CHAPTER-I

INTRODUCTION

1.1 General Background of the Study

Financial institutions are said to be the bridge between the savers & users. The development of economy basically depends upon the development of financial system of the country. That's why financial institutions are becoming a paramount part for the development of the entire economic & industrial sector of the country. Banks receive deposits, support the payment system and provide the largest source of funds to the economy. Banking, more especially commercial banking sector is the heart of the development of the business as they supply life-blood (capital) to the industries. They have significant role in the smooth functioning of the economy. Therefore, stable and safe banking practices are of crucial importance for the development of a safe and growth-oriented strong economy. Keeping this in mind, government has initiated the financial sector reform program in mid 1980's. As a result, there is a prominent growth in financial industry and commercial banks hold a large scale share in the economic activities of the country.

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 (NEPSE). By the year 2012, Thirty two commercial banks are established with their more than 1200 operating branches across the country. Similarly, Eight Seven Development Banks, Seventy Nine Finance Companies, eighteen Micro Credit Development Banks are functioning in the country.

Central bank being the supervisor of the entire banking system allocated the authority to regulate & supervise the banking for the stability of the financial sector. So, for the effective and efficient functioning of the commercial banks, Nepal Rastra Bank issues directives to the commercial banks. 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. According to the Bank and Financial Institution Act 2063, Nepal Rastra Bank is guiding the commercial banks through its stated eleven directives. Those are stated as follows:

Dir-1: The provision of minimum Capital Fund to be maintained by the commercial banks.

Dir-2: The provision of Loan Classification and Loan Loss Provisioning on the credit.

Dir-3: The provision of relating to single borrower limit.

Dir-4: The provision of accounting policy and the structure of financial statements to be followed by the commercial banks.

Dir-5: The provision of reducing risk on activities of the commercial banks.

Dir-6: The provision of institutional good governance to be followed by commercial banks.

Dir-7: The provision of implementation schedule of regulatory directives issued in connection with inspection and supervision of the commercial banks.

Dir-8: The provision of investment on shares and securities.

Dir-9: The provision of submission of statistical data to the Nepal Rastra Bank, Banking Management Division and inspection and Supervision Division.

Dir-10: The provision of sale and re-registration of foundation shares of commercial banks.

Dir-11: The provision of stringent blacklisting procedure for loan defaulters.

To reflect this dynamic environment, the functions and objectives of the Bank have been recast by the new NRB Act of 2002, the preamble of which lays down the primary functions of the Bank as: to formulate necessary monetary and foreign exchange policies to maintain the stability in price and consolidate the balance of payments for sustainable development of the economy of the nation; to develop a secure, healthy and efficient system of payments; to make appropriate supervision of the banking and financial system in order to maintain its stability and foster its healthy development; and to further enhance the public confidence in Nepal's entire banking and financial system.

To address the needs for timely changes in policies and activities emanated from external and internal economic forces, NRB has embarked on a major restructuring process in both policy and operational fronts. The adoption of financial sector liberalization policies by NRB has necessitated its organizational restructuring to enhance policy credibility and increase operational transparency and accountability. Policies and activities of the NRB are very critical in creating macro-economic growth environment and fostering sound health of banking and financial industry of the country. For the very first time, the Strategic Plan of the NRB has been prepared to address these issues. The mandate of the NRB, as enshrined in the NRB Act-2002, is to maintain price, external sector, and financial sector stability. In order to be efficient and effective to accomplish these objectives, the first Five Year Strategic Plan (2006-2010) has been prepared with defined vision, mission, core values, and strategic goals. Action plans with defined responsibility, operational timeframe and key performance indicators have been devised to implement the plan. To improve the financial sector legislative framework, some new Acts, namely Bank and Financial Institution Act, 2006; Nepal Rastra Bank (First Amendment) Act, 2006; Insolvency Act, 2006; Secured Transaction Act, 2006; Company Act, 2006 have recently been enacted. Money

Laundering Control and Deposit and Credit Guarantee Acts are expected to be soon materialized, all with the goal of strengthening the financial sector through building on its healthy development and improved stability.

1.1.1 Banking in Nepal

Till the early 1980s, the financial sector was not opened up for private sector, only two commercial banks - Nepal Bank Limited and Rastriya Banijya Bank, that were government controlled, were functioning in Nepal. The economic reforms initiated by the Government more than two decades ago have changed the landscape of several sectors of the Nepalese economy. The Nepalese banking industry is no exception. As a result of this policy, large number of banks and financial institutions boomed across the country.

The first conventional bank in Nepal was the Nepal Bank Limited, established in 1937 A.D. followed by Rastriya Banijya Bank in 1966 A.D. These two banks are the pioneers of the Nepalese banking industry. These banks have the largest network and they have their operations even in remote areas of the country. Rastriya Banijya Bank is fully owned by the Government while the Government has controlling stake in Nepal Bank Limited. As the financial market was barred for private investors till the mid 1980s, these two banks were the only players in the banking industry.

The economic liberalization policy adopted in the mid 1980s brought about a surge in the banking industry. A large number of banks were established and there is a tremendous growth in the number of the financial institutions in last two decades. At the beginning of the 1980s when financial sector was not liberalized, there were only two commercial banks, and two development banks performing banking activities in Nepal. The first bank in the history, Nepal Bank Limited established in 1937 stagnated with its monopoly up to 1966 after which another commercial bank, Rastriya Banijya Bank initiated. Agriculture Development Bank and Nepal Industrial Development Bank were established accordingly in 1967 & 1968 to meet the increasing need of banking practices. At the time, there were no micro credit development banks, finance companies, co-operatives and NGOs with the limited banking transactions. As the financial sector liberalized in 1980, financial sector made a hall mark progress both in terms of the number of financial institutions and beneficiaries of the financial services. By the year 2011, NRB licensed bank and non-bank financial institutions reached to 212, out of them 31 are commercial banks (including Agriculture Development Bank Limited). The statute requires all institutions accepting deposit from the public in Nepal to be licensed by Nepal Rastra Bank.

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.

1.1.2 Nepal Rastra Bank as a Central Bank

Nepal Rastra Bank (NRB), the central bank of Nepal was established in 26th April 1956 (14th Baishakh 2013 B.S.) as per the Nepal Rastra Bank act 2012 B.S. It was established to discharge the central banking responsibilities including the development of the embryonic domestic financial sector. Since then, there has been a huge growth in both the number and the activities of the domestic financial institution. NRB as the central bank of the country is established with the responsibilities of the management & supervision of the monetary and the credit system of the country, NRB has been given wide regulatory responsibilities and the authorities under the various provisions.

NRB has set up with the full ownership of the government of Nepal and an autonomous body with the main objective of stabilizing the economy and the entire financial system of the country. Unlike the other commercial banks, it neither accepts deposits nor provides loan to the public. But it accepts the credit of Government of Nepal & its offices, commercial banks and other financial institutions and provides loan to the Government of Nepal and financial institution as they need and demand. NRB is committed to strengthen and ensure the stability and soundness of the banking system. 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. At present NRB is regulating financial sector through its following legal bodies.

- Nepal Rastra Bank Act, 2012
- Foreign Exchange Act, 2019
- Bank & Financial Institution Debt Recovery Act, 2058
- Banking and Financial Institution Act, 2063
- Directives, Guidelines & Circulars-Unified Directives 2067

1.1.3 Brief Profile of the Sample Banks

Nepal Bank Limited (NBL)

Nepal Bank Limited, the first Bank of Nepal, was established in 30th Kartik 1994 B.S. NBL is the pioneer financial institution of Nepal. From the very conception and its creation, NBL is a joint venture between the government and the public sector. Out of 2500 equity shares of Rs. 100 face value, 40% was subscribed by the government and the balance i.e. 60% was offered for the sale to public sector. At Present, there is 41% share owned by the government and the rest by the public sector. NBL was established under company law, Nepal Bank Law 1994 in Judda

Sadak paying of rent Rs. 100 per month. The bank stands its operation with the authorized capital of Rs. 10 million with only 10 shareholders when the bank first started. In that era, very few understood or had confidence in this new concept of formal banking in Nepal. Rising equity shares were not easy and mobilization of deposits even more difficult. At present, it has authorized capital of Rs.1000 million and paid up capital of Rs 380.4 million. One of the admirable efforts of the bank was that it helped initially in removing the dual currency system and circulating the Nepalese currency throughout the country.

Nabil Bank Limited (NABIL)

NABIL Bank Limited, the first foreign joint venture bank of Nepal, started operations in 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 47 points of representation across the kingdom and over 170 reputed correspondent banks across the globe. Bank has authorized capital of Rs. 2100 million, issued capital Rs. 2029.78 million and paid up capital Rs.2029.78 million. In which, general public invested 30% share, foreign ownership 50 percentage share, other licensed institution 5.15% and others 3.85 percent.

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.

Highly qualified and experienced management team manages operations of the bank including day-to-day operations and risk management. Bank is fully equipped with modern technology which includes ATMs, credit cards, state-of-art, world-renowned software from Infosys Technologies System, Banglore, India, Internet banking system and Tele-banking system (www.nabilbank.com.np).

Standard Chartered Bank Nepal Limited (SCBNL)

Standard Chartered Bank Nepal Limited (earlier known as Nepal Grindlays Bank ltd.) came into existence in 2043(1987) as a joint venture between ANZ Grindlays and Nepal Bank Ltd. After acquiring of the Grindlays operation in the region by standard chartered in July 2001, it has become a subsidiary of Standard Chartered London, which holds 75% of shareholdings in the company with remaining 25% held by the public shareholders.

The bank has successfully completed 24 years of its operation in Nepal in 2010. The global network of Standard Chartered Group gives the Bank a unique opportunity to provide truly international banking in Nepal.

The Bank believes- “A satisfied customer is our most valuable Award”. The Bank has been the pioneer in introducing customer focused products and services in the country and aspires to continue to be a leader in introducing new products in delivering superior services. It is the first Bank in Nepal that has implemented the Anti- Money Laundering policy and applied the Know Your Customer' procedure on all customer accounts.

1.2 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.

Capital resource is the prime source of the economic development of the country. Economic development of a country succeeds only when the development of the capital formation mechanism exists. Banking, especially the commercial banking sectors can flourish the capital resources in the country. Commercial banks do collect or deposit necessary capital from the people in the different parts of the country. They powerfully help in the creation of the capital resources for the national investment.

But, Nepalese commercial banks have not formulated their investment policy in an organized manner. The implementation of the investment policy is 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.

Commercial bank's investment has been found to be have lower productive due to the lack of supervision regarding whether there is a proper utilization of their investment or not. NRB as a bank of the banks formulates plans, policies, guidelines, rules and directives to control, to supervise and to promote the banking sector. Commercial banks have to strictly follow the rules and directives issued by the NRB. But, lack of farsightedness in policy formulation and absence of strong commitments towards its implementation has caused many problems to commercial banks.

Therefore, the directives themselves are not important unless properly implemented. The rules & regulations are only the tools of NRB to supervise and monitor the financial institution and they are worthless until they could not implement by the concerned institutions.

Every study has certain sum of research questions for making study more reliable, analytical and micro research. The research without any specific question will be insignificant. This research study entitled "Impact & Implementation of NRB Directives on Non-Performing Loan (A Comparative Study of the Selected

Nepalese Commercial Banks)" highlights to attempt the following research questions:

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

1.3 Objectives of the Study

Each and every of the study posses a certain objective. The research without any specific objectives will be worthless. This research study entitled "Impact & Implementation of NRB Directives on Non-Performing Loan (A Comparative Study of the Selected Nepalese Commercial Banks)" highlights to attempt the following objectives:

- ❖ To evaluate the relationship between loan loss provision and total loan and advances.
- ❖ To analyze the status of Non-Performing Loan of the sampled banks.
- ❖ To analyze the impact of NRB guidelines with respect to NPL on financial performance of the sampled banks.
- ❖ To analyze whether NRB directives are being actually followed or not in respect to the Non-Performing Loan by the sampled banks.
- ❖ To analyze whether the implementation of NRB directives are being monitored or not.

1.4 Significance of the Study

Nepal Rastra Bank issues directives on various aspects to regulate and promote the financial institutions. NRB as a bank of the banks issues directives to ensure that banks are investing the public deposit in right way. 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 and Nabil Bank Limited. Moreover, this study tries to attempt the relationship between loan loss provision and total loan & advances.

1.5 Limitations of the Study

This study is the partial fulfillment for the Degree of Masters in Business Studies, Tribhuvan University. So, it may not be applicable and suitable for all the aspects. Meaning that, the study limits its findings & recommendations to a specific purpose that is impact and implementation NRB directives on Non-Performing Loan. The main limitations of this study are presented below.

- ❖ This study concentrates only on the NRB directives specific to Non-Performing Loan. Also, data and information of the sampled commercial banks only are used by the researcher.
- ❖ This study based upon the data and information of a Five Years from 2007/08 to 2011/12.
- ❖ The study based upon the secondary data.
- ❖ This study based on the reliability of the data provided by the concerned banks.
- ❖ Statistical tools are used in this study wherever needed. Hence, drawbacks and weakness of those tools are also the limitation of the study.

1.6 Organization of the Study

This study will be classified into five different chapters viz. Introduction, Review of the Literature, Research Methodology, Data Presentation and Analysis, and Summary, Conclusion & Recommendations.

Chapter - I Introduction:

The first chapter introduction includes the overall background of the study subtitling General Background, Banking in Nepal, Brief Profile of the Selected Banks for the Study, Statement of the Problem, Objectives of the Study, Limitations of the Study and Organization of the study.

Chapter - II Review of Literature

The second chapter Review of Literature enables the reviews of the previous studies with respect to the study. This is also devoted to the theoretical analysis and the brief reviews of the related journals, literature, and articles.

Chapter - III Research Methodology

Research Design, Population and Sample, Nature & Sources of the Data, Data Collection & Analysis Procedures and Analytical tools used for the study have been included in the third chapter.

Chapter - IV Data Presentation and Analysis

The Data Presentation and Analysis chapter includes presentation and analysis of the relevant secondary data and information through a definite course of the methodology. For the analysis of the collected data, appropriate mathematical, financial as well as statistical tools are used as per their necessity and findings of the study are included.

Chapter - V Summary, Conclusion & Recommendations

The last chapter Summary, Findings, Conclusion & Recommendations will contain the findings, summary & conclusion and necessary recommendations of the overall research study.

CHAPTER-II

REVIEW OF LITERATURE

Review of literature is the fundamental part of research work which describes what research studies have been conducted in the past and what remains to be done. Literature review is basically a "stock taking" of available literature in the selected research topic. The literature review thus provides a useful knowledge of the status of the research topic. In this section, the researcher has tried to focus on the Role of NRB in Financial System, Introduction to the Non-Performing Loan, Loan Loss Provision, and reviews of various related articles, journals and unpublished thesis.

2.1 Conceptual Review

Nepal Rastra Bank being the regulator and the supervisor on the whole of the financial system of Nepal, it has got clear and mandatory responsibilities as prescribed in the Nepal Rastra Bank Act, 2058. These responsibilities have been assigned to it in order to prevent the interest of the depositors and stakeholders of the financial system. The clear objectives and responsibilities of the bank as specified in the NRB Act 2058 in relation to financial system are as follows:

- To promote stability and liquidity required in the banking and financial sector.
- To develop a secure, healthy and efficient system of payments.
- To regulate, inspect, supervise and monitor the banking and financial system.
- To promote the entire banking and financial sector of Nepal and to enhance public credibility towards the system.

2.1.1 Vision, Mission, Core Values, Strategic Objectives and Strategic Guidelines (NRB Strategic Plan, 2006:2).

Vision: A modern, dynamic, credible, and effective Central Bank.

Mission: Maintaining macro-economic stability through sound and effective monetary, foreign exchange, and financial sector policies.

Core Values (CREATE)

C = Credibility

R = Responsibility

E = Efficiency

A = Accountability

T = Transparency

E = Effectiveness

Strategic Objectives

- Formulate necessary monetary and foreign exchange policies in order to maintain price and balance of payments stability for sustainable development of the economy and managing it;
- Promote financial stability and ensure adequate liquidity in the banking and financial system;
- Develop a secure, healthy, and efficient currency management and payments system;
- Regulate, inspect, supervise, and monitor the banking and financial system; and
- Promote and develop the overall banking and financial system, and enhance accessibility and its public credibility.

Strategic Guidelines

- Develop a long-term vision of the bank and implement it through medium-term and annual strategic plans.
- Formulate and implement sound and effective monetary, foreign exchange, and financial sector policies.
- Formulate and implement sound, efficient, and effective regulatory and supervisory system to make financial system healthy and stable.
- Reengineer the organizational structure of the Bank.
- Formulate and implement strategic human resource planning and development.
- Develop and implement management information system.
- Automate and modernize payments and settlement system of the country.

2.2 Non-Performing Loan: An Introduction

Commercial banks should categorize their loans and advances according to their perceived risk and other relevant characteristics; this process is known as loan classification. Banks used to review their loans portfolios and assign loans to categorize them on the base of perceived risk and other factors. This would help in monitor the quality of their loans portfolios and when necessary, to take the remedial actions to counter the deterioration in the credit quality of the loan portfolios. According to the prudential rule provided in Bank & Financial Institution Debt Recovery act 2058 by NRB effective from 1st Shrawan 2058, banks should have to classify their loans and advances into following four categories on the basis of ageing of the principle.

Pass Loan

Loans and advances not past due and past due up to 3 months shall be included in this category. These are classified and defined as performing loan.

Sub-Standard Loan

Loans and advances past due for a period of over 3 months to 6 months fall in this category.

Doubtful Loan

Loans and advances past due for a period of over 6 months to 1 year are Doubtful loan.

Loss

Loans and advances past due for a period of over 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be considered as loss.

Such loans & advances falling in the category of Sub-Standard Loan, Doubtful Loan and Loss Loan are considered as Non-Performing Loan. A Non-Performing Loan is that is in default or in close to being default. A Non-Performing Loan has the following features.

- loan that is not earning income,
- full payment of principle and interest is no longer anticipated,
- principle or interest is 90 days or more delinquent or
- the maturity date has passed and payment in full has not been made.

The term Non-Performing Loan has different meanings. According to the International Monetary Fund (IMF), "A loan is Non-Performing when payments of interest and principle are past due by 90 days or more, or at least 90 days interest payments have been capitalized, refined or delayed by agreement or payments are less than 90 days overdue, but there are good reasons to doubt that payments will be made in full".

The term Non-Performing Loan has different meanings. In some countries, non-performing loan means the loan is impaired. In some other countries, it means that the payments of interest and principle are past due, but there is a significant difference among the countries as to how many days a payment should be in arrears. Anyway, the common meaning of non-performing loan is that the payments are more than 90 days past due especially for retail loans.

As per the directives issued by NRB, at the end of each quarter i.e. at the end of *Asoj, Poush, Chaitra and Ashadh,* banks should prepare their statement of outstanding Loan & advances classified on the basis of ageing and submit the particulars to the Banking Operation Department and Inspection & Supervision Department of NRB within one month from the end of each quarter.

Additional conditions for which the loan is considered as Loss Loan (Unified Directives 2010:9)

In case of the loan having any or all of the following condition, the loan amount is regarded as Loss loan. The conditions are:

- Inadequate collateral amount,
- Insolvency of debt holder or the borrower is declared to be bankrupt,
- The borrower is absconding or cannot be found,
- Miss use of loan or the loan has not been used for the purpose originally intended,
- Purchased or discounted bills are not realized within 90 days from the due date or
- Loans provided to the borrowers included in the blacklists and where the Credit Information Bureau blacklists the borrower.
- Owning to non-recovery, if initiation of auction of collateral passed six months or recovery process is under litigation

2.3 Loan Loss Provision

In short, loan is the money lent at interest. But in commerce & finance, the term loan is used as the transfer of money or other properties on promise to repay along with the interest, usually at a fixed future date. Loan and advances are the primary source of income and the most profitable of all the assets of the banks. They occupy a largest portion of revenue of the bank. Hence, banks need to be careful about the safety of such loans and advances because banks may be influenced by the bad debts. From an accounting perspective, loans should be recognized as being impaired and necessary provisions should be made, if it is likely that the bank will not be able to collect all the amounts due i.e. principle and interest.

Loan loss provision is an arrangement made in order to safeguard from the bankruptcy if loaned amount is not recovered or if the debtors default on repayment of loan. It provides buffer against future unexpected losses. Loan loss provision is thus a method that banks used to recognize a reduction in the realizable value of their loans. Banks are expected to evaluate credit losses from their loan portfolios on the basis of available information- a process that involves a great deal of judgment and is subject to opposing information. Banks are directed to make a provision as per the classification of the loans into four categories viz. pass loan, sub-standard loan, doubtful loan and loss loan as per the following system.

Table 2.1

Provision for Loan Loss

Loan Classification	Time Period	Loan Loss Provision
Pass Loan	Less than 3 months	1%
Sub-Standard Loan	3 Months to 6 months	25%
Doubtful Loan	6 months to 1 year	50%
Loss Loan	More than 1 year	100%

Provisions made for the performing loan i.e. pass loan is considered as general loan loss provision and the provision made for the non-performing loan is considered as specific loan loss provision.

Additional guidelines for the Loan Loss Provision

a. For restructured or rescheduled loan, loan loss provision should be at least 12 percent.

b. If priority sector or deprived sector loan which is insured or guaranteed priority sector credit has been rescheduled or restructured, provision should be only 25 percent of above point (a) such loans.

c. If interest and principle of restructured or rescheduled loans have been served regularly since last two years, such loans can be converted in pass loan.

d. Priority sector or deprived sector loans which are not insured should be provisioned as per general provision (i.e. stated above in the loan loss provision).

e. Where the loan is extended only against personal guarantee, a statement of the assets and equivalent to the personal guarantee amount not claimable by any other shall be obtained. Such loans shall be classified as per above and where the loans fall under the category of Pass, Sub-Standard and Doubtful, in addition to the normal loan loss provision applicable for the category, an additional provision by 20 percent shall be provided. Classification of such loans and advances shall be prepared separately. Hence the loan loss provision required against the personnel guarantee loan will be 21%, 45% and 70% for Pass, Substandard and Doubtful Loan category respectively.

2.4 Review of Journals and Articles

Basyal, M. (2057) *Financial Performance of commercial bank,* discussing the financial performance of government owned banks in the article, Placing RBB and NBL under Management Contracts Rational and Opposition agreed that the disappointing performance of these two banks has become serious concern to

all the stakeholders. Further he mentions that they are having with huge level of NPA, which could be termed as the darkest sides of their operational inefficiency and undisciplined financial behavior.

Pradhan, R. (2058) in his article, *NPA Some suggestion to tackle them expressed that unless the growth of NPA is kept in control,* in journal it has the potential to cause systematic crisis. He has mentioned that a dream of globalization led to huge investment which unfortunately could not be utilized properly due to hesitant liberalization policies. Large corporate bodies misused the credits and delayed payments and contributed indirectly for enhancing NPA ratio. He further argues that lack of vision in appraisal of proposal while loan sanctioning, reviewing or enhancing credit limits, absence of risk management policy of financing, concentration of credit in few group of parties and sector, lack of coordination among various financiers, lack of initiatives to take timely action against willful defaulters, indecision on existing out of bad loans for fear of investigating agencies like special policy, CIAA, Public Accounts Committee of the parliament have also contributed in whatsoever measures to the worsening situation of NPA front. He further pointed out that most crucial reason for the increase in the NPA is the shabby and defaulter friendly legal system. Suggesting the remedy of NPA, he adds that administrative system should be strengthened. Legal reforms should be made and Assets Reconstruction Company should be formed. Henderson (2003) CEO of RBB during his interview to New Business Age agrees that the challenging target of RBB turn around in restructuring and collection of NPA.

Regmi, G. (2063) In the article titled *'Non-Performing Assets Management'* the writer stated about the management of NPAs in the commercial banks. He writes, the NPAs includes the non-performing loan, non-banking assets, remaining non-performing loan, suspend interest and unutilized assets. The increasing NPA are the emerging problem in commercial banks, which is the main factor for failure of the banks.

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

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

As the banks experience many difficulties in recovering the loans and advances their large amount is being blocked as non-performing assets. She suggested that there is an urgent need to work out a suitable mechanism through which the overdue loan can be realized.

Dhugna, R. (2007) in his article "*Why Assets Management Co. is considered the best to solve the non-performing loan problem"* as above has tried to highlight one of the approach mainly Assets Management Company (AMC) for resolving the problem of NPL. As per him, AMC is specialize financial intermediary to manage the non-performing and distress loans of banks and financial instructions who buy the NPL from financial institution and take necessary steps to recover the maximum value from the acquired assets. As per his view, if NPLs are not resolved in time there would be inherent direct of indirect costs to the economy. As stated by him NPL may arise due to the external factors like decrease in market value of collateral deterioration borrower's repayment capacity, economic slowdown, borrower's misconduct, improper credit appraisal system, lack o frisk management practice, ineffective credit monitoring and supervision system. Hence he suggested that, NPL should be kept at minimum level and the specialized institution such as AMCs should manage the distressed loans.

He says that both traditional approach and AMC are available to deal with NPL problem. Under traditional approach, bank handles the NPLs in its own way especially through recovery unit who focus on continuing negotiation with the borrower and give top priority to the loan recovery. As opined by the writer, this approach is useful in dealing with small business loans where personal touch is adopted but for big loan this approach does not work. AMCs seem as the only realistic option when the financial sector recovery is the underlying objective in financial system where the institution fails to resolve the NPL problem through their own efforts.

He stated that the main advantage of establishing AMC is that AMC is able to move in an expeditious manner removing the distraction of managing NPLs from the banking system and frees up resources within the financial institution allowing them to concentrate on their core activities.

He concludes, "As in most of the countries, Nepalese Financial System is largely dominated by the banking sector. The banking sector is severely affected by the NPL problem, it is estimated that the NPL of the Nepalese Banking system is around 16%. Therefore there is no doubt that is has serious implication on the economic performance of the country. It will be the eclipse in the development of financial soundless in the economy, if not controlled in time. However, traditional or AMC root can be practiced to get recovery from this sickness of the financial system, the AMC root may be more effective approach to be quick recovery as it has been experience around the world."

Rawal, M. (2007) in *"Measures adopted to overcome the problem of financial sector and the NPLs"* addressed that financial sector reform measures can be broadly grouped under three heads: (1) restructuring of large two state-owned banks (ii) reengineering of the central banks and (iii) capacity building in the financial sector. In this connection, management of two state-owned banks has been handed over to the expert groups comprising the people within and outside of Nepal; the reengineering and restructuring process of the central bank (Nepal Rastra Bank) is in progress. Side by side, the capacity building in the financial sector is smoothly approaching ahead. Enactment of new NRB Act 2002 which, gives greater autonomy in its operation, enforcement of inspection and supervision directives based on international standard, withdrawal of government/ NRB involvement from the financial institutions, adoption of accommodative monetary measures are the efforts made to build up sound financial environment. Moreover, with a view to strengthening legal arrangement s, Debt Recovery Act has been approved and the Debt consolidate financial sector through an umbrella act Banks and Financial Institutions Act has recently been approved and for the purpose to resolve the problem of non-performing assets- Asset Management Company Act is in the process of being approved. In addition, establishment of Credit Rating Company, strengthening of Credit Bureau and Bankers' Training Center are some of the tasks progressing ahead. With the arrangement of such a legislative, regulatory, supervisory and institutional framework, the financial sector would, hopefully, take a pace for reviving which, in turn, would help NPLs to be reduced.

Sapkota, A. (2008) has written as article titled *"portion of NPA in commercial Banks – High in Public, Low in Private"* which was published in Rajdhani on 19th May 2004. In this article, Mr. Sapkota has stated that the problem o f NPL is seen less in private banks in comparison to public banks. The NPA of two big nationalized banks being about 60% if the total loans are very serious situation. He further mentioned that in order to improve this situation and to make healthy banking environment, financial reform program has been brought as its consequences, the management of two bog banks was handed to foreign company on a contract but the ratio of NPL was not reduced.

Even most of the privately owned banks has NPA within international standard, some privately owned bank's NPA is higher that international standard. As per international standard 5% NPA is acceptable. He also states that, Nepal's total NPA of banking sector is 30%, which is very high.

Adhikari, (2009) *"Non-performing Loan and its Management"* states in articles that one of the main function of commercial bank is to management of non-performing loan. Main function of commercial bank and financial institution is accepting deposit and provide loan. In underdeveloped country like Nepal providing Loan and interest income generating through loan is the main source of bank and financial institution. If provided loan become non-performing loan the bank and financial institution suffer from big financial scarcity. One side un-recover interest cannot make income and other side loan its self converts in NPL that make huge effect in financial condition of bank and financial institution. So management of NPL is crucial factor for any bank and financial institution. In practical, there may be default rate in aggregate banking system. Two commercial banks hold by gvt. Nepal Bank Ltd. and Rastriya Banijya Bank are accounting for the highest number and amount of non-performing assets (NPA) among the other commercial banks.

The main causes of being loan become non perfuming loan are as follows

- Lack of proper analysis

- Lack of specific loan policy
- Lack of supervision
- slump on aggregate economy
- monopoly on corporate loan and its unsuccessful
- weak in consortium loan
- less responsibility of borrower
- Inadequate in internal Control and Audit
- Inadequate in supervision of Central bank

In this way NPA generate in bank and financial institution. In every Banking s system there is some level of non-performing loan. So, it should be managed differently. Bank manages their loan and credit if nonperforming loans are at acceptable level. But, if bank's NPL are more than acceptable level then is impacts on aggregate financial position of bank and market like be worse. In this case bank should manage and treat its NPL differently. A single unit with expert should be assign for proper and appropriate management of huge amount of non-performing loan. For better management of nonperforming loan assets Management Company or corporation (AMC) is required. Proper management of nonperforming loan and recapitalization, these two important improvements are required for better banking system.

2.5 Review of the Unpublished Thesis

Ghimire, S. (2005) entitled with "*Non- performing Assets of commercial Banks: caused and effects*" has following facts and findings.

Objectives;

- To analyze the cause and effects of nonperforming assets in commercial bank.

- To evaluate the impacts of NPA on the profitability of commercial bank.
- To analyze the level of NPA selected commercial banks.

Research Methodology

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

Major findings;

- Nonperforming Assets on overall profitability of the banks tend to have inverse relationship. Profitability of the bank tends to have inverse relationship. Profitability is affected due to provision requirement.
- There is some relationship between credit extend and increment on nonperforming assets.
- It may be significant in case of aggressive credit expansion. Findings showed that Non Banking Assets is credited due to having Nonperforming Assets.

Paudyal, D. (2006) entitled with "A *study of Non- performing Assets of commercial Banks of Nepal*" has following facts and findings.

Objectives;

- To find out the proportion of nonperforming loan in the selected commercial banks.
- To evaluate the impact of NPA on the profitability of the commercial banks under the study.

- To analyze the impact of NPA on ROA and ROE of the commercial banks under the study.

Research Methodology

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

Major findings;

- In recent years NABIL Banks has shown significant decrease in Non Performing Assets, which is the result of banks effective credit management and its efforts in recovering bad debts through establishment of recovery cell.

- High degree of negative correlation exists between NPA and ROE of NABIL Bank. The bank should reduce their level of NPA to increase ROE and ROA and Profitability.

- Loan loss provision for Doubtful loan seems to be higher in case of both bank NABIL and SCBNL.

Baral, R. (2009) entitled with "*A study of Non- performing Loans of Nepalese commercial Banks"* has following facts and findings.

Main Objectives;

- To find out problems of the non performing loans and its effects in ROA and ROE of the Nepalese commercial banks.

- To examine whether the Nepalese commercial banks are following the NRB directives regarding loan loss provision for non performing loan or not.

Research Methodology

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

Major findings;

- The return on assets (ROA) and Return on equity (ROE) of the bank somehow depend upon Non Performing Loan. The bank should reduce its NPLs to increase ROA and ROE of the bank.
- Management inefficiency is one of major cause behind high level of NPA of commercial banks.
- No banks have been following NRB directives regarding loan loss provision.

Shrestha, M. (2010) entitled "*A study of Non- performing Loan and loan loss provision of commercial Banks*" A case study of NIBL, HBL and EBL".

Main objectives;

- To find out the proportion of nonperforming loan in the selected commercial banks.
- To study and analyze the guidelines and provisions pertaining to loan classification and loan loss provisioning.
- To find out the relationship between loan and loan loss provision in the selected commercial bank.
- To study and the impact of loan loss provision on the profitability of the commercial banks.

Research Methodology

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

Major findings;

- The EBL has the highest portion of the loan in total asset followed by NIBL and HBL. He concludes that the EBL shows the risk adverse attitude.
- Likewise the nonperforming loan to the total loan is found in HBL, NIBL and EBL.
- The loan loss provision is also highest in HBL where as the EBL has the least Loan Loss Provision.
- The HBL has the highest portion of loss loan followed by NIBL and EBL.

Karki, S. (2010) in his thesis paper, *"Comparative Financial Performance Appraisal of Joint Venture Banks"* with references to Everest bank limited and Nepal Arab Bank Ltd

Main Objectives

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

Research Methodology

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

Major Findings

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

Khadka, B. (2011) in his thesis paper, *"Comparative Financial Performance Appraisal of Joint Venture Banks"* has studied mainly three banks i.e. NABIL, NIBL and SCBNL.

Main Objectives

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

Research Methodologies

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

Loans and advances Ratio, Loan Loss Provision to Non Performing Loan, Arithmetic Mean Standard Deviation and Hypothesis Test.

Major Findings

- Hence, the bank has been suggested to manage its investment portfolio efficiency
- Operational efficiency of the bank is indicate by the operational loss has been found unsatisfactory.
- His main finding is that both SCBNL and NABIL have mobilized the debt funds in proper way for generating more return but NIBL could not do so as good as NABIL and SCBNL.

Thapa H. (2012) on his thesis entitled, *"A Study on Investment Policy of SCBNL in Comparison to Other Joint Venture Banks (NABIL and HBL).*"

Main Objectives

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

Research Methodologies

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

Major Findings

On the basis of this feedback information, regular changes or implementation of new rules and regulations can be easily carried out.

- NRB should also encourage frequent training to new entrants to provide orientation on the conceptual dimensions and practical aspects of operation of the banks
- Constraints of socio- economic political system on one hand and that of issues and challenges of JVBs commanding significant banking business of other spectrum
- The collection of deposit and loan investment done by the commercial banks also to sustain themselves in the environment of competitions,
- They should introduce novel technology and equipment’s to collect deposit.

2.6 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 and Standard Chartered Bank Limited.

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 Methodology refers to the combination of the elements of task of the overall research study. Research Methodology consists of, research design, population & sample, nature & sources of data.

3.1 Research Design

Research design is the overall framework of the activities to be undertaken for the course of research study. It is a strategy for the research work. It guides about the collection and analysis of data, the research instruments to be employ and the sampling plan to be followed. The research design describes about the general work plan for collection, interpretation, analysis and the evaluation of collected data. It is the core integrated system that is employed for overall research work.

3.2 Population & Sample

Population & sample are the completely very necessary terms in research work. Population, in research is the entire group of whole items in selected industry. Population may be in finite or infinite. Thirty One Nepalese commercial banks presented in the introduction chapter is the population for this study and is finite.

In every case, study of each and every unit of population could not be carried out. Hence, only selected numbers are carried to study the problem of the whole industry is known as sample. Out of thirty two banks, only three are selected for the study of problem is sample for this study. These three banks are selected in this manner that could help in achieving a comparative analysis. Meaning that, out of thirty two commercial banks, banks with the higher portion of NPL and the banks with the lower portion of NPL are selected for the comparative study. Therefore, rather than random it may be purposive sampling. Selected three commercial banks are as follows:

- Nepal Bank Limited

- Nabil Bank Limited
- Standard Chartered Bank Nepal Limited

3.3 Nature & Sources of Data

The research study is primarily based on the already published data i.e. secondary data collected. But during the study, primary data are also collected. This research study specially comprises the secondary data for the overall study and analysis. Necessary secondary data has been collected through the following various sources:

- Annual reports, brochures and newsletters of the selected banks
- Articles published in news papers, journals and souvenirs
- NRB guidelines, acts and laws
- Unpublished thesis and reports
- Bank websites and other related websites

3.4 Method of Data Analysis

The necessary data collected from the different sources are presented and analyzed systematically. 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. Data are analyzed through Ratio Analysis: Credit Deposit Ratio, Non-performing loan to total loans & advances, Provision held to non-performing loan, Loan loss provision to total loan & advances. Statistical Analysis: Correlation Analysis, Probable Error, Coefficient of Determination.

3.4.1 Financial Tools

Financial analysis is the process of identifying the financial strength and weakness of a firm by properly establishing relationship between the items of the financial statements. To evaluate the financial condition and performance of the bank, a financial analyst needs some yardsticks. The yardsticks frequently used are the ratios and index relating two pieces of financial data. Analysis and the interpretation of the various ratios should give experienced, skilled analyst and a better understanding of the financial condition and performance of the firm than they would obtain from the analysis of the financial data alone.

3.4.1.1 Credit Deposit Ratio

The core function of the bank is to mobilize its public deposit effectively so that the deposited money of customers is provided security as well increase the profitability of the bank. Credit Deposit Ratio (CDR) is the parameter that reflects the efficiency of bank in term of mobilization of available deposit effectively. Mathematically, Credit Deposit ratio is calculated by dividing total loans and advances by total deposit figure. Greater the CD ratio implies the greater utilization of total deposits and better earning and vice-versa.

Credit Deposit Ratio= $\frac{\text{Total Loan and Advances}}{\text{Total Deposits}}$

3.4.1.2 NPL to Total Loan & Advances

This ratio shows the quality of debts or assets in the form of loan & advances. The NPL to total loan & advances ratio is the mathematical proportion of NPL to the total loan & advances. Hence lower the ratio is preferred. In real, there is not any standard about this ratio but as per the international standard 5 % is allowed. In the context of Nepal, 10% is acceptable.

NPL to Total Loan &Advances = $\frac{\text{Non−Performing Loan}}{\text{Total Loan and Advances}}$

3.4.1.3 Provision Held to NPL

Provision held to NPL is the proportion of volume held for the NPL of the bank. Provision for the NPL means the cushioned amount by the bank to safeguard the possible losses in future. Meaning that higher the portion signifies that the banks are safeguards against future contingencies and in another side it may reduce the efficiency of operation as well profit of the bank. Although higher the ratio refers better the financial strength of the bank.

Provision Held to NPL = $\frac{\text{Loan Loss Provision}}{\text{Non−Performing Loan}}$

3.4.1.4 Loan Loss Provision to Total Loan & Advances

Loan loss provision indicates the cushion against the future risk created by the defaulters in the payments of loan & advances. Indirectly, this ratio describes the quality of assets in the form of Total Loan & Advances that a bank is holding. Since, as per the directives issued by NRB high provision should made for the NPL, the higher volume of provisioned amount implies increasing Non-Performing Loan. Similarly, lower the provisioned amount implies lower amount of NPL and accordingly good quality of loan & advances. So, lower ratio is preferred.

Loan Loss Provision to Total Loan & Advances= $\frac{\text{Loan Loss Provision}}{\text{Total Loan and Advances}}$

3.4.2 Statistical Tools

Statistical analysis is one of the particular languages, which describes the data and makes possible to talk about the relations and the differences of the variables. Statistical tools are the mathematical techniques used to analyze, communicate and interpret the numerical parts of the data.

3.4.2.1 Arithmetic Mean (X)

Average is statistical constants, which enable us to comprehend in a single effort of the whole. It represents the entire data by a single value. It provides the gist and gives the bird's eye view of the huge mass of unwieldy numerical data. It is calculated as:

$\bar{x} = \sum[X] / N$

Where,

$\bar{x}$ = Arithmetic Mean

N= Numbers of observation

X= Sum of observation

3.4.2.2 Standard Deviation (S.D.)

The standard deviation is the square root of mean squared deviations form the arithmetic mean and is denoted by S.D. or σ. It is used as absolute measure of dispersion or variability. It is calculated as:

$\sigma = \sqrt{[\sum(x - \bar{x})^2/N]}$

Where,

σ= Standard Deviation

3.4.2.3 Coefficient of Variation (C.V.)

The coefficient of variation (C.V.) is the relative measure based on the standard deviation and is defined as the ratio of the standard deviation to the mean expressed in percentage. It is independent of units. Hence, it is a suitable measure for comparing variability of two series with same of different units. A series with smaller C.V. is said to be less variable or more consistent or more homogeneous or more uniform or more stable than the other vice versa. It is calculated as:

$C.V = \sigma / \bar{x}$

Where,

σ= Standard Deviation

$\bar{x}$= Mean

3.4.2.4 Correlation Coefficient(r)

Correlation coefficient refers to the degree of relationship existing between the two or more variables. The value of correlation coefficient determines the associations between the dependent and independent variables. It is the geometric mean of the two regression coefficients. When the change in the value of one variable is accompanied by the change in another variable, then the variables are said to be correlated. Meaning that, increase and decrease in one variable cause increase or decrease in another variable, then such variables are said to be correlated. The value of correlation coefficient is denoted by *'r'*. The value of 'r' describes only the degree of relationship but it does not explain about the cause and effects of the relationship.

There are various techniques of calculating the value of correlation coefficient. Among the different techniques, Karl Pearson's coefficient of correlation is widely used. Following types of correlation coefficient are calculated for this study applying the Karl Pearson's techniques.

- Correlation coefficient between the Total Loan & Advances and Non-Performing Loan.
- Correlation coefficient between the NPL and Total Loan & Advances.
- Correlation coefficient between Loan Loss Provision and Total NPL.

$$\text{Correlation Coefficient} = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}}$$

The statistical tool-correlation analysis is used in the study to measure the relationship between variables in determining within the relationship is significant or not. For the purpose decision making interpretation are based on the following terms.

1. When, r= 1, then is perfect positive correlation.
2. When, r= -1, then is perfect negative correlation.
3. When, r= 0, then is no correlation.
4. When, 'r' lies between 0.7 to 0.999(-0.7to -0.999), then is high degree of positive (or negative) correlation.

5. When, 'r' lies between 0.5 to 0.6999, there is moderate degree of correlation

6. When, 'r' is lies less than 0.5, there is low degree of correlation.

3.4.2.5 Probable Error (P.E.)

Probable error is the mathematical expression that helps to judge the reliability and significance of the value of coefficient of correlation. It is denoted by P. Er. If the value of correlation is greater than six times of the value of the Probable Error, then the obtained correlation coefficient is significant. If it is not, then it is said to be insignificant and there is chance of correlation.

Probable Error = $0.6745 \times \frac{1-r^2}{\sqrt{n}}$

Where,

r= Correlation Coefficient

N= Number of pairs of observations

If the value of 'r' is less than the probable error, there is no evidence of correlation, i.e., the value of 'r' is not at all significant. Then, if the value of 'r' is more than six times of the probable error, the coefficient of correlation is practically certain, i.e. the value of 'r' is significant.

Here, the researcher has been calculating the correlation coefficient between total deposits and total loan & advances as well as total loan & advances and loan loss provision.

3.4.3 Diagrammatic and Graphical Presentation

Collected data are presented through different charts and diagrams. These are the visual aids that give a bird eye view of a given sets of numerical data. Diagrams and charts are presented here so that the collected data could be read in a simple and readily manner. Lots of Bar Diagrams, Histograms, and Trend Liners are used for the presentation and analysis of the data.

CHAPTER-IV

DATA PRESENTATION AND ANALYSIS

This chapter deals with the analysis and interpretation of the data into the understandable format that are collected for the purpose of the study. The data were tabulated and kept in sequential order according to the purpose of the study. Data collected are analyzed on the basis of financial and statistical tools supported by the diagrams and graphs. Findings, conclusions and the necessary recommendations obtained from the analysis are presented in the next chapter.

4.1 Financial Analysis

Financial analysis is the process of identifying the financial strength and weakness of a firm by properly establishing relationship between the items of the financial statements. Analysis and the interpretation of the various ratios should give experienced, skilled analyst and a better understanding of the financial condition and performance of the firm than they would obtain from the analysis of the financial data alone.

4.1.1 Credit Deposit Ratio

Credit Deposit Ratio is calculated as total loans & advances to total deposit ratio. Banks receive fund as deposits from the public so that to mobilize it in terms of loans & advances to generate the interest as income. It is the ratio that measures the banks efficiency in mobilizing deposit collected from public. In another word, CD ratio is the fundamental parameter to ascertain fund deployment efficiency of commercial banks. Greater the CD ratio implies better the mobilization of deposits and vice-versa. Hence, higher the ratio is preferred.

4.1.2 Non-Performing Loan to Total Loan & Advances

As per the directives issued by the NRB, commercial banks should classify their loan in terms of pass loan, substandard loan, doubtful loan and loss loan. Hence, the loans falling in the category of substandard, doubtful and the loss loan are considered as non-performing loan. Increase in the NPL results higher volume of loan loss provision and of course deduction in the banks profit. That’s why, NPL could not only affect the banking operation but also it has serious implication in the economic performance of the country. This ratio NPL to total loan & advances implies the proportion of the NPL in the bank’s loan portfolio. Meaning that, higher the ratio represents higher portion of NPL and vice-versa. Hence, lower the ratio preferred the best.

4.1.3 Loan Loss Provision to Loan & Advances

This ratio is often known as loan Loss Ratio. Loan loss provision is the amount cushioned against the future contingencies created by the default of the borrowers in the payment of loans and ensures continual solvency of the banks. As per the directives issued by the NRB, commercial banks should create loan loss provision according to their category to offset the possible future losses. Hence, this ratio implies the portion of the LLP in terms of total loans & advances. Since high provision has to be made for the NPL, higher the ration reflects increasing level of NPL in the total loan portfolio and lower the ratio implies the good quality of loans & advances.

4.1.4 Provision Held to Non-Performing Loan

The ratio provision held to NPL determines proportion of loan loss provision created to offset the possible losses of NPL. The ratio measures up to what extent is the risk inherent in the NPL is covered by the total loan loss provision. Higher the ratio signifies the banks are clearly safeguarded against the future contingencies that may create due to the NPL. In other side it also indicates the more risky assets. Hence, higher the ratio better is the financial strength of the bank.

Table 4.1

Total Deposit, Loans & Advances, NPL & LLP of Nabil Bank Ltd.(in Million)

Particulars	2007/08	2008/09	2009/10	2010/11	2011/12	Mean	S.D.	C.V.
Total Deposit	**31915.04**	**37348.25**	**46410.70**	**49696.11**	**55023.69**			
Total Loans & Advances	**21365.05**	**27589.93**	**32168.87**	**38034.09**	**41605.68**			
Performing Loan	21598.37	27774.19	32543.42	38215.63	41867.70			
Non-Performing Loan	161.08	224.81	486.28	389.85	1000.05			
Substandard Loan	66.22	113.30	59.02	170.21	162.44			
Doubtful Loan	42.57	45.75	22.73	104.65	36.78			
Loss Loan	52.28	65.75	404.53	392.83	783.62			
Loan Loss Provision	**394.40**	**409.07**	**762.09**	**871.39**	**126208**			
LLP for Pass Loan	291.71	280.44	335.41	384.88	420.43			
LLP for Substandard Loan	32.30	44.07	14.75	42.55	40.61			
LLP for Doubtful Loan	21.26	23.52	11.36	52.32	18.39			
LLP for Loss Loan	46.09	59.83	400.40	388.91	778.34			
Provision Maintained (%)								
Pass Loan	175.50	291.71	280.44	335.41	384.88			
Substandard Loan	56.63	32.30	44.07	14.75	42.55			
Doubtful Loan	7.11	21.26	23.52	11.36	52.32			
Loss Loan	38.14	46.09	59.83	400.40	388.91			
Ratios								
Total L & A to Total Deposit	66.94	73.87	69.31	76.53	75.61	72.46	4.15	5.73
NPL to Total L & A	0.75	0.81	1.51	1.03	2.40	1.30	0.68	52.55
LLP to Total L & A	1.85	1.48	2.37	2.29	303.34	62	134.77	216.44
LLP to NPL	244.85	181.96	156.72	223.52	12620.79	2685.44	5553.79	206.81

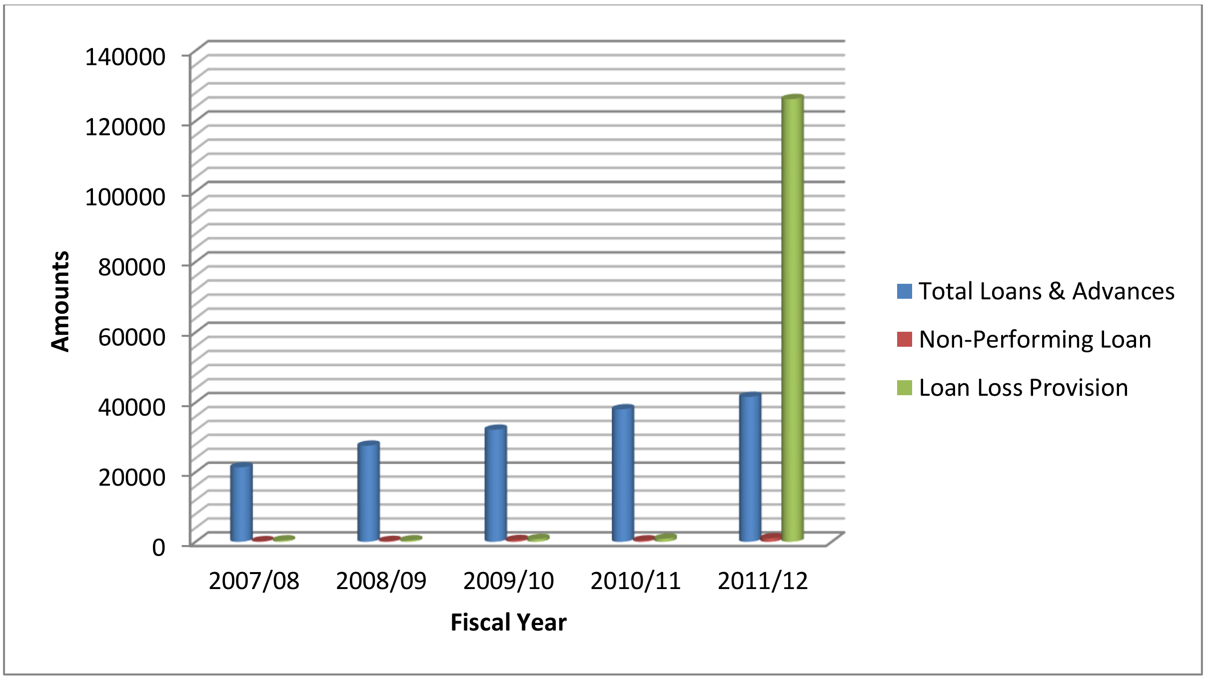
Source: Annex IV

The Table no 4.1 represents the status of Total Deposits, Total Loans & Advances, Performing Loan, Non-Performing Loan, Loan Loss Provision, their Ratios followed by their mean value, S.D. and C.V. respectively of the sample banks *viz*. Nabil Bank Limited, Nepal Bank Limited and Standard Chartered Bank Nepal Limited for the year 2007/08 to 2011/12.

Nabil Bank, we see that Nabil's total loan and advances to total deposit ratio is come to 72.46% on an average. This means the bank is employing its limited fund as a loan and advances. Similarly, firm shows very negligible amount 1.30% on an average on NPL to Total Loan and Advances refers banks efficiency of making right investment on loan and advances. As well looking to the average LLP to Total Loan and Advances as 62% shows a good level of ratio too. Average LLP to NPL as 2685.44%.

Figure 4.1

Total Loan & Advance, NPL & LLP

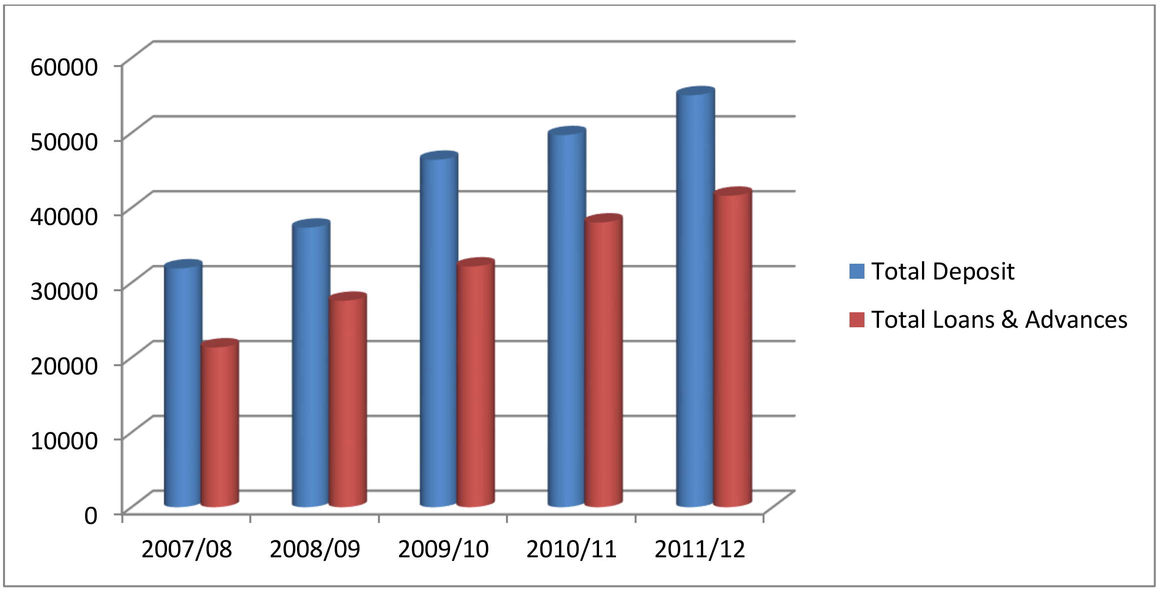


Source: Table no 4.1

The Figure 4.1 Also, looking to the other parts of data it is shown that the bank is purely implementing the NRB norms and policies regarding NPL in terms of creating loan loss provision for every loan deployed. Accordingly, we see a large sum of money separated for the non performing loans for the possible losses. But this should also be analyzed that it is cutting the profitable income of bank. However the above presented bar diagram represents banks increasing trend of loan and advances and decreasing level of non-performing loan. And these all the successful result can be the reason of NRB's well designed norms and provisions regarding loans and non performing loans.

Figure 4.2

Total Deposit and Loan & Advance



Source: Table no 4.1

Figure 4.2 Looking to the last part of table, we see NABIL's very lowest level of variation in its financial records. This can also be recorded as a good part for the progressive steps of bank. These negligible values in coefficient of variation determine the lowest level of variation in its portfolio in different years, which in turn reflects committed financial parameters of the bank.

Table 4.2

Status of Total Deposit, Loans & Advances, NPL & LLP of Nepal Bank Ltd.
(in Million)

Particulars	2007/08	2008/09	2009/10	2010/11	2011/12	Mean	S.D.	C.V.
Total Deposit	**41829.39**	**45195.23**	**42882.03**	**46808.43**	**49045.00**			
Total Loans & Advances	**13251.96**	**17614.89**	**23560.95**	**24671.28**	**28780.00**			
Performing Loan	13697.85	18593.37	23827.90	25171.02	28943.25			
Non-Performing Loan	2067.14	966.72	1211.45	1534.84	2136.75			
Substandard Loan	63.97	64.76	326.03	78.18	22.50			

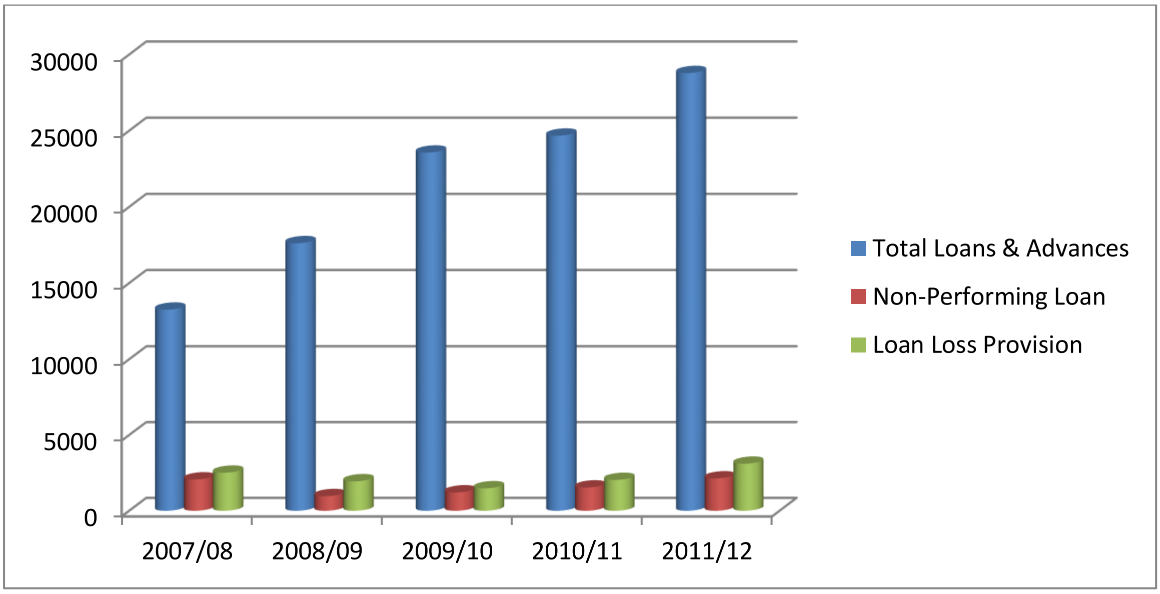
Doubtful Loan	20.57	17.88	16.20	100.62	34.25			
Loss Loan	198.25	884.06	869.70	1172.25	2080.00			
Loan Loss Provision	**2513.03**	**1945.19**	**1483.62**	**2034.59**	**3103.20**			
LLP for Pass Loan	578.36	565.42	508.74	769.51	996.20			
LLP for Substandard Loan	57.06	20.37	81.50	19.54	8.34			
LLP for Doubtful Loan	10.43	10.70	8.10	50.31	18.36			
LLP for Loss Loan	1867.16	884.06	869.70	1172.25	2080.30			
Provision Maintained (%)								
Pass Loan	370.16	578.36	565.30	508.79	5.99			
Substandard Loan	5.49	57.06	20.37	81.50	37.07			
Doubtful Loan	15.11	10.43	10.68	8.10	53.61			
Loss Loan	1808.95	1867.16	875.92	877.43	100.00			
Ratios								
Total L & A to Total Deposit	31.68	38.98	54.94	52.71	58.68	47.40	11.52	24.29
NPL to Total L & A	15.60	5.49	5.14	6.22	7.42	7.79	4.35	54.55
LLP to Total L & A	18.96	11.04	6.30	8.25	10.78	11.07	4.83	43.60
LLP to NPL	121.57	201.22	122.47	132.56	145.23	144.61	33.06	22.86

Source: Annex IV

Looking to the Table 4.2 and Figure 4.3 and Figure 4.4 of Nepal Bank Limited, banks total loans and advances and total deposit ratio status seems very week. Bank bears a very high level of deposit and alternatively its total loans and advances is in very lower position (the mean ratio in 5 years come to 47.40%). As well the higher portion of the loans and advances comes to the part of the non performing loans (it is 15.60% in 2007/08). This shows banks week efficiency in making portfolio investment policy. However, reduction in non-performing loan from 15.60% to 5.49% in forwarded years from 2008/09 is an appreciable part and also is a good sign of banks progress. Also, bank has created a very large sum of money (11.07% on an average) in loan loss provision which is absolutely hampering the profitable income of the bank.

Figure 4.3

Total Loan & Advance, NPL and LLP of NBL

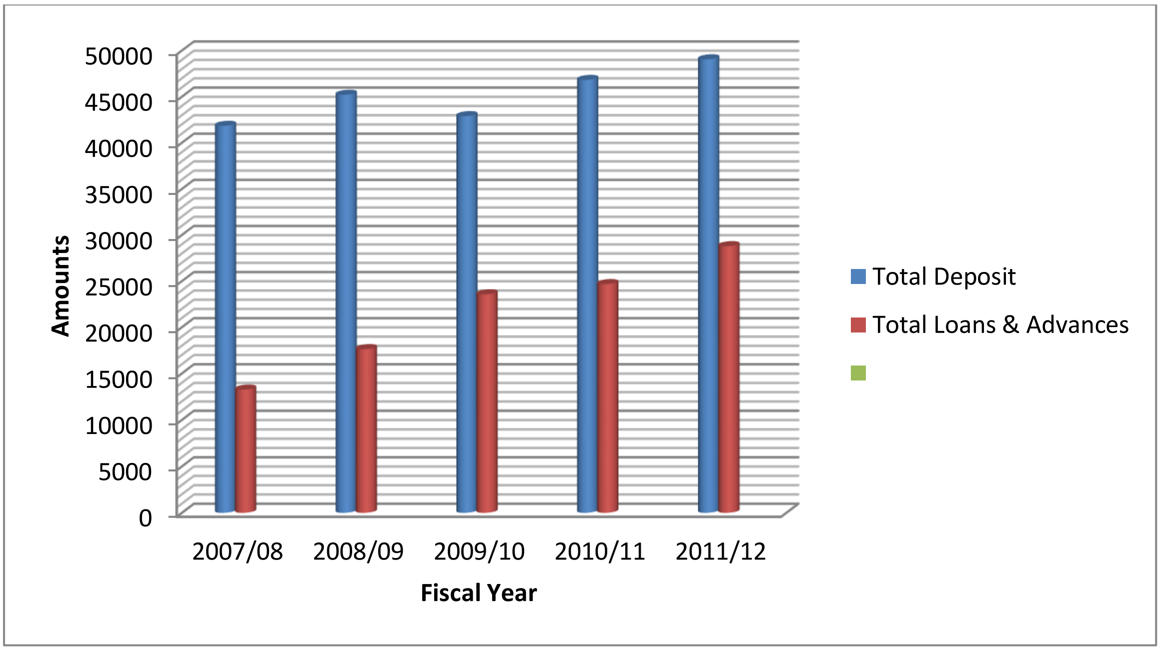


Source: Table no 4.2

On another hand, due to the NRB controlling effectual guidelines, bank is creating provision and this is the positive fact for implementing the NRB norms. NRB's guidelines to create the 1%, 25%, 50% and 100% for differently categorized loans are quietly implemented by bank. Also, bank's LLP position shows bank is fully complying the NRB norms for the loan loss provision as more than the NRB requirements. But, this could not be a good sense from the business perspective.

Figure 4.4

Total Deposit and Loan & Advance of NBL



Source: Table no 4.2

As well 24.29% coefficient of variation on Total Deposit to Total Loan and Advances shows a very higher level of variation on different years. But the increasing on the non performing loan from 31.68% to 58.68% is highly appreciable fact for the bank. This all means bank should try to promote on the loan and advances as per the rise in total deposit and able to maintain this ratio. Banks current 47.40% average deposit mobilization cannot be considered as good. And also 7.79% average NPL to Total Loan and Advances is reflects banks poor financial situation.

Table 4.3

Total Deposit, Loans & Advances, NPL & LLP of Standard Chartered Bank Nepal Ltd. (in Million)

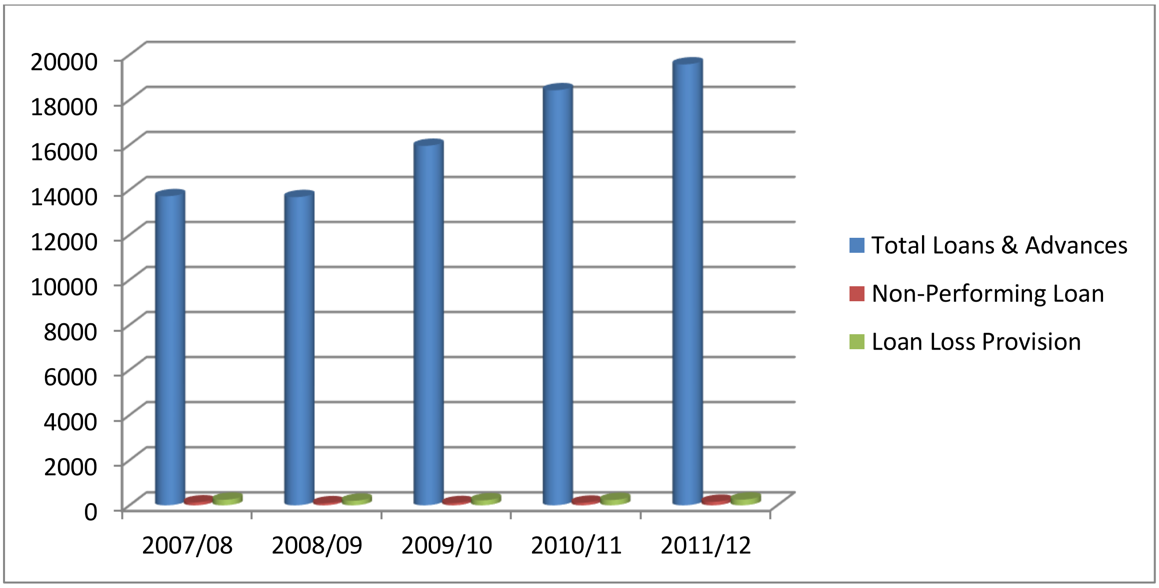
Particulars	2007/08	2008/09	2009/10	2010/11	2011/12	Mean	S.D.	C.V.
Total Deposit	**29743.99**	**35350.82**	**35282.72**	**37999.24**	**35965.63**			
Total Loans & Advances	**13718.59**	**13679.75**	**15956.95**	**18427.27**	**19575.96**			
Performing Loan	13835.26	13789.66	16078.44	18546.67	19674.02			
Non-Performing Loan	128.71	91.04	98.13	115.80	154.48			
Substandard Loan	24.90	34.42	50.94	85.72	124.44			
Doubtful Loan	48.01	11.85	2.17	3.53	10.70			
Loss Loan	55.80	44.76	45.02	26.54	19.33			
Loan Loss Provision	**245.38**	**200.94**	**219.62**	**235.20**	**252.54**			
LLP for Pass Loan	138.35	137.89	160.78	185.46	196.74			
LLP for Substandard Loan	6.22	8.60	12.73	21.43	31.11			
LLP for Doubtful Loan	45.00	9.67	1.08	1.76	5.3			
LLP for Loss Loan	55.80	44.76	45.02	26.54	19.33			
Provision Maintained (%)								
Pass Loan	105.93	138.35	137.89	160.78	185.46			
Substandard Loan	4.11	6.22	8.60	12.73	21.43			
Doubtful Loan	63.09	45.00	9.67	1.08	1.76			
Loss Loan	114.36	55.80	44.76	45.02	26.54			
Ratios								
Total L & A to Total Deposit	46.12	38.70	45.23	48.49	54.43	46.59	5.69	12.21
NPL to Total L & A	0.94	0.67	0.61	0.63	0.79	0.73	0.14	18.77
LLP to Total L & A	1.79	1.47	1.38	1.28	1.29	1.44	0.21	14.55
LLP to NPL	190.65	220.72	223.81	203.11	163.48	200.35	24.63	12.29

Source: Annex IV

As we go through the Table 4.3 and Figure 4.5 and Figure 4.6 presented financial table of SCBNL, we come to the point that SCBNL has given highest priority in complying the norms and standard given by NRB in terms of loan and advances and NPL. An exact creation of LLP, as per the guidelines prepared by NRB is resulting a higher level of efficiency in every aspect of the bank.

Figure 4.5

Total Loan & Advance, NPL and LLP of SCBNL

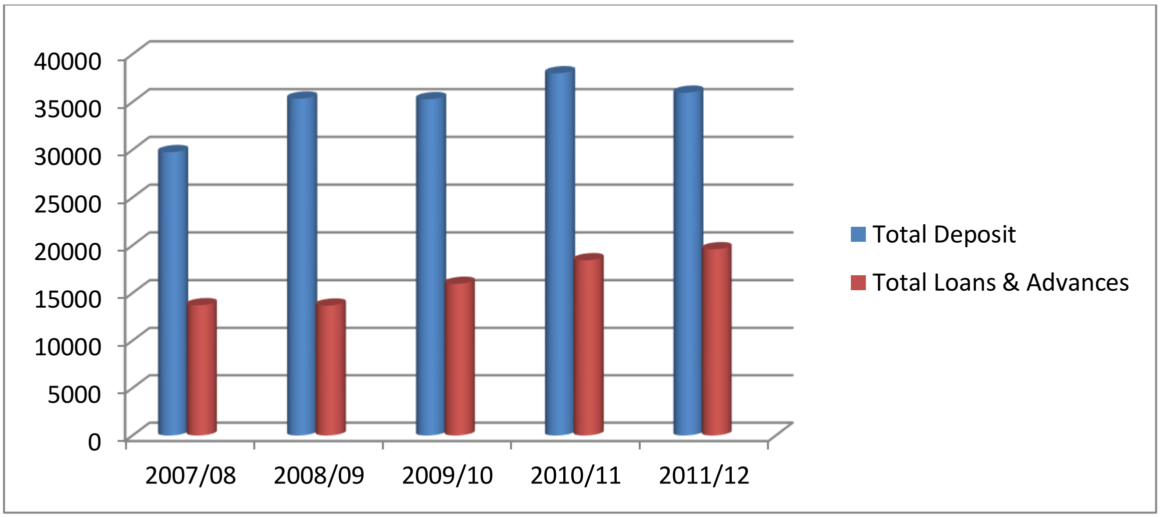


Source: Table no 4.3

Similarly SCBNL's NPL to TLA ratio below 5% shows its efficiency in maintaining a good standard loan and advances in investment portfolio and thus eradicating the chances of happening of the bad loans. But the average ratio credit to total deposit ratio to 46.59% represents its inefficiency in employing the deposit to the interest earning fields. However, the increasing trend shown on chart is preferably marking the possibility of investment as a loan and advances. Its increment to 46.42% from 54.43% on 5 years measures banks 50% increment in overall base and can be a good symptom of increase in loan and advances.

Figure 4.6

Total Deposit and Loan & Advance of SCBNL



Source: Table no 4.3

Looking to the LLP part of SCBNL, it seems that SCBNL is most conscious in creating the loan loss provisions against possible losses from both the perspectives- NRB norms and profitability of the bank. SCBNL is separating a good level of LLP for the possible losses in loan and advances. Its mean ratio of LLP to Loan and advances as 1.44% is also marking very fewer amounts in creating the provision. As well, lesser the coefficient of variation is also showing lesser the variability in financial standards.

4.2 Statistical Tools

Statistical analysis is one of the particular languages, which describes the data and makes possible to talk about the relations and the differences of the variables. Statistical tools are the mathematical techniques used to analyze, communicate and interpret the numerical parts of the data.

4.2.1 Correlation Coefficient

Correlation coefficient refers to the degree of relationship existing between the two variables. The value of correlation coefficient determines the associations between the dependent and independent variables. When the change in the value of one variable is accompanied by the change in another variable, then the variables are said to be correlated. There are various techniques of calculating the value of correlation coefficient. Among the different techniques, Karl Pearson's coefficient of correlation is widely used which lies between -1 and +1 i.e. -1<= r =>1. It is judged as perfectly positively correlated for +1 and perfectly negatively correlated for -1. Following types of correlation coefficient are calculated for this study applying the Karl Pearson's techniques.

- Correlation coefficient between the Total Loan & Advances and Non-Performing Loan.
- Correlation coefficient between the Loan Loss Provision and Total Loan & Advances
- Correlation coefficient between Loan Loss Provision and Non-Performing Loan.

4.2.1.1 Correlation Coefficient between the Total Loan & Advances and Non- Performing Loan

The correlation coefficient between Non-Performing Loan and the Loans & advances describes the entire relationship between NPL and Loans & Advances in terms of dependency of NPL in Loan & Advances. This correlation coefficient measures how a unit change in Loans & Advances affects the NPL. Here NPL is the dependent variable and Loans & Advances is the independent variable.

Table 4.4

Correlation Coefficient & Probable Error of NPL and Loans & Advances

Banks	Corr. Coeff	Result	P. Er	6*P. Er	Result
NABIL	0.8372	Highly +ve corr.	0.09	0.538	Significant

NBL	0.1198	Low +ve corr.	0.295	1.77	Insignificant
SCBNL	0.6038	very +ve corr.	0.190	1.15	Insignificant

Source: Appendix I

The Table no 4.4 presented table exhibits the correlation coefficients and the probable error and their meaning of relationship between the NPL and TLA. The table shows NABIL, NBL and SCBNL have positive correlation. NABIL has the highest correlation coefficients 0.8372, amongst the banks and also its value is greater than the value of 6 times of the Probable Error. Hence the correlation coefficient is said to be significant and reliable. NBL has the lowest correlation coefficients 0.1198 and that is less than of its value of the probable error. Hence the correlation coefficients is said to be insignificant and non reliable. Similarly, SCBNL also have their correlation coefficient 0.6038 and the value is less than the value of probable error and hence the correlation coefficient of these bank is insignificant and non reliable. Principally, as NBL has the lowest correlation coefficient, it bears the lowest portion of NPL and NABIL holds the highest portion of NPL as it bears highest correlation coefficient. Similarly as SCBNL and NBL have the insignificant correlation coefficient, there is no chance of the dependency of the NPL in its Total loan and advances. And alternatively NABIL have the dependency of the NPL in its Total loan and advances.

4.2.1.2 Correlation Coefficient between the Loan Loss Provision &Total Loan & Advances

This correlation coefficient describes about the degree of relationship between Loan Loss Provision and Total Loans & Advances. Hence, LLP is the dependent variable and is assumed to depend upon the independent variable Total Loans & Advances. The main objective of computing correlation coefficient between these two variables is to find out whether the LLP is significantly correlated to loan & advances. How a change in one unit of loans & advances effects the change in LLP is measured by this correlation coefficient. Hence through this comparison, we can find out changes taken place in LLP with every change in loans & advances.

Table 4.5

Correlation Coefficient & Probable Error of LLP and Total Loan and Advances

Banks	Corr Coeff	Result	P. Er	6*P. Er	Result
NABIL	0.6566	vely +ve corr.	0.171	1.02	Insignificant
NBL	0.1970	Low +ve corr.	0.028	1.72	Insignificant
SCBNL	0.5605	very +ve corr.	0.206	1.23	Insignificant

Source: Appendix II

The table no 4.5 exhibits the value of correlation coefficient and Probable Error along with their meaning of relationship of the sample banks regarding total loans and LLP. Out of the 3 sample banks, NABIL has the highest correlation coefficient 0.6566 less than the 6 times value of its probable error. Hence the correlation coefficient is said to be Insignificant and non reliable. Similarly, NBL have their correlation coefficient lower than the value of probable error is insignificant and non reliable. Also, as NABIL entails the highest correlation coefficient amongst the sample bank. Alternatively, as SCBNL has the Positive correlation coefficient, it 2nd highest level of LLP in its financial statements.

4.2.1.3 Correlation Coefficient Between Loan Loss Provision & Total NPL

As we have already discussed that the Loan Loss Provision is depends upon the Non-Performing Loan, i.e. higher the NPL will results possibility of higher level of LLP. This correlation coefficient describes the degree of relationship between LLP & NPL whether they are significantly correlated or not. Here LLP is the dependent variable and NPL is the independent variable. A unit change in NPL remains how long change in LLP is measured by this correlation coefficient.

Table 4.6

Correlation Coefficient & Probable Error of LLP and NPL

Banks	Corr coeff	Result	P. Er	6*P. Er	Result
NABIL	0.9226	Highly +ve corr.	0.04	0.126	Significant
NBL	0.8532	Highly +ve corr.	0.08	0.48	Significant
SCBNL	0.9348	Highly +ve corr.	0.03	0.23	Insignificant

Source: Appendix III

The Table no 4.6 presented table shows the value of correlation coefficient and probable error and the meaning of the relationship between the NPL & LLP of the sample banks. In other words it helps in determining the dependency of the LLP over NPL. As presented SCBNL has highly positive correlation coefficient 0.9348 and the value of correlation coefficient is also greater than the value of probable error. Hence the correlation coefficient is said to be significant and reliable. NABIL has the 2nd highest correlation coefficient that shows there is dependency of the LLP over NPL. As NBL has the lowest correlation coefficient but the value is grater than the value of probable error, its correlation coefficient is said to be significant and reliable. This means there is no dependency of LLP over its NPL. NBL's lowest correlation coefficient also refers it has lowest level of LLP over NPL amongst the sample banks. Alternatively SCBNL's highest correlation coefficient refers the greatest level of LLP over NPL amongst the sample bank comparing to others.

4.3 Theoretical Analysis of the Implementation of NRB Directives

4.3.1 Implementation Part of the NRB Directives

As stated earlier, in order to streamline the Banking sector, NRB as a central bank of Nepal issues different regulatory and advisory guidelines and directives to the financial institutions in Nepal. These directives, especially issued in favor of banking industry are playing vital role for the development of the sustainable financial market. NRB issues effective new directives and amends the olds timely as per the necessity of financial environment.

Amongst the directives issued for the regulation on the loan and advances especially Non Performing Loans has helped to make the strong financial culture in the banking industry. Here, we are trying to record some implementory facts of the sample banks regarding Non Performing Loans related directives.

As per the new directives issued by the NRB for the banks in commercial banks, Banks should categories their loans and advances portfolio in four categories viz. Pass, Substandard, Doubtful and Loss. Loans and Advances due for 0-3 months-Pass, 3-6 months-Substandard, 6-12 months- Doubtful and 12 months and above-Loss. Also, in addition the overdue basis, loans and advances to be classified on Loss loans on the basis of CIB Blacklisting, Collateral Value, and Misuse of funded loan and Bankruptcy of the Borrower. As well, banks should formulate necessary loan loss provision to avoid the possible losses in future as 1% for Pass, 25% for Substandard, 50% for Doubtful and 100% for Loss Loans. Additionally, if the loan is provided under the category of priority or deprived sector, then only one fourth of the provisioning required is to be created for LLP. Meaning that, for the Pass loan provided under the priority or deprived sector can be provisioned only by 0.25% of the outstanding loan amount. Similarly, for Substandard it is 6.25% and for Doubtful-12.5% only to be provisioned. Furthermore, if the loan is provided on personal guarantee only, then additionally 20% above normal LLP to be created as LLP on the outstanding loan amount. This means, the required provision under this will 21%, for Substandard 45% and for Doubtful 70% to be provisioned.

Table 4.7

Status of The New Directive in respect to Loans & Advances.

Particulars	Basis of Classification	Loan Category & LLP	Overdue Period

Banks should categories their Loans and Advances in four categories.	Classification to be made on the basis of ageing of past dues as:	Loans to be classified into four categories and necessary LLP to be formulated as:	The period of the overdue of each category of loan in shorter will be:
	Pass	Pass=1%	Pass=0-3 months
	Substandard	Substandard=25%	Substandard=3-6 months
	Doubtful	Doubtful=50%	Doubtful=6-12 months
	Loss	Loss=100%	Loss=1 year and above

Source: NRB Directives

Talking on the subject regarding the implementation of NRB directive, all the sample banks has been found satisfactorily implemented the directive as per the table presented above. Simultaneously, all the banks have been created necessary loan loss provisions for the possible losses against the loans. Looking on the financial part of the NBL in 2007/08, Total loans and advances is Rs. 17938.00 out of which 46% contains the portion of Non Performing Loan which figure has been decreased to 13% in 2010/11. As well, the Non Performing Loan portion of NABIL and SCBNL also has been decreased to 1.12% and 1.83% respectively. During the study period which can be regarded as the best part of the directive. This could be summarized as the inefficiency of management and not implementing the NRB directives et all. Hence this can be concluded that due to the NRB regulatory efforts, not only the Non-Performing Loans of the banks has decreased, their income level has also been increased. This is because of the effect of that higher volume of NPL requires higher portion of LLP and lesser NPL requires lesser the amount of LLP and the LLP deducted in the net profit of the bank.

Non-Performing Loan not only deducts the interest earning of the bank but also creation of loan loss provision pushes to decrease the profit of the bank. As a reason, the operating status of NBL has been badly affected. At this point, we can say that NRB regulatory forces have helped to increase the profit level of the financial institutions as well. At the present context of Nepal where the banking sector has severely affected by the increasing level of Non-Performing Loan, tightening the policies and provisions is essential to safeguard the banks from the banking crisis and to ensure the banks remain liquid even in the economic downturns.

As mentioned earlier, loan loss provision should be deducted from the net profit of the bank. That means net profit of the bank will come down due to the creation of LLP. However, the impact of the LLP on profitability of the bank is short term. After few periods, when banks have enough provision for loss loans, the profitability of bank will be tuned to pick up. Hence, in long run banks will enjoy the greater cushion against loan disbursed and improves their financial strength leading to increase their profitability. And keeping this in mind, the sample banks have clearly implemented the NRB directives regarding NPL and as a reason banking sector has been flourished even in the failure of the economic condition of the country. In summary, NRB’s rules and regulations has been safeguarded the banking from the economic and financial failure.

4.4 Findings of the Study

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 7.79% 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 11.07% 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 47.40% average deposit to the interest earnable locations which shows the banks inefficiency in making loan and advances portfolio. However, handover of the management to the foreign management team has raked over banks overall financial discrepancies into the lane. Banks a huge sum of non-performing loan has been recovered, managerial strategies have been formulated, deposit mobilization structure has been revised, all the functions have been systematized and NRB standards have been maintained as per the NRB policies and norms. As a reason, bank has been equipped towards profit in a short span of time.

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 1.30% which is less than the international as well NRB standard. Similarly, its average deposit mobilization rate 72.46% with the CV of 5.73 shows banks efficiency in mobilizing the deposit to interest earnings.

Similarly average loan loss provision ratio 62% 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.

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 2011/12 stands at Rs. 36965.63 million where the deposit employed towards loans and advances is only 46.59%. Average deposit mobilization into loans and advances is only 46.59% which figure represents a very smaller amount has been deployed under the loan portfolio. But on the other hand, average Non Performing Loan ratio 0.73% 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 1.44% 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.

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Establishment of the Nepal Bank Limited in 1937 A.D, established a significant evolution in the financial sector of nation. Nepal Bank helped to set a milestone in the country's financial market. Nepalese financial sector comprises banking and Non-Banking sector. Banking sector comprises NRB and other commercial banks where Non-Banking sector comprises other finances and co-operatives and other governmental and nongovernmental financial institutions. At present, 32 commercial banks are playing their banking activities and rest 87 developments banks are operating beyond the nation. Similarly, 78 finance companies, 23, micro credit institutions and other financial intermediaries providing their services in the country. NRB being the central bank of the country and as an agent of government is authorized to supervise, control and promote the country's financial institutions of the country. In last two decades, when the Nepalese financial market is opened for the private sector and joint venture organization, financial sector made a hallmark progress in terms of quality services, quantity of the institutions and number of the services and products.

Banking more specifically commercial banking sector is the heart of the development of the country's economy. They play a significant role in the smooth functioning of the economy and stable, safe and glorious banking environment is crucially important for the entire development of the nation. Keeping this in mind, when government opened the domestic market for the private sector, the commercial banks opened in a prominent number to share the economic activities of the country.

NRB as monitoring, supervising and inspecting body of the entire financial institutions is authorize to put out the provision, directives and guidelines to the financial players in country. NRB as a government agent to govern the financial industry, used to issue different policies, norms and standards to facilitate, control and to promote the financial industry. NRB always has been practiced to maintain the safety, soundness and integrity of the financial system while promoting the confidence through the implementation of policies and standards that are in line with the international best practices. The main aims of NRB directives are maintain the stability, sustainability, and healthy development of the entire banking and financial system of the country.

This study research entitled Impact & Implementation of NRB Directives mainly aimed to elaborate the impacts and implementary part of NRB prudential directives in respect to NPL. To meet the aimed objectives of the study, researcher has tried taken three main commercial banks out of total 32 from the different category. NBL from government wing bank who holds the largest portion of NPL, second NABIL and SCBNL from joint venture groups having very least of NPL. For the findings of the aimed, objectives, primary as well as secondary data have been used for entire study. Statistical charts and diagrams have been presented as per the necessity. All the data used for the study have been collected from published annual reports, journals, NRB official papers and form different web based sites. Collected data have been systematically analyzed and presented along with the charts and diagrams using different mathematical, statistical and financial tools. And the findings and recommendations have been prepared on the basis of five years timed data from 2007/08 to 2011/12.

5.2 Conclusion

- As previous stated, commercial banks are the bridge between the savers and users of the money. Banks used to collect the funds form idle locations and helps 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. Meaning that loans and advances are the major source of income of the bank as it generates interest earning.
- 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 losses 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, miss 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.
- In recent years, some other financial institutions form private and joint venture sector are also not exception. 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.

- Also irresponsibility and lack of accountability of the top level of management, sanctioning of the loan violating the necessary formal procedures, improper credit appraisal system and not meeting the NRB prudential norms and standards are other reason of NPA.

- 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.

5.3 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:

- 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.

- Also bank should develop its policy to strictly adopt the policies, norms and standards given by NRB, this will help in successful and efficient operation of the bank.

- 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.

- 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.
- 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.
- 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.
- Nepal Bank Limited is also in the serious problem of bad loans. Very bigger amount of loan and advances has been availed in loss loan category..
- 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.

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APPENDICES

Appendix I

Calculation for Mean value, & Correlation between Total Loan & Advance & Total NPL of Nabil Bank

Year	Loan & Adv (X_1)	NPL (X_2)	$x_1=X_1-\bar{x}_1$	$x_2=X_2-\bar{x}_2$	$x_1 . x_2$	x_1^2	x_2^2
2007/08	21365.05	161.08	-10787.7	-291.334	3142816.2	116373910	84875.5
2008/09	27589.93	224.81	-4562.79	-227.604	1038510.2	20819089.1	51803.58
2009/10	32168.87	486.28	16.146	33.866	546.80044	260.693316	1146.906
2010/11	38034.09	389.85	5881.366	-62.564	-367961.78	34590466	3914.254
2011/12	41605.68	1000.05	9452.956	547.636	5176779	89358377.1	299905.2
$N_1 = 5$ $N_2 = 5$	**$\sum X_1$= 160763.6**	**$\sum X_2$ = 2262.07**			**$\sum x_1.x_2$ = 8990690.4**	**$\sum x_1^2$= 261142103.1**	**$\sum x_2^2$ 441645.4**

For Loan & Advance,

$$\text{Mean } (\bar{X}_1) = \frac{\sum X_1}{N_1} = \frac{160763.6}{5} = 32152.72$$

For NPL,

$$\text{Mean } (\bar{X}_2) = \frac{\sum X_2}{N_2} = \frac{2262.07}{5} = 452.42$$

Correlation between Loan & Advance & NPL,

$$(r_{12}) = \frac{\sum x_1 x_2}{\sqrt{\sum x_1^2 \sum x_2^2}}$$

$$= \frac{8990690.4}{\sqrt{261142103.1.1 \times 441645.4}} \quad = 0.8372$$

$r^2 = 0.8372^2 = 0.701$

For Probable Error,

$$\text{PE} = 0.6745 \times \frac{1 - r^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.701}{\sqrt{5}} = 0.09 \text{ or, } 9\%$$

$6 \text{ PE} = 6 \times 0.09 = 0.54$

Appendix II

Calculation for Mean value, & Correlation between Total Loan & Advance & Total LLP of NBL Bank

Year	Loan & Adv (X_1)	LLP (X_2)	$x_1 = X_1 - \bar{x}_1$	$x_2 = X_2 - \bar{x}_2$	$x_1 . x_2$	x_1^2	x_2^2
2007/08	13251.96	2513.03	-8323.86	297.104	-2473051	69286579	88270.787
2008/09	17614.89	1945.19	-3960.93	-270.736	1072365	15688935	73297.982
2009/10	23560.95	1483.62	1985.134	-732.306	-1453726	3940757	536272.08
2010/11	24671.28	2034.59	3095.464	-181.336	-561319	9581897.4	32882.745
2011/12	28780	3103.2	7204.184	887.274	6392085	51900267	787255.15
$N_1 = 5$ $N_2 = 5$	**$\sum X_1 =$ 10789.1**	**$\sum X_2 =$ 11079.63**			**$\sum x_1.x_2 =$ 2976355**	**$\sum x_1^2 =$ 150398435**	**$\sum x_2^2$ 1517978.7**

For Loan & Advance,

$$\text{Mean }(\bar{X}_1) = \frac{\sum X_1}{N_1} = \frac{10789.1}{5} = 21575.82$$

For Interest Rate,

$$\text{Mean }(\bar{X}_2) = \frac{\sum X_2}{N_2} = \frac{11079.63}{5} = 2215.92$$

Correlation between Deposit & Interest Rate,

$$(r_{12}) = \frac{\sum x_1 x_2}{\sqrt{\sum x_1^2 \sum x_2^2}}$$

$$= \frac{2976355}{\sqrt{150398435 \times 1517978.7}} = 1970$$

$r^2 = 0.1970^2 = 0.03$

For Probable Error,

$$PE = 0.6745 \times \frac{1 - r^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.03}{\sqrt{5}} = 0.28 \text{ or } 28\%$$

$6PE = 6 \times 0.28 = 1.72$

Appendix III

Calculation for Mean value, & Correlation between NPL & LLP of SCBNL

Year	Deposit (X_1)	Loan & Advance (X_2)	$x_1=X_1-\bar{x}_1$	$x_2=X_2-\bar{x}_2$	$x_1 . x_2$	x_1^2	x_2^2
2007/08	245.38	128.71	14.64	11.08	162.23	214.45	122.72
2008/09	200.94	91.04	-29.80	-26.59	792.34	887.80	707.13

2009/10	219.62	98.13	-11.12	-19.50	216.78	123.57	380.33
2010/11	235.2	115.8	4.46	-1.83	-8.18	19.93	3.36
2011/12	252.54	154.48	21.80	36.85	803.43	475.41	1357.78
$N_1 = 5$ $N_2 = 5$	$\sum X_1 =$ 1153.68	$\sum X_2 =$ 588.16			$\sum x_1.x_2 =$ 1966.60	$\sum x_1{}^2 =$ 1721.16	$\sum x_2{}^2$ 2571.32

For Total Deposit,

Mean $(\overline{X}_1) = \frac{\sum X_1}{N_1} = \frac{1153.68}{5} = 230.74$

For Loan & Advance,

Mean $(\overline{X}_2) = \frac{\sum X_2}{N_2} = \frac{588.16}{5} = 117.64$

Correlation between Deposit & Loan & Advance,

$$(r_{12}) = \frac{\sum x_1 x_2}{\sqrt{\sum x_1{}^2 \sum x_2{}^2}}$$

$$= \frac{1966.60}{\sqrt{1721.16 \times 2571.31}} = 0.9348$$

$r^2 = 0.7291^2 = 0.874$

For Probable Error,

$$PE = 0.6745 \times \frac{1 - r^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.874}{\sqrt{5}} = 0.03 \text{ 0r, } 3\%$$

$6PE = 6 \times 0.03 = 0.23$

Appendix IV

Calculation for Average value of Sample Banks

Year	NABIL		NBL		SCBNL	
	Total La to Total Deposit	NPL to Total LA	Total La to Total Deposit	NPL to Total LA	Total La to Total Deposit	NPL to Total LA
2007/08	66.94	0.75	31.68	15.60	46.12	0.94
2008/09	73.87	0.81	38.98	5.49	38.70	0.67
2009/10	69.31	1.51	54.94	5.14	45.23	0.61
2010/11	76.53	1.03	52.71	6.22	48.49	0.63
2011/12	75.61	2.40	58.68	7.42	54.43	0.79
Total	362.28	6.5	236.99	39.87	232.97	3.64

Mean of Nabil Total Loan and advance to TD Ratio $(\overline{X}) = \frac{\sum X}{N} = \frac{362.28}{5} = 72.46$

Mean of Nabil NPL to Total LA $(\overline{X}) = \frac{\sum X}{N} = \frac{6.5}{5} = 1.3$

Mean of Total Loan and advance to TD Ratio of BNL $(\overline{X}) = \frac{\sum X}{N} = \frac{236.99}{5} = 47.39$

Mean of Total Loan and advance to TD Ratio of SCBNL $(\overline{X}) = \frac{\sum X}{N} = \frac{232.97}{5} = 46.59$