful debts. It is an actual loss to the bank. The provision for loan loss is the amount set aside by the bank and deducted while calculating net income. for the purpose of possible loan loss that become due by the customers. In this study, NPA is mostly considers while calculating figures because NPA reflects an actual loss to the bank.

Net NPA =Gross NPA -Provision for loan loss

Commercial banks as a wide operational depository financial institution should be aware regarding reducing and management of NPL adopting basic strategies like :

Improving credit management policy.

- Applying better recovery management.

-Providing training to employees regarding loan faculty.

-Following prescribed guideline of an authoritative body.

Overview of selected commercial banks

Global IME Bank Ltd.

Global IME Bank Ltd. (GIBL) emerged after successful merger of Global Bank Ltd (an “A” class commercial bank), IME Financial Institution (a "C" class finance company) and Lord Buddha Finance Ltd. (a “C” class finance company) in year 2012. Two more development banks (Social Development Bank and GulmiBikas Bank) merged with Global IME Bank Ltd in year 2013. Later, in the year 2014, Global IME Bank made another merger with Commerz and Trust Bank Nepal Ltd. (an “A” class commercial bank). During 2015-16, Global IME Bank Limited acquired Pacific Development Bank Limited (a "B" Class Development Bank) and Reliable Development Bank Limited (a "B" Class Development Bank). It is in line with the aim of the bank to be “The Bank for All” by giving necessary impetus to the economy.

The bank has been able to achieve excellent diversification of its assets. A well balanced distribution of exposure in areas of national interest has been possible through long term forecasting and timely strategic planning. The bank has diversified interests in hydro power, manufacturing, textiles, services industry, aviation, exports, trading and microfinance projects, just to mention a few. GIBL has been conferred with “The Bank of the Year Award 2014” for Nepal by the Bankers Magazine (Publication of the Financial Times, UK) and “Best Internet Bank 2016- Nepal” by International Finance Magazine, London.

Nepal Investment Bank Ltd

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one of the largest banking group in the world.

Later, in 2002 a group of Nepalese companies comprising of bankers, professionals, industrialists and businessmen acquired the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd., and accordingly the name of the Bank also changed to Nepal Investment Bank Ltd. At the bank's shareholding pattern is as follows.

Agriculture Development Bank

Agricultural Development Bank Ltd Agricultural Development Bank Limited (ADBL) is an autonomous organization largely owned by Government of Nepal. The bank has been working as a premier rural credit institution since the last three decades, contributing a more than 67 percent of institutional credit supply in the country. Hence, rural finance is the principal operational area of ADBL. Furthermore, the bank has also been involved in commercial banking operations since 1984.

With the main objective of providing institutional credit for enhancing the production and productivity of the agricultural sector in the country, the Agricultural Development Bank, Nepal was established in 1968 under the ADBN Act 1967, as successor to the cooperative Bank. The Land Reform Savings Corporation wasmerged with ADBN in 1973. Subsequent amendments to the Act empowered the bank to extend credit to small farmers under group liability and expand the scope of financing to promote cottage industries. The amendments also permitted the bank to engage in commercial banking activities for the mobilization of domestic resources. ADBL has largest number of branches all over the country. The total number of 249branches are providing financial services throughout the country including rural as well as urban areas. The bank is able to provide wide variety of advance banking services with its technological improvement and continuous progress. Its unique motto of providing service is concerned towards enhancing agricultural sector of the country by making huge investment in that sector. This is contributing towards increasing productivity of the country.

Everest Bank Ltd.

Catering to more than 10 lacs customers, Everest Bank Limited (EBL) is a name you can depend on for professionalized & efficient banking services. Founded in 1994, the Bank has been one of the leading banks of the country and has been catering its services to various segments of the society. With clients from all walks of life, the Bank has helped the nation to develop corporately, agriculturally & industrially.

Punjab National Bank (PNB), our joint venture partner (holding 20% equity) is one of the largest nationalized bank in India having presence virtually in all important centers. Owing to its performance during the year 2012-13, the Bank earned many laurels & accolades in recognition to its service & overall performance. Recently, PNB was awarded with “IDRBT Banking Technology Excellence Award” under Customer Management & Intelligence Initiatives. The Bank also bagged “Golden Peacock Business Excellence Award 2013” by Institute of Directors. Similarly, the Bank was recognized as ‘Best Public Sector Bank‘ by CNBC TV 18. The bank has now more than 7,000 branches and 8,500 ATMs spread all across India. As a joint-venture partner, PNB has been providing top management support to EBL under Technical Service Agreement.

NIC Asia Bank Limited

NIC ASIA Bank was founded as Nepal Industrial and Commercial Bank on 21 July 1998. It was renamed NIC ASIA Bank on 30 June 2013 after it merged with Bank of Asia. Nepal witnessed the first merger of two commercial bank in its history. After the merger, NIC ASIA was recognized as ”Bank of the Year 2013-Nepal” by The Banker, Financial Times, UK. This is the second time that the Bank was recognized with this prestigious award, the previous occasion being in 2007. The Bank has successfully completed its 21 years of operation. The company has currently the following wholly owned subsidiaries: 1. NIC Asia Capital Limited 2. NIC Asia LaghubittiyaSanstha limited

The paid up The Bank with its 317 branches,405 ATMs, 95 Extension counters and 44 branchless banking service is the largest bank in terms of footprint expansion, customer base including balance sheet size.

The Bank is headed by Mr. Tulsi Ram Agrawal as its Chairman and Mr. Roshan Kumar Neupane as Chief Executive Officer. Mr. Neupane was appointed as CEO of the bank on 2 December 2018 with 4 years tenure. Mr. Neupane is believed to be youngest CEO in Nepalese Commercial Banks.

2. Statement ofthe problems

The non-performing loan (NPL) of financial institutions are considered as critical issue in the context of Nepal for last few decades. It's impact on banking system is being failure to properly management of assets to side of balance sheet. Which will not only contributes to decline in net profit but also enhance liquidity crisis and has negatively effect on goodwill of the bank as well. Customer's level of confidence will be decline with the existing situation of non- performing loan. They might be willing to withdraw their interest towards banking industry.

According to Banking supervision Report, (2017) total NPL of whole banking industry sector is 28.86 billion including public and private sector's bank in fiscal year 2016/17 which accounts for 15.31% of increment than previous year. The report had clearly shows the increasing trend of NPL in banking sectors in Nepal. The statistics shows clearly regarding need of awareness from the banks

to adequately management of NPL in order to overcome from upcoming consequences might hinder the bank's earning capacity.

(i) What is the pattern of NPA in Global IME Bank, Nepal investment bank, Agriculture Development bank, Everest bank limited and NIC Asia bank limited ?

(ii) How does provision for loan loss coverage affect the profitability of commercial banks?

(iii) what is the impact of the NPA on profitability of those commercial banks?

3.Purpose of the study

The major objectives of this study are to assess the impact of nonperforming loan on the bank's profit. The specific objectives of this research are as follows:

(i) To analyze the present pattern of NPA in selected commercial banks?

(ii) To analyze the effect of provision for loan loss coverage ratio on profitability of commercial banks?

(iii) To examine the impact of NPA on profitability on Nepalese Commercial Banks?

4. Conceptual Framework of the study

The conceptual relationship between dependent and independent variable are:

5. Significance of the Study

The study will have some theoretical and practical significance to related parties. Some of the usefulness of this research are listed as follows:

(i) This study will provide awareness to the commercial banks regarding NPL management.

(ii) The research might be significant to develop a strategy to reduce the size of NPL and increase profitability.

(iii) The study will be helpful to the new academic researchers like us to make an analysis of the performance of selected commercial banks in reference to NPL.

(iv) The research will also be useful to the readers to gain a knowledge regarding the effect of NPL on profitability.

(v) The research will also bring the clear picture to know the current status of NPL of those commercial banks?

(vi) The study will also render some present and latest information and facts of the selected commercial banks."

6.Limitations of the Study

In the course of conducting entire research, due to various constraints and unfavorable situations. There will be following limitations in the study:

(i) There will be small size of sample so that the research might not generalized whole population of 27 commercial banks.

(ii) The research will be conducted by taking major two variables i.e,NPL and profit of the bank which might not provide satisfactory result because it will not consider other variables that affects the profitability of the commercial banks like management, liquidity, capital structure, employee motivation etc.

(iii) There will be insufficiency of data availability due to some unfavorable conditions.

(iv) Primary data will not be used in this research so that the qualitative aspects can- not be explore from this study.

7. Review of Literature

This chapter will for the review of the previous studies related to this research subject to know the prevalent situations of the non – performing loan and its effect on profitability and others factors as well. This first part will deals with the conceptual Ahmad &Ariff (2007) states that nonperforming is the percentage of loan values that are not serviced for three months and above. Basically, Non- performing loan reflects the performance standard of the banks. A high level of NPL reflects the high probability of loss and net worth get affected due to large number of credit defaults and similarly low level of NPL reflects the high probability of profit due to low credit default. Parul (2012) states that the NPL growth involves the necessity of provisions because it decrease the overall profits and shareholders. If there is the high proportion in bank credit there will be the higher probability that the banks can suffer from the financial crisis and vice versa.

Shrestha,(2010) in his report entitled, “A Study on Non-performing Assets (NPAs) - with Special Reference to Commercial Bank of Nepal”, in which he pointed out some major issue in NPAs. NPA reduce the yield on evidences but also reduces the profitability of CBE. “An asset which ceases to generate income of the bank is called non-performing asset. The past due amount remaining uncovered for the two quarter consequently the amount would be classified as NPA for the whole year. It includes borrowers’ defaults or delays in interest or principal repayment”.

Banks are increasingly facing credit risk which arises from non-performance by a borrower. The impact of high non-performing loans in banks profitability, especially, when it comes to disposals. Felix and Claudine (2008) states that return of equity (ROE) and return on assets (ROA) are negatively related with nonperforming loan.

Zoubi& Al-Khazali (2007) argued that loan loss provision (LLP) have positive relationship with ROA and suggests that bank managers use loan loss provision in managing their present and future earnings. Kithinji et. al. (2010) found that total loan to total deposits (TLTD) is positively related to the return on assets (ROA). Furlong

&Keeley (1989) found that there is positive correlation between the capital adequacy ratio and returns. Ochei et al. (2013) states that CAR with positively related with bank's profitability.

Jha&Hui et al. (2015) found that there is negative relationship of non-performing loan, capital adequacy ratio with return on assets. Similarly, there is negative relationship of nonperforming loan, capital adequacy ratio with return on equity (ROE). It also revealed that there is positive relationship of total loan to total deposit with return on assets (ROA) and positive relationship with return on equity (ROE).

Chhetri(2012) in the article titled "NonPerforming Assets: A need for Rationalization", the writer has attempted to provide connation of the term NPA and its potential sources, implication of NPA in financial sector in the South East Asian Region. He had also given possible measures to contain NPA. "Loans and advances of financial institutions are meant to be serviced either part of principal of the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan settlement. Since the date becomes past dues, the loan becomes non-performing asset. The book of the account with lending institution should be effectively operative by means of real transaction effected on the part of the debtor in order to remain loan performing.

Pradhan (2014) has conducted a research on "A Study on Non- Performing Assets of Commercial Bank with References to SCBNL, RBB, Everest bank, NB bank and NBBL". Main objective of his study are to find out the proportion of non-performing loan and the level of NPA in total assets, total deposit and total lending in the selected commercial bank relationship between loan loss provision in the commercial bank impact of non-performing assets in the performance of commercial bank. He has concluded improper credit policy, political pressure to lend, lack of supervision and monitoring, economic slowdown, overvaluation of collateral are the major cause of occurring NPA. In recent year, not only the private sector's bank (like NBBL,EBL and SCBNL) but also public sector's banks (RBB and NBL) are trying to maintain their loan and advances to control over becoming the nonperforming assets. To overcome the NPA from public banks, they should try to recover their loan and interest amount on time and also make a suitable loan loss policy.

He has concluded "high level of non-performing assets not only decrease the profitability of the banks but also affect the entire financial as well as operational health of the organization. If the NPA doesn't control immediately, it will be main causes for shutdown of the banks in future.

ROA is the measuring tools of bank profitability and also the ability of the bank management to generate the income by utilizing the company assets as their disposal. Ekwe&Daru (2012) used return on assets as dependent variable because it is an indicator of managerial efficiency. Khrawish (2011) states that ROA indicates the efficiency of the management of a company in generating net income from all the resources of the institution. Miller &Noulas (1997) found a negative relationship between credit risk and profitability. It shows that whenever there is negative relationship between them, then it signify that greater risk linked with loans,thehigher

level of loan loss supplies which thereby and create a trouble at the profit maximizing strength of a bank.

8.Research Methodology

The research methodology will considered about method of doing research on which whole study is based upon, which will contain the nature and sources of data to be used in the research sampling method and procedures will be mentioned with data analysis tools.

8.1 Research Design

The research design of this study is will be descriptive.

8.2Population and Sampling

The population for this study will be overall commercial banks in Nepal. As on January, 2021 prescribed by NRB, monthly Banking statistics, there are 27 commercial banks in Nepal. The study will be done by selecting five commercial banks among them by using quota sampling under non probability sampling method. In which the sample will represent both private and public commercial banks in Nepal.

(i) Global IME bank ltd
(ii) Nepal Investment Bank ltd
(iii) Agricultural Development Bank Itd.

(iv) Everest Bank Limited

(v) NIC Asia Bank Limited

8.3 Sources of Data

Data used in this study will be fully secondary data which are collected from of banking and financial statistics and various reports and directives of Nepal Rastra Bank. The required information will also be obtained from journals, articles, related websites, unpublished thesis and dissertations, books will be used to collect the required data for the research.

8.4 Data collection and processing and procedure

The data collection and procedure from bank web site, journal, magazine, newspaper.

8.5 Data analysis tools and techniques

This chapter will considered about method of doing research on which whole study is based upon , which will contains the nature and sources of data to be used in the research and sampling method and procedures will be mentioned with data analysis tools. The list of financial and statistical tools are listed as follows:

Financial Tools

(i) Return on Assets (ROA)

(ii) Return on equity (ROE)

(iii) Profit Margin Ratio (PMR)

(iv) Non-Performing Loan to total loan ratio (NLTTLR)

(v) Total Loan to Total Assets Ratio (TLTTAR)

(vi) Provision for loan loss coverage ratio (PLLCR)

(vii) Capital Adequacy ratio (CAR)

Statistical Tool

In this study descriptive statistics will be used to making analysis of data and its Interpretations. They are listed as below:

(i) Arithmetic mean

(ii) Standard Deviation

(iii) Correlations of coefficient and regression analysis

(iv) Trend analysis

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