CHAPTER I

INTRODUCTION

1.1 Background of the Study:

Nepal is the beautiful transit country between India and Chine, being itself as a very potential opportunity it has situated in lap of Himalayas, Nepal is located in between the latitude 26° 22°N to 30° 27’ North and longitude 80° 40’ E to 88°12’ East an elevation 90 to 8848 m. The country is bordering between the two most populous countries of the world, India in the east, west and south and China in north.

Nepal is the land locked country and home place natural beauty with traces of artifacts Nepal is one of the least developed countries in the world. More than 80% of the total people are still in the rural areas and most of them are deprived from he minimum requirement of human livelihood. In Nepal still 47% of people are under the line of poverty and average life expectancy of Nepalese people is 62.2 Years.

Geographically, the country is divided in three Regions Mountain, Hill and Tarai accommodation 7.3, 44.3 and 48.4 percent of the population respectively. Based on area of district these regions constitute 35, 43 and 23 percent of total land area. There are 5 development regions and 75 administrative districts. Districts are further divided into smaller units, called village development committee (VDC) and municipality.

Currently there are 3915 VDC's and 58 Municipalities in the country. Each VDC id composed of 9 words, Municipality words range from 9 to 35, and Kathmandu is the capital city.

There are members of peaks, rivers and lakes in the country. Major peaks are the Mount Everest (8848 m.). Mt. kanchanjangha the third highest peak of the world and the second highest in the country (8586 m.). Mt Lhotse (8516 m.), Mt. Makalu (8463 m.) , Mt. Choyou (8201 m.), Mt. Dhawlaghiri (8167 m.), Mt. manaslu (8163 m.), Mt.Annapurna (8091 m.), Mt. Gaurishankar (7134 m.), Mt. Machhapuchhre (6996 m.) and many other big or small gracious peak. (Nepal in figure 2006, CBS).

Economic growth is the most ceuricious part for the country, for its sustainable development from the grass route. Nepal is one of the least developed countries in the world. It is an agricultural and landlocked country bounded on the north by the Tibetan Autonomous Region in China and on the east, south, and west by India. Its total area is about 147181 sq. km (56,827 sq miles). According to the annul report of National Planning Commission, still 35% of Nepalese people are below the line of poverty. Majority of the people still depend upon the agriculture. At the same time, higher percentage of illiteracy can be found among the people. Geographically, Nepal is divided into mountain, hill, inner plain and plain area. Politically, it is divided into five development regions, fourteen zones and seventy five districts. The population of Nepal according to the 2001 census is about 23,200,000. The per capita income of the average Nepalese is USD 311, according to the F/Y 2005/06. Nepal is poorly developed in the entire sectors; the poor economic condition of the country is due to low level of income, low education, lack of awareness etc. economic status is growing very slowly. The unstable political environment and rapidly growing terrorism also affects directly in the development of the country. However there are many more alternatives like developing roads, transport, electricity and tourism to support the economic growth of our country, it is being very slowly.

Nepal is a landlocked country surrounded by mountains and hills. About 17% of area lies in Terai region. Physically, Nepal is divided into three regions of the basis of geographic features. The Himalayan region consists of area ranging from 4887m to 8848m above the sea level; embraces eight earth's tallest mountain peaks. These regions are least flexible. So there is sparse human habitant in this region and occupy only about 15% of the total area of the country. The Terai region consists of nearly 17 % of the total area. About 40% of this region is under cultivation. Population in this region constitutes 46.7 of the total population of the country. The hilly region covers about 68% of the total area. Only 10% area of the region is cultivated. Out of the total population 46% of population constitutes in this region (Agrawal, 2058: 85).

Economic development is the foundation development of any country. Economic development is supported by the financial infrastructure of that country. Financial institution constitutes an important part of the financial infrastructure. The main function of the bank is the collecting of idle finds and mobilizes them to productive sector causing overall economic development, which finally leads to national development of the country. Bank pools the fund through deposit and mobilize them to productive sector in the form of loans and advances. Bank is the financial institution which deals with money by accepting various types of deposits, disbursing loan and rendering several of financial services. It is the intermediary between the deficit and surplus of financial sources.

It cannot be denied that the issue of development rest upon the mobilization of resources and the bank deals in process channelising the available resources in the needed sectors. Commercial bank collects deposits from the public and the largest portion of deposited funds is utilized by disbursing loan and advances. The balance sheet of a commercial bank reflects deposit constitutes a major portion of the liabilities and the loan and advances constitutes a major portion of the assets side. Similarly, the profit of the bank depends upon the spreads that if enjoys between the interest it receive form the borrowers and that to be paid to the depositors. An average bank generates about 70% of its revenue through its lending. The return that the bank enjoys of deposit mobilization through loan and advances is very attractive but they do not come free of cost and free of risk. There is risk in lending. The bank graces umber of risk like interest rate risk, liquidity risk, credit risk, borrower risks etc. such in excessive from had led many banks to go bankrupt in number of countries.

Assets and liabilities are the two major parts of balance sheet of commercial bank. Cash reserves, deposits to other banks, investment in securities, loan and advances and other assets comprise the total assets. Liabilities comprise public deposits, borrowings, other current liabilities and share capital. As this study is focused with the Non-performing Asset (NPA), it is mainly concerned with the assets of bank. Generally, the loan advances occupy more than two third parts of assets of bank in balance-sheet and it is found that they produce more thane half of bank revenues. Therefore, in practice loan quality is mostly studied as assets quality. In banking literature, loan is often found synonymously used to assets. According to onsite inspection manual, for Commercial Banks Finance Companies, Volume – two, published by Nepal Rastra Bank, the study of asset quality is mainly concerned with loans quality. So, it should be clear that assets are used to indicate the meaning of loan.

Since this study is mainly concerned with loan, some facts are highlighted regarding loan. The deposits of public create loanable fund. Banks make their profit by issuing loans. But loans also have higher probability of default than other assets. The loans, which are actively working gives well, return to the banks. The default loans cause the loss in return to the bank. For the strength and stability of banking system, the assets/loan should yield positive returns. The assets/loans, which do not yield positive returns, become Non-performing Assets (NPA). In a narrow sense, Non-performing Assets, NPA refer to loan and advances, which do not yield any positive, return or contribute to the profit of banks. In a broader sense, NPA includes the unutilized cash balances, physical assets and the workforce. In this study major concern is with the narrow sense of NPA, which means the loan/assets that do not yield positive return in cash.

It is well known that the loans, which do not yield positive return in cash, are NPA since the loans do not yield positive returns in cash, it has direct effect to lender bank. In this situation bank can not pay the interest to the depositors and dividend to the share holders. If the interest income which has to maintain the operational expenses including depositor's interest and share holders' expectations could not be regularized, it may have great financial effect to the bank. On one hand the outstanding interest is not allowed to show as income and on the other hand loan and advances become non-performing, which creates the situation of additional expenses to profit and loss account of bank. As a result there may be significant effect in the financial position of the bank" (Adhikary, 2062:167)

Nepal is an undeveloped country having very low per capita income and corporate growth rate. The traditional concept of business and commerce is deep rooted in the people and most of them are unaware of modern form of commerce. Majority of population live below the poverty line. The agro-dominated economy is further worsened by the complex geographical situation. Various factors like land locked ness, poor resource mobilization, lack of entrepreneurship, lack of institutional commitment, erratic government policies, political instability, Maoists problem etc. are responsible for the slow pace of development in Nepal.

But after the restoration of democracy in 1990 and universal echo of economic liberalization, Nepal has implemented liberal economic policy. As a result, many more companies are established in different sectors such as industrial, tourism, transportation, trade and mostly in the financial sector whose contribution in economy has great significance.

In Nepal, the industrial revolution took after the establishment of Biratnagar Jute Mill in 1993 B.S. (1936 A.D.) and in 1994 B.S. (1937 A.D.) Nepal Bank Limited was established (vaidya, 1999:67). Nepal Rastra Bank was established in 2013 B.S. (1956 A.D.), which has helped to make banking system more systematic and dynamic during that time. In 2022 B.S.(1965 A.D.) Rastriya Banijya Bank was established which is fully government owned bank. His Majesty's Government with the view of accelerate the pace of economic development under the structural adjustment program undertook a significant step towards financial liberalization in the year 2043/44 B.S. (1986/87 A.D.) The liberalization policy of the government of Nepal has encouraged the private sector to invest in various fields, which support the domestic overall economic growth. The government of Nepal introduced financial sector reforms in 1980s, which encouraged the healthy competition in the financial sector as well as allowed the entry of foreign banks in the Nepalese market in the forms of joint ventures banks.

Definition of NPA

To define NPA first of all meaning of Assets should be understood. Assets mean the property of a person or a company. This indicates that assets are the property of a company accumulated with the help of sources.

Non Performing Assets (NPA) means the amount of loan that the individual commercial banks had provided and the customer has not paid in until the time already matured. The distributed loan is not returned timely by clients and becomes overdue then, it is known as Non Performing assets for the banks.

A Brief Introduction of Sample Commercial Banks.

Himalayan Bank Ltd. [HBL]

Himalayan Bank Limited was incorporated in 1992 by a few distinguished business personalities of Nepal in partnership with Employees Provident Fund and Habib Bank Limited, one of the largest commercial bank of Pakistan. Banking operation commenced from January 1993. It is the first commercial bank of Nepal whose maximum shares are held by the Nepalese private sector. Besides commercial banking services, the Bank also offers industrial and merchant banking services.

The Bank has five branches in Kathmandu Valley at the following locations: Thamel, New Road, Maharajgunj, Pulchowk (Patan) and Suryavinayak (moved from Nagarkot). In addition, the bank also has nine other branches outside Kathmandu Valley in Banepa, Tandi, Bharatpur, Birgunj, Hetauda, Bhairawa, Biratnagar, Pokhara and Dharan. The bank also operates a counter in the premises of the Royal Palace. The Bank will be aggressively opening new branches at different parts of the Kingdom to serve its customers better. A new Branch at Butwal will be operational soon.

HBL has always been committed to providing a quality service to its valued customers, with a personal touch. All customers are treated with utmost courtesy as valued clients. The Bank, wherever possible, offers tailor made facilities to its clients, based on the unique needs and requirements of different clients. To further extend the reliable and efficient services to its valued customers, HBL has adopted the latest banking technology. This has not only helped the Bank to constantly improve its service level but has also prepared the Bank for future adaptation to new technology. The Bank already offers unique services such as SMS Banking and Internet Banking to customers and will be introducing more services like these in the near future.

Nepal Investment Bank Ltd. [NIBL]

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

With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd.

The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank's Annual General Meeting, Nepal Rastra Bank and Company Registrar's office with the following shareholding structure.

- A group of companies holding 50% of the capital
- Rashtriya Banijya Bank holding 15% of the Capital.
- Rashtriya Beema Sansthan holding the same percentage.

The remaining 20% being held by the General Public (which means that NIBL is a Company listed on the Nepal Stock Exchange).

1.2 Focus of the Study:

Non Performing Assets [NPA] means the amount of loan that the individual commercial bank had provided and the consumer has not paid it until the time is already matured. Once the distributed loan is not returned timely by clients and becomes overdue then, it is known as Non Performing Assets for the bank. Commercial banks are loosing their profitability because of non performing assets.

In every commercial bank's profitability is affected by the Non performing assets of the banks. The main focus of this study is to examine the impact of the NPA on profitability of the commercial banks and the proper management of non performing assets of the commercial banks. In same way the study will also be focused on non performing assets regarding made in the past five years of two sample banks.

1.3 Statement of Problem:

The main features of commercial bank are mobilizing the deposit and lending them to different needy sectors. Lending or loan advances are the major source of income to commercial banks. Without loan and advances, banks neither maintain its operational expenses nor can give good interest to depositors and dividend to shareholders. Generally loan and advances of commercial banks occupy more than 40% of total assets. So it is necessary to manage the good portfolio of loan and advances in banks. In the economy of development countries, loan and advances are the major functions of commercial banks and the interest earning from them is the main source of income.

Nepalese commercial banking industry is still under the developing condition. They have to follow all the rules and regulations or the directives issued by the Rastra Bank of Nepal, the central bank of the country. The core banking business is mobilizing the deposits and utilizing it for lending to industry. Lending business is generally encouraged because it has the effect of funds being transferred from the system to productive purposes, which results into economic growth. However, lending also carries credit risk, which arises from the failure of borrowers to fulfill its contractual obligation during the course of transaction. It is well known that the bank and financial institutions in Nepal face the problem of swelling non-performing assets and the issue is becoming more and more unmanageable. The total NPA in the banking system is 14.2 percent of total loan in year 2063 B.S. (2006A.D.) while it was 18.7 percent of total loan in year 2062 B.S. (2005A.D.) While it is even worse in case of two largest commercial banks: Rastriya Banijya Bank and the Nepal Bank Limited are 45.3 and 25.1 percent respectively in the year 2063. (Annual report of NRB 2008/09: 28-29).

The following are the research question of this study:

- What is the overall impact of the NPA on the profitability of the commercial banks under the study?
- Is there any relationship between NPA and the profitability of the commercial banks and the other non-banking assets, [NBA]
- What might be the other factors that influence the non-performing assets of the commercial banks in the banking industry of Nepal?
- Are there any interest factors of the individual commercial banks in increment of the non-performing assets of them?

1.4 Objectives of the Study:

The main objectives of the study are to examine and study of the non-performing assets in total assets, total deposits and total lending of the Nepalese commercial banks. The other specific objectives of the present study are listed as follows:

- To study and evaluate the relationship between the profitability and the non-performing assets of Himalayan Bank Ltd. and Nepal Investment Bank Ltd.
- To study the proportion of NPAs to total assets, total deposits and total lending of both the banks under study.
- To analyze the non-performing assets and non-performing loan to total loan of the banks under study.
- To examine whether the Nepalese commercial banks are following the NRB directives regarding non performing assets or not.
- To recommend on the basis of major findings of the study.

1. 5 Significance of the Study:

Banking habit has been an inseparable part of modern people. Whether it is in industrial sector or personal life it has served a lot. For the safety of the depositors along with fulfillment of the need groups, banking behavior has served well. Since commercial banks are the bridge between savers and need group of money, there should be balance between the desires of these two groups. In other words depositors get nothing unless deposits are flowed as loan and advances to borrowers and paid back interest to the depositors. But it is not always true that all loan and advances yield positive income to banks. In practice, there is certain probability of becoming default rate in loan and advances. Such defaulted loan and advances are known a NPA and they create risk.

Generally, it is found that the loan and advances occupy 60 percent of the commercial banks' assets. The income of the commercial bank is covered by interest income earned to loan and advances on one hank, has to maintain the provision against such loan and advances. So, defaulted loan and advances has double effects: minimizing the income of bank and unsafe risk of deposits.

Success of any banks doesn't depend on how much money a bank can lend? But it depend quality of the loan. Therefore we can say that the success of the bank depends upon the amount of its performing assets/loans.

This study mainly concerned with the analysis of the NPA to total assets, total deposits and total lending of Nepalese commercial banks. Therefore it is significant to find out the level of NPAs. It is also significant to find out whether Nepalese commercial banks have maintained loan loss provision according to NRB directives or not. Lastly it also provides literature to the scholars and new researchers who want to do further researcher in this field

Since the study was on the background of the above stated facts, mainly it helped to identify the NPAs to total assets, total lending and total deposit of the banks

1.6 Limitation of the Study:

The following are some limitations of the study:

- Primary this study is concerned only with NPA of Nepalese Commercial Banks. It does not consider other financial aspects of the banks
- The study is concentrated only on commercial banks of Nepal. Hence, findings were not applied to other financial institutions; "the development banks i.e. the grade 'b' financial institutions and finance companies i.e. the grade 'c' financial institutions."
- Profitability of an organization is caused by very many factors but here we study only those factors, which are directly affected by the non-performing assets of the commercial banks.
- The whole study is mainly base on secondary data, provided by the concerned banks; the reliability is up to the available data.
- The study is concerned with non performing assets of commercial banks.
- The whole study is based on the data of only five years (F/Y 2004/05 to 2008/09).
- The study covers only two commercial banks of the Nepalese banking industry.

1.7 Organization of the Study:

The study has been organized into five chapters. The title of each of these chapters is as follows:

CHAPTER I Introduction

Introduction chapter comprises background of the study, focus of the study, statement of problem, objectives of the study, significance of the study, limitation of the study and organization of the study.

CHAPTER II Review of literature

Review of literature chapter comprises conceptual review of the NPA and review of the past thesis.

CHAPTER III Research methodology

Research methodology deals with the method of investigation and includes research design, nature of the data, data collection procedure and tools used.

CHAPTER IV Presentation and analysis of data and major findings

Data presentation and analysis of data deal with different statistical and the financial tools that used in the analysis of the data.

CHAPTER V Summary, conclusion and recommendations

Last chapter includes the summary, findings of the study and recommendations.

CHAPTER II

REVIEW OF THE LITERATURE

This chapter has been provided into three parts. Part one presents theoretical framework, part two includes the empirical works on credit management as well as review of Nepalese study on the topic, part three provides the conclusion and remarks.

Before entering into any research, it is necessary to be clear about its theoretical aspects. This chapter includes a discussion on the theoretical framework and major empirical works. The theoretical analysis and review of literature conducted in this chapter provides the framework, with the help of which this study has been accomplished. This chapter also includes the conceptual framework of the study to make the basic knowledge for the study, which is also, be the foundation of the study

.

2.1 Theoretical Framework

2.1.1 Meaning and origin of bank

In general a bank is referred to as an institution that deals with money, currency and bullion. It collects the deposits in the form of currency and gold from the savers and supplies to the people in demand of money with different terms and conditions as to the interest and repayment. Hence it pays interest to the depositors as consideration to the money received and charges different levies in the form of processing fees, commissions, interests etc., from the people who have taken loan from it. At the same time it in the request of its customers, discounts the bills, gives guarantee, issues letter of credit, investing in different securities, underwriting of securities etc. The word bank has been derived from Italian word, “Banco” which in Italian means a BENCH. Since the people who dealt in money used to do their work whilst sat on bench the trade that they were carrying was called as ‘Banco’, which in the due course got modified into bank.

Now a day the function of banks are changing which has induced their principle competitors to change. The principle competitors such as other financial institutions including security dealers, brokerage firms and insurance companies are trying to be similar to bank in the services they offer.

Sayers defined the bank as, “Ordinary banking business consists of changing cash for deposits and bank deposits for cash, transferring bank deposits from one person or corporation to another, giving bank deposits in exchange for bills of exchange, government bonds, the secured of unsecured promises of businessmen to repay etc.” Walter Leaf defined the bank as, “A bank is that institution or individual who is always ready to service money on deposits to be returned against the cheque of their depositors.” And Horace White puts bank in his words as, “Bank is a manufacturer of credit and machine for facilitating exchanges.” G. Crowther says, “A banker is a dealer in debt in his own and other people’s. The bankers business in then to take the debt of other people to offer his own in exchange and thereby to credit money.” Dr. H. L. Hart exclaims, “A banker is one who, in the ordinary course of his business, receives money which he repays by honoring cheques of persons from whom or on who account he receives it.”

The first renowned bank was called the “Bank of Venice”, set up in Venice, Italy in the year 1157 A.D. The Bank of Barcelona and the Bank of Genoa were established in the year 1401 A.D. and 1407 A.D. respectively. In England the banking embarked on with English Goldsmith only after 1640 A.D. The Bank of Amsterdam was the grandest bank during the 17th Century.

2.2 Concepts of Commercial Banks

Commercial banks are the heart of the financial system. They hold deposits of many persons, government establishments and business units. They make funds available through their lending and investing activities to borrowers, individuals, business firms, and government units in doing so they assist both the flow of goods and services from the producers to consumers. They dispense the large portion of medium through which monetary policy is affected. This shows the consequential role in the smooth functioning of the economy.

Commercial banks play the most important role in the modern economic organization. Their businesses mainly consist of receiving deposits, giving loans and financing the trade of a country. They provide short-term credit i.e., lend money for short period. According to the American Institute of Banking, “Commercial Banks is a corporation that accepts demand deposits subject to check and makes short-term loans to business enterprise regarding of the scope of its other services.”

In the Nepalese context, the Nepal Commercial Bank Act, 2031 B.S. (1974A.D.) defines, “A commercial bank is one which exchanges money, deposits money, accepts deposits, grant loans and performs commercial banking functions.”

In the like manner, various writers on banking have defined the bank in different ways. Since a modern bank performs number of functions. So, it has become very difficult to give a precious definition of a commercial bank.

2.2.1 Evolution of banking system in Nepal

There are several types of banks but among them commercial banks play significant contribution in the financial system of the country. They pool together the savings of the community and arrange for their productive use. They supply the financial needs of modern business by various means. They accept deposits from public on condition that they are repaid on demand or on short notice. Their business is confined to financing the short-term and medium term needs of trade and industry such as working capital financing.

Commercial Bank Act, 2031 B.S. (1974A.D.) of Nepal has defined the commercial banks as an organization, which exchanges money, accepts, grants loans and performs commercial banking functions and which is not a bank meant for co-operative, agriculture, industries or for such specific purpose. (Bank and Financial Institution Ordinance 2005)

It is the fact that financial sector plays a vital role for the economic development of a country. Even before the establishment of a banking system in Nepal, financial transactions were in practice as undertaken by some moneylenders like sahu-mahajans, jamindars, relatives, friends, and few informal organizations limited to ethnic group such as guthi. The borrowing from the other and the informal organization was limited and based on personal understanding. At that time people deposit their gold, silver and valuable goods for the sake of security. Thus, the private moneylenders can be taken as forerunner of the concept of financial institution.

However, the private money lenders supported the economic development of a country, the transactions undertaken by them was totally based on their personal understanding. No legal restriction was against them and their monopolies in transactions were the reasons for covering the interest in personal understandings and exploiting the people. Thus, it was then realized the need to establish financial intermediaries in supporting the economic development of a country.

Nepal has been ruled over by many rulers like Kirati, Lichchhavi, Malla, Ranas, and Shahs. Mostly Kirati, Lichchhavi and Malla regimes, who were concerned with the construction of temples, pati-pouwa, chautaris,etc. At that period neither the people nor the government needed to think about the economic development of the country. According to ancient "Vanshavali" in fourteenth century, the ruler of the Kathmandu Jayasthiti Malla segregated the local domiciles into 64 different classes according to profession they had undertaken. Tankadhari was one of those classes who used to deal in coins and precious metals such as gold. These Tankadhari's were said to have carried out the borrowing and lending of money (coins). Hence, Tankadharis can be regarded as the traditional bankers of Nepal.

After long time, during the Rana regime, only handfuls prime minister thought about the economic development of the country. They established some offices in 1993 B.S. (1936A.D.) 'Tejarath Adda' was established during the tenure of Prime Minister Ranoddip Singh Rana as a first institutionized credit house. Tejarath Adda provided loans under the security of gold and silver to the government employees and public. The government established its various branches and sub-branches at different places of the country for the sake of benefits of people. In the overall development of the banking system in Nepal, the Tejarath Adda may be regarded as the father of modern banking institution and for a quite long time it rendered a good service to the government employees as well as to the general public. The government also implemented the rules against the vast interest rate taken by moneylenders. Thus, the government financial institution occupies an important role in the banking history of Nepal.

No financial institutions were established over a long period due to political reasons. To fulfill the growing need of economy in Nepal, banking activities were performed only after the establishment of Nepal Bank Limited in 1994 B.S. (1937A.D.) as the first commercial bank in Nepal. This bank was established under the Nepal Bank Act 1994 B.S. (1937A.D.).

At beginning, 49% of the ownership belongs to the promoters as well as general public and remaining belongs to government. The incorporation of Nepal Bank Ltd. is the real starting of the banking institution in Nepal? The bank started the act of consolidating the scattered capital since its establishment in order to mobilize it in productive sector. It developed systematic tradition in culture of modern banking system in Nepal. Such system could be able to establish a strong base for the enlistment of national economy. Beside, it also acted as central bank for more than three decades.

Nepal Rastra Bank was established in Baisakh 14, 2013 B.S. (26 April1956 A.D.) under Nepal Rastra Bank Act, 2012 B.S. (1955 A.D.), the central bank of Nepal. It is totally owned by government. NRB is heavily assisting for the development of the whole economy. It is giving timely directives to all financial institutions operating and conducting in all over the country.

After a long period, the second commercial bank namely Rastriya Banijya Bank (RBB) has been established in 2022 B.S. (1965A.D.) with cent percent government ownership. This bank has been established under the Rastriya Banijya Bank Act 2021 B.S. (1964 A.D.) Both Nepal Bank Limited. (NBL) and Rastriya Banijya Bank (RBB) have made a remarkable contribution by providing reliable banking services to the Nepalese people. Its contribution is well noted in terms of capital formation to the small dispersed saving into meaningful capital investment in order to flourish industry, agriculture, and commercial sector in the country.

The government introduced Commercial Bank Act in Nepal in 2033 B.S. (1976A.D.) to cover the vast field of financial sector. This act has helped to emerge number of commercial bank with a view to maintain economic interest in comfort of the public in general facilitated to provide loan for agriculture, industry, trade and make a available banking services to the country and people.

Among vacuum in the banking sector got some rays of hope only when the government forwarded the economic liberalization policy in 2039 B.S. (1982 A.D.) And decided to allow foreign banks to operate their activities in Nepal in “joint venture model”. Joint Venture Banks can be defined as an association of two or more parties having common objectives and goals so as to get maximum satisfaction. Basically at that time, it was envisioned that joint venture banks (JVBs) would support the country in various ways.

In Nepalese context the main purpose of joint venture is top develop economic forces in order to achieve distinguished result, which the partners separately could not achieve. Nowadays, joint venture banks (JVBs) are playing dynamic and vital role in economic development of the country.

The Nabil Bank Ltd. Is the first joint venture bank established in 2041 B.S. (1984 A.D.) and started its operation with modern banking services. In the same way, Nepal Indosuez Bank (currently Nepal Investment Bank), the second joint venture bank established in 2042 B.S. (1985 A.D.) with an objective to encourage efficient banking services and facilities. Likewise Standard Chartered Bank is operated in 2044 B.S. (1987 A.D.).

With the satisfactory result of joint venture banks, Nepalese promoters are highly encouraged and as a result, commercial banks are introduced with cent percent domestic investment. At present, Nepal Industrial and Commercial Bank (NIC), Lumbini Bank Ltd., Machhapuchhre Bank Ltd., Bank of Kathmandu, Nepal Credit and Commerce Bank Ltd., Laxmi Bank Ltd., Siddhartha Bank Ltd., Kumari Bank Ltd. came into operation with cent percent domestic investment by Nepalese promoters which are the plus point of development of banking sector of Nepal. Now, there is a strong competition between commercial bank for the existence so that the growing needs of the customers can easily achieve.

2.2.2 Function of Commercial Banks

Banks can be defined according to the functions they perform. A bank is established with the prime objective of profit maximization. To achieve this, the bank carries out functional activities, "Principally, commercial banks accepts deposits, provide loan, primarily to business firms thereby facilitating the transfer of funds in the economy". Although, in the yester years banks were viewed as acceptor of deposits then provider of loan, but modern commercial banks have to perform overall development of trade, commerce, industry, agriculture including supports for priority and deprived sectors. The growing bank needs and habits of people and competitive environment has made the banking sector challenging and their operation cannot be underemphasized in present context of market globalization. Hence, a bank is a commercial institution licensed as a taker of deposits, concerned mainly with the making and receiving payments on behalf of their customers, accepting deposits, creating money and making short-term loans to private individuals, companies and other organization.

Although profit maximization is a major objective of commercial bank, to achieve this objective commercial bank performs various functions under the mandatory rules and regulations and directives of NRB and the Commercial Bank Act 2031 B.S. (1974 A.D.).

Primary Functions

Accepting Deposits:

Accepting a deposit is the most important function of commercial banks. Commercial banks collect money from those who want to deposit in different types of accounts such as:

- Fixed Deposit Account
- Current Deposit Account
- Saving Account

Advancing of Loans:

Commercial banks provide the loans required or credit to various sectors of economy such as industry, trade, agriculture, business-deprived sector etc. In this way bank creates credit facilities. It provides loans from various procedures in different form such as:

- Overdraft
- Cash Credit
- Direct loan with collateral

- Discounting of bills of exchange
- Loans of money at call and short notice

General Utility Functions:

Commercial banks also perform general utility functions such as:

- Issuing of letter of credit to its customers.
- Issuing of bank drafts and traveler's cheque etc., for transfer of funds from one place to another.
- Dealing in foreign exchange and financing foreign trade by accepting or collecting foreign bills of exchange.
- Serving as referred to the financial standing and credit worthiness of its customers.
- Underwriting loans to be raised by public bodies and corporations.
- Providing safety vaults of lockers for the safe custody of valuables and securities of the customers.
- Acting as a trustee and executing the will of the deceased.
- Remittance of money

Agency Function:

Apart from the above functions, commercial banks also perform agency functions for which they act as agent and claim commission on some facilities such as:

- Collection of customer's money from other banks.
- Receipt and payment of dividend, interest.

- Security brokerage service.
- Financial advisory service.
- To underwrite the government and private securities.

2.3 Some Important Terms:

2.3.1 Definition of loan and advances

Loan is defined as a thing that is lent esp. a sum of money. Likewise, debt means a sum of money owed to somebody. However, in financial terms loan or debt means principal or interest available to the borrower against the security. Debt means the money that bank owes or will lend to individual or person.

Likewise, the term loan is defined as a lending. Delivery by one party to and receipt by another party of sum of money upon agreement expressed to implied, to repay it with or without interest. Any thing furnished for temporary use to a person at his request on condition that it shall be returned, or it's equivalent in kind, with or without compensation for its use. Loan includes:

- The creation of debt by lender's payment of or agreement to pay money to the debtor or to a third party for the account of the debtor.
- The creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately.
- The creation of debt pursuant to a lender credit card or similar arrangement.
- The forbearance of debt arising from a loan.(Koirala, 2006: 35 - 36)

Further, debt means ‘Principal and interest provided to debtor by banks or financial institutions, with or without the pledge of immovable or moveable property of other securities of guarantees or without guarantee, and the word also mean over dues of the transactions beyond balance or fees, commission and interest incurred in that relation (Debt recovery act for Bank and Financial Institutions).

The supreme court of India has defined the debt during the decision of the case of United Bank of India vs. DRT. Sudhir Gupta states that “In the case in hand, there cannot be any dispute that the expression ‘debt’ has to be given the widest amplitude to mean any liability which is alleged as dues from any person by a bank during the course of any business activities undertaken by the bank either in cash or otherwise, whether secured or unsecured, whether payable under a decree or other of any court or otherwise and legally recoverable on the date of the application.

2.3.2 Concepts of Non Performing Assets:

Non Performing Assets [NPA] means the amount of loan that the individual commercial bank had provided and the consumer has not paid it until the time is already matured. Once the distributed loan is not returned timely by clients and becomes overdue then, it is known as Non Performing Assets for the bank. Reduction of NPA has always been a significant problem for every commercial bank. NPA may be defined broadly as the Bad Debt; however, it in terms of banking sector consists of those loans and advances which are not performing well and likely to be turn as bad debt. NPA as per the current directives of Nepal Rastra Bank, NRB, has been categorized as classified loans and advances. NPA has severe impacts on the financial institutions. On the one hand, the Investment becomes worthless as expected return cannot be realized and on the other, due to the provision required for the risk mitigation the profitability is directly affected. The existence of the bank can be questioned in this situation. Thus, interest along with principal has to be recovered timely and without any obstacles.

To start with performance in terms of profitability in a benchmark for any business enterprises, including the banking industry, however increasing non performing assets have a direct impact on banks profitability as legally banks are not allowed to book income on such assets (Manamohan, 2002 : 06).

Loans and Advances dominate the assets side of balance sheet of any bank. Similarly, earning from such loans and advances occupy major space in income statement of the banks. However it is very important to be reminded that most of the bank failures in the world are due to shrinkage in the value of the loan and advances. Hence loan is known as risky assets. Risk of non-repayment of loan is known as credit risk or default risk. Performing loans have multiple benefits to the society while non-performing loans erodes even existing capital.

Performing assets are those loans that repay principal and interest to the bank from the cash flow it generates. Loans are risky assets, though a bank interest most of its resources in granting loans and advances. If an individual bank has around 10% non-performing assets or loans, it sounds the death knell of that bank other remaining the same. The objectives of bound loan policy are to maintain the financial health of the banks, which result in safety of depositor's money increases in the returns to the shareholders. Since the loan is a risky asset there is inherent risk in every loans, however, the bank should not take risk above the certain degree irrespective of the returns prospects.

2.4 Classification of NPA:

As per the NRB directives NPA are said as classified loans. And this includes sub-standard, doubtful and loss categories as defined by new NRB directives. The circular further says a NPA is a credit facility in respect of which interest has remained unpaid for two quarters.

According to the circulars, the loans are classified based on weakness and dependence on collateral securities into four categories and prescribed the provisioning rate as follows:

Table No. 2.1

Classification of Loan and Advances

Classifications of loan and advances	**Criteria for Provisioning**	Provision Rate
Pass	Not past due and past due for a period up to 3 months. [Performing loans]	1%
Substandard	Past due for a period of 3 months to 6 months	25%
Doubtful	Past due for a period of 6 month to 1 years	50%
Loss	Past due for a period of more than 1 years or advances which have least possibility of recovery.	100%

Source: Nepal Rastra Bank, Directives for commercial banks.

2.5 Effects of NPA on Profitability of Banks:

Under the circumstances assets that do not earn any income to the bank affect the profits in a number of ways, which are explained as follows (Koirala, 2006:38 – 40):

Profitability Impact:

- The resources locked up in NPA are borrowed at a cost and have to earn a minimum returns to service this cost.
- NPA on the one hand do not earn any income but on the other hand drain the profits earned by performing assets through the claim on provisioning requirements.
- Since they do not earn interest they bring down the yield on advances and the net interest margin or spread.
- NPA have a direct impact on assets and returns on equity, the two main parameters for measuring profitability of the commercial banks.
- Return on assets will be affected because while the total assets include the NPA they do not contribute to profits which are the numerators in the ratio.
- Return on equity is also affected as provisioning eats more and more into profits earned.
- The cost of maintaining these include administration costs, legal costs and cost of procuring the resources locked in them.
- NPA bring down the profits, affects the shareholders value and thus, adversely affect the investor confidence.

As a whole, the impact of NPA can be assessed with the following:

- Lower ROE and ROA
- Lower image and rating of banks
- Disclosure reduces investor’s confidences.
- Increases costs/difficulties in raising capital.
- NPA do not generate income.
- They require provisioning.
- Borrowing cost of resources locked in
- Opportunity loss due to non-recycling of funds.
- 100% risk weight on net NPA for CRR.
- Capital gets blocked in NPA.
- Utilizes capital but does not generate income to sustain the capital that is locked.
- Recapitalization by government comes with string.
- Administration and recovery costs of NPA.
- Effects in employee morale and decision.

2.6 Causes and Measures of NPA:

[Country-wise Analysis]

(Source: Reddy,Prashant K ' A coparative study of NPA in india in the global context, a report page 4-8)

China

Causes

I. Moral Hazard: The SOE's believe that there the government will bail them out in case of trouble and so they contribute to take high risks and have not really strived to achieve profitability and to improve operational efficiency.

II. Bankruptcy laws favors borrowers and law courts are not reliable enforcement vehicles.

III. Political and social implications of restructuring bi SOE's force the government to keep them afloat.

IV. Banks are reluctant to lend to the private enterprises due to

   a. Non- standard accounting practices.

   b. While an NPA of an SOE is financially undesirable, an NPA of a private enterprise is both financially and politically undesirable.

Measures

I. Reducing risk by strengthening banks, raising disclosure standards and spearheading reforms of the SOE's by reducing their level of debt.

II. Laws were passed allowing the creation of asset management companies, foreign equity participation in securitization and asset-backed securitization.

III. The government, which bore the financial loss of debt 'discounting'. Debt/equity swaps were allowed in case a growth opportunity existed.

IV. Incentives like tax breaks, exemption from administration fees and clear-cut asset evaluation norms were implemented.

Thailand

Causes

I. Liberalized capital and current account and external borrowings with inaccurate assessment of exchange rate risk and risk of capital flight in a crisis.
II. A legal system that made credit recovery time consuming and difficult.
III. Real estate speculators look massive loans projecting high growth in demand and prices of properties. When this did not materialize all the loans went bad.
IV. Steep interest rate rise turned a lit of loans into NPAs
V. Inability to correctly assess credit risk.

Measures:

I. Amendments were made to the Bankruptcy Act.
II. Corporate Debt Restructuring Plan (1998) focused on capital support facilities for bank recapitalization and setting up of AMC's.
III. New rules governing NPA exit procedures based on international standards were introduced.
IV. Privatization of government entities was mooted, but faced strong political oppositions for fear of a social backlash.
V. Adoption of international standards for loan classification and provisioning.
VI. Caps on Foreign equity ownership in financial institutions were removed.

Korea

Causes

I. Directed Credit: Protracted periods of interest rate control and selective credit allocations gave rise to an inefficient distribution of funds. The Chaebols' focus on increasing market share and pursuing diversification with little attention to profitability caused tremendous stress on the economy.

II. The "compressed growth" policy via aggressive, leveraged expansion worked well as long as the economy was growing and the ROI exceeded the cost of capital. This strategy backfired when slowing demand and rising input costs placed severe stress on their profitability.

III. Lack of Monitoring-Banks relied on collaterals and guaranteed in the allocation of credit, and little attention was paid to earnings performance and cash flows.

IV. Contagion effect from South East Asia coincided with a period of structural adjustments as well as a cyclical downtum in Korea.

Measures

I. Speed of action:- the speedy containment of systemic risk and the domestic credit crunch problem with the injection of large public funds for bank recapitalization were critical steps towards normalizing the financial system.

II. Corporate Restructuring Vehicles (CRVs) and debt/equity swaps were used to facilitate the resolution of bad loans.

III. Creation of the Korea Asset Management Corporation (KAMCO) and a NPA fund to fund to finance the purchase of NPA's.

IV. Securitization KAMCO's recoveries came through asset-backed securitization and outright sales. International investors like the Lone Star Fund participated in the process.

V. Strengthening of Provision norms and loan classification standards based on forward-looking criteria (like future cash flow) were implemented.

VI. The objective of the central bank was solely defined as maintaining price stability. The Financial Supervisory Commission (FSC) was created (1998) to ensure an effective supervisory system in line with universal banking practices.

Japan

Causes:

I. Investments were made Real Estate at high prices during the boom. The recession caused prices to crash and turned a lot of these loans bad.

II. Legal mechanisms to dispose bad loans were time consuming and expensive and NPA's remained on the balance sheet.

III. Expansionary fiscal policy measures administered to stimulate the economy supported industrial sectors like construction and real estate, which may have further exacerbated the problem.

IV. Crony capitalism to the Keiretsus.

V. Weak corporate governance coupled with a non-bankruptcy doctrine was a moral hazard in Japanese economy.

VI. Inadequate accounting systems and information flow makes assessment of loan performance outside a bank in Japan difficult.

Measures:

I. Amendment of foreign exchange control law (1997) and the threat of suspension of banking business in case of failure to satisfy the capital adequacy ratio prescribed. Legislation to improve information flow has been passed.

II. Accounting standards: - Major business groups established a private standard setting vehicle for Japanese accounting standards (2001) in line with international standards.

III. Government Supports: - The government's committee public funds to deal with banking sector weakness.

2.7 Reviews of Articles:

On the way of conducting this research work, some books, journals and publications have been studied to formulate ideas about the subject matter. Although, the specific books regarding the NPA could not be found, however, some banking related books have been consulted such as Tannan's Banking Law and Practices in India, (1997). Assessing the gravity of the problem Tannan found that the banks and financial institutions at present face considerable difficulties in recovery of dues from the clients and a significant portion of the funds of the banks and financial institutions is thus, blocked in unproductive assets.

In India for addressing the question of speeding up the process of recovery was examined in great detail by committee set-up by the government under the chairmanship of the Late Shri Tiwari.

Suneja, (1992) pointed out the causes of NPA that the risk connected with lending to business depends on an enormous number of factors. For any particular type of business the risk failure is affected. The state of economy trend in demand for the project or service provided competition from any other suppliers, financial resources are too limited and management skills and lacking. Reiterating the difficulties that Suneja says probably the most difficult decision facing a banker is to determine when it becomes necessary to recall a loan and to begin the process of liquidating the security. Further she suggests that if a customer fails to make repayment on the due date, the bank has to consider what steps need be taken to recover the debt.

Basyal (2057), 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 behaviour.

Ghimire (2056) in her article, "efficiency indicators of commercial bank" she has made a comparative analysis and found that efficiency indicator of the banks may be viewed on the basis of amount allocated for loan loss provisioning against loan and investment.

Pradhan (2058) in his article, “NPA Some suggestion to tackle them” expressed that unless the growth of NPA is kept in control, 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.

2.8 Review of Related Thesis:

Thapa (2003) Conducted a study “Lending Practices and Procurers of Nepal Bangladesh Bank Limited” has outlined his major findings as follows.

Not concentrating only in big cities and large groups he has suggested NB Bank to expand branches in rural areas. Banks should invest in productive sector, develop the concept of micro financing and group financing Make should maintain the balance in its loan portfolio and current requirement of the customers. Banks should give preferences to the short term lending. Banks should provide the consortium loan for those for those projects under government guarantee and security thereby uplifting the economic condition of the country.

Dinesh Kumar Khadka, (2004) "Non-Performing Assets of Nepalese Commercial Banks", his objectives to study and examine the level of NPAs in total assets, total deposits and total lending of commercial banks of the banking industry of Nepal. He also had studied whether the Nepalese commercial banks have been following the directives of NRB regarding loan loss provision for non-performing loan/assets or not. He had taken sample banks as Nepal SBI Bank Limited, Nepal Investment Bank Limited, Nepal Bangladesh Bank Limited, Bank of Kathmandu Limited, Nabil Bank Limited. From his studies, it is found that the level of NPA of Nepal Bangladesh Bank Limited seemed greater than all of the other banks under his study. Similarly, Nepal SBI Bank and Bank of Kathmandu stand at second and third position respectively. The position of Nabil Bank Limited seemed to be quite satisfactory because, the bank has been reducing its NPA every year. NPA of Nepal Investment Bank reducing it at minimum than that of all the other banks. From the study it has also been found that none of the banks have been following the directives of NRB regarding the loan loss provision. Despite of high level of NPA the loan loss provision made by the Nepal Bangladesh Bank seemed to be quite satisfactory than any of the other banks. Despite of the outstanding success in managing the NPA the loan loss provision made by Nepal Investment Bank is not considerable. It meant the loan loss provision of Nepal Investment Bank is very less than the requirement.

Govinda Ghimire (2005) “Non Performing Assets of Commercial Banks" main objectives to evaluate the impact of NPA on the profitability of the commercial banks. He also studied about the internal and the external factors that affect the non-performing assets to increase from the loan and advances. The internal factors that influence the effective management of the NPA and its increment. The objective of his study is also to find out the relationship between the non-banking assets and the non performing assets, in which he was able to find out the internal responsible factors that contribute turning good loan into bad loans, bad intention, weak monitoring and mismanagement are the most responsible factors. Similarly, weak legal provision and credit concentration are also found as the least preferred factors in turning good loans into bad loans. Some factors such as lack of portfolio analysis, not having effective credit policy and shortfall on security were identified as having average effect on NPA growth. In connection to the external factors it has been found that recession, political and legal issues are more relevant factors in turning good loans into bad one. Like wise legal provision for recovery as a reason for increment in NPA in Nepalese Banks have been found the factors having less impact. Supervision and monitoring system have been identified as average factors. It is therefore, can be generalized that economic and industrial recession and not having strong legal provision for loan recovery are the major external factors that have major contribution for the increment of NPA.

It has also been concluded in the study that Nepalese Commercial Banks gave must priority to trade sector for lending its resources, at the same time it is found that service sectors are not being given that much emphasis. He had recommended to the sample banks, Nepal Bangladesh Bank Ltd. Nepal SBI Bank Ltd and Bank of Kathmandu Ltd. as on different headings, subject matter such as financial strength, personal integrity and security, monitoring and control system, avoidance of credit concentration, strong legal system, assets management company, avoidance of undue pressure, etc.

Subash koirala, (2006) “Non performing assets and profitability of commercial banks in Nepal” his objectives were to evaluate the impact of NPA on the profitability of the commercial banks. he also studies about the internal and external factors those influence the performing assets to non performing one. He had taken sample banks as Nabil banks Limited, Himalayan Bank Limited, Nepal Bangladesh Bank Limited, Everest Bank Limited, Nepal SBI Bank Limited and Nepal Investment Bank Limited.

The NPA of Nepal Investment Bank during the study period was increasing. The ratio of NPA to lending was found to be decreasing over the years as it was 8.29% in fiscal year 2057/58 and decreased to 2.69% in the fiscal year 2007/08. The net profit was also increasing during the study period.

In case of Everest Bank Limited, the level of NPA was decreased to 1.6% on the fiscal year 2007/08 which was 6.79% in the fiscal year 2057/58. the NPA was increasing during this period and despite of the increasing NPA profit of the bank was found to be increasing during study period.

In case of Nepal Bangladesh Bank Limited, the level of NPA was increased from 9.03% in fiscal year 2057/58 to 19.04% in fiscal year 2007/08. The NPA of the bank was found to be increased and that causing the gradual decrease in the profitability of the bank.

The NPA of the Nabil Bank Limited was decreased upto one fifth from the fiscal year 2057/58 to fiscal year 2007/08. The level of NPA was found to be decreased from 16.20% in fiscal year 2057/58 to 1.32%in fiscal year 2007/08 whereas the ROA was found to be increased from 1.71% to 3.06% over the five years period.

In case of the Nepal SBI Bank Limited, the level of NPA was found to be fluctuation in it. Although it was decreasing it was not desirable level. The level of NPA in fiscal year 2057/58 was 8.64% and in fiscal year 2007/08 it was 6.54%.

The NPA of Himalayan bank Limited was found to be fluctuating during the study period, though it was found to be decreased in fiscal year 2007/08 in comparison to fiscal year 2057/58. The level of NPA was found to be highest for the Nepal Bangladesh Bank Limited in the fiscal year 2007/08, whereas the lowest was found that of Everest Bank Limited in fiscal year 2004/05. In overall the performance of the Nabil Bank was found to be satisfactory as the level of NPA was gradually decreasing over the years covered by this study.

A Study Done by Roji Subedi (2007), entitled with “A Study of Non Performing Loan & Loan Loss Provision of Commercial Bank, A Case Study of NABIL, SCB and NBL” has made study about a part of credit risk associated with those banks. The main objectives of her study were:

The major finding in her study was that the NBL has the highest portion of the loan in total asset followed by NABIL and SCBNL. She concludes that the SCBL shows the risk-averse attitude. Likewise the non-performing loan to total loan is found highest in NBL, NABIL and SCBNL. Likewise the Loan Loss Provision is also highest in NBL where as the SCBL has the least Loan Loss Provision.

Likewise, the NBL has the highest portion of Loss loan followed by NABIL and SCBL. This study is more concentrated on non-performing loans; however, there exist lots of areas in credit risk management where further research is called for. In context of credit risk, collateral risk, concentration risk, organization risk management system can be studied.

A study conducted by Rajendra Shrestha (2008) on the topic “A study on non-performing assets of Nabil and SCBL” In the same way, proportion loan loss provision of NBL was found to be significantly higher (i.e. 40.17%) as compared to other two commercial banks. The proportion of NABIL and SCBNL was found to be 5.69% and 4.49%.

The average ratio of provision held to non-performing loan of NBL, NABIL & SCBNL was found to be 80.03%, 57.85% and 122.32% respectively shows that the SCBNL has maintained adequate level of provision against non-performing loan where as NABIL was found to be comparatively lower. The NBL was found to be an average position.

2.9 Research Gap:

From the study of previous thesis it has found that increasing Non-performing assets is one of the major challenges faced by Nepalese commercial banks in the present context. Some researchers were done in which matter relating to loan loss provision for Non-performing assets or not. Some researcher was done what is the internal and external factors affects the Non performing assets to increase from the loan advances. The previous theses covered only upto the fiscal year 2007/08 but this thesis also based on secondary data provided by concerned Nepalese commercial banks up to the fiscal year 2008/09. Hence this thesis had attempted to fill this research gap by taking the reference of Nepal Himalayan Bank Limited and Nepal Investment Bank Limited. This research will be able to deliver some of the present issue, latest information and data relating to Non-performing assets.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Introduction:

Research methodology is a systematic way to solve the research problem. In other words, research methodology describes the methods and process applied in the entire aspect of the study. Research methodology refers to the various sequential steps (along with a rational of each steps) to be adopted by a researcher in studying a problem with certain objectives in view (Kothari,1994:9).Thus the overall approach to the research is presented in this chapter. This chapter consists of research design, sample size and selection process, data collection procedure and data processing techniques and tools.

3.2 Research Design:

A research design is the specification of methods and procedures for acquiring the information needed. It is the overall operational pattern of framework for the project that stipulates what information is to be collected, from which sources and by what procedures (Poul, 1997:34). Thus a research design is a plan for the collection an analysis of data. For research there exits different types of research design like; Historical research, Descriptive research, Case study research, Field study research, Analytical research, True experimental research and so on. Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance.

The study is evaluative and analytical type of study regarding the credit management. The research design used in the study is descriptive and evaluative. The data relative to topics are collected through financial statement of the finance and other available sources. The data for five years had been collected and various financial and statistical tools had been used to resolve the objectives.

3.3 Population and Sample:

The large group about which the generalization is made is called population under study, or the universe and small portion on which the study is made is called the sample of the study.

Nowadays a number of commercial banks have been emerging rapidly. Some have already been established and others are in the process of establishment. Currently, there are 27 commercial banks are in Nepal. In this study, all the commercial banks are population of the study. Among them HBL and NIBL Banks have been selected as samples for the present study on the basis of well financial performance.

The population of the present study is listed as under, the commercial banks operating in the banking industry of Nepal.

Table 3.1

List of Commercial Banks in Nepal

S. No.	Commercial Banks	Establishment Year B.S.	Head Office
1.	Nepal Bank Limited	1994/7/30	Kathmandu
2.	Rastriya Banijya Bank	2022/10/10	Kathmandu
3.	NABIL Bank Limited	1984/07/16	Kathmandu
4.	Nepal Investment Bank Limited	2042/11/26	Kathmandu
5.	Standard Chartered Bank Limited	2043/10/16	Kathmandu
6.	Himalayan Bank Limited	2049/10/5	Kathmandu
7.	Nepal HBL Bank Limited	2050/3/23	Kathmandu
8.	Nepal Bangladesh Bank Limited	2050/2/23	Kathmandu
9.	Nepal Investment Bank Limited	2051/7/1	Kathmandu
10.	Bank of Kathmandu Limited	2051/11/28	Kathmandu
11.	Nepal Credit and Commerce Bank Limited	2053/6/28	Siddhartha nagar
12.	Lumbini Bank Limited	2055/4/1	Chitwan
13.	Nepal Industrial and Commercial Bank Limited	2055/4/5	Kathmandu
14.	Machhaputhhre Bank Limited	2057/6/17	Pokhara
15.	Kumari Bank Limited	2057/12/21	Kathmandu
16	Sunrise Bank Limited		Kathmadndu
17.	Laxmi Bank Limited	2058/12/21	Birjung
18.	Siddhartha Bank Limited	2059/9/9	Kathmandu

19	Prime Commercail Bank Limited		Kathmandu
20.	Agricultural Development Bank Limited	2024/11/7	Kathmandu
21	Global Bank Limied		Kathmandu
22	Citizen Bank Limited		Kathmandu
23	Bank of Asia Nepal		Kathmandu
24	DCBL Bank Limited		
25	NMB Bank Limited		
26	Kist Bank Limited		Kathmandu
27.	Janata Bank		Kathamandu

Source: Annual report of NRB 2008/09: 52

The following are the banks, which are taken as sample for the study.

1. Nepal Investment Bank Limited
2. Himalayan Bank Limited

3.4 Sources of Information:

The main sources of information are the concerned banks and their published documents, NRB and its published documents, experts' views, newspaper, and many others if possible. The major sources of data may be the secondary sources of data are the information received from the books, journals, newspapers, published reports and dissertation etc. The major sources of secondary data are:

- Economic survey, Ministry of Finance
- Nepal Rastra Bank Directives
- Nepal Rastra Bank Samachar
- Annual General Reports of the concerned commercial banks.

- National and international newspaper, journals, magazines etc.
- And many other books as far as possible.
- Different websites

3.5 Tools of Analysis::

Few statistical packages such as Excel are used to process and analyze information. Secondary information collected from annual general reports of the sample banks was first tabulated in Excel spreadsheet and then analyzed using formula and charts of the same software. For these statistical tools such as correlation analysis is done and in some cases, financial tools such as Returns on assets have also been made. Suitable tools such as descriptive statistics, Mean, Standard Deviation, etc. were done wherever necessary.

Statistical tools

In this research, following statistical tools are used

Average:

Average is defined as sum of observations divided by their number in the selected sample.

Average (mean) =

$$\overline{X} = \frac{X}{N}$$

Coefficient of correlation (r):

The correlation coefficient indicates the linear relationship between two or more variables. The measures of correlation called the "correlation coefficient" can be summarized in one figure, the degree and direction of movement. It can be calculated by using the method of Karl Person's correlation coefficient, because it is one of the widely used mathematical methods of calculation, the correlation coefficient between two variables. In symbolically, it is defined as:

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

Assumptions

- If r = 1, there is positively perfect correlation between the two variables.
- If r = -1, there is negatively perfect correlation between the two variables.
- If r = 0, the variables are uncorrelated.

The nearer the value of r to +1, the closer will be the relationship between two variables and the nearer the value of r to -1, the lesser will be the relation.

Probable error (P.E):

The probable error of the correlation coefficient helps to interpret its value. P.E., which is the measure of testing the reliability of correlation coefficient, denotes it. If r be the calculated value of r from a sample of n pair of observation the P.E. is denoted by

$$\text{P.E.} = \frac{0.6745(1 - r^2)}{\sqrt{n}}$$

It can be interpreted to know weather its calculated value of r is significant or not in the following ways.

- If r <PE, it is Insignificants perhaps there is no evidence of correlation
- If r >6PE, it is significant.

It is other causes, nothing can be concluded. The probable error of correlation may be used to determine the limits within which the population correlation coefficient lies. The limits for population correlation are r +PE, r –PE.

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

4.1 Introduction:

This is the section where, the filtered data are presented and analyzed. This is one of the major chapters of this research because it includes detail analysis and interpretation of data from which concrete result of HBL and NIBL can be obtained. In this chapter, the relevant data and information necessary for the study are presented and analyzed keeping the objectives set in mind. This chapter consists of various calculations made for the analysis of NPA of concerned finance companies. To make our study effective and precise as well as easily understandable, this chapter is categorized in three parts; presentation, analysis and interpretation. In presentation section data are presented in terms of table, graph chart of figures, according to need. The presented data are then analyzed using different financial & statistical tools earlier mentioned in chapter three. At last the results of analysis are interpreted. Though there is no distinct line of demarcation for each section (like presentation section, analysis section & interpretation section) but the arrangement of writing is made by afore mentioned way

Data presentation is the interpretation of the study. Data analysis summarizes the collected data and its interpretation presents the major findings of the study. Analysis is not complete without interpretation and interpretation cannot proceed without analysis. In this course of analysis, data gathered from. The data have been analyzed by using financial and statistical tools. The results of the computation have also been summarized in appropriated tables. The samples of computation of each model have been included in annexes. This chapter includes presentation of data and analysis of that data to reach at a conclusion

Simple percentage is used to analyze the data as arithmetical tools. Karl's Pearson's correlation coefficient is used to analyze the data as statistical tool.

Nowadays Non-Performing Assets (NPA) have been occupying major space in the total assets and total lending of the bank. It stands around 15% in the Nepalese banking system while it is even worse in case of two large commercial bank, Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL). The NPA of RBB is found 45.3% while that of NBL is 25.1% of the total lending. In this way it shows that commercial banks have been suffering by high level of NPA, and the efforts of the banks have been diverted to reduce it.

Keeping this fact into consideration, a provision has set up by Nepal Rastra Bank in Fiscal year 2057/58 to control the level of NPA of Nepalese commercial banks. According to that provision, every bank has to classify its total loan and advances (including purchased and discounted bills) as pass loan, substandard loan, doubtful loan and bad loan, on the basis of overdue against schedule. Commercial banks are also directed to maintain loan loss provision as stated in section 11 of directives no. 2 of NRB's directives for commercial banks 2059. Main purpose was to find out the level of NPA in Nepalese commercial banks and to take necessary steps to control the level of NPA in future.

Here in the study, data of five fiscal year starting from F/Y 2004/05 to 2008/09 have been presented to study and analyze the level of NPA in total assets, total lending and total deposits of the commercial banks. Data are also presented to examine or analyze the efforts to NPA on the profitability of the banks under study.

4.2 Data presentation and Analysis of Sample Banks:

4.2.1 Data Presentation and Analysis of " Nepal Investment Bank Limited":

Table No. 4.1

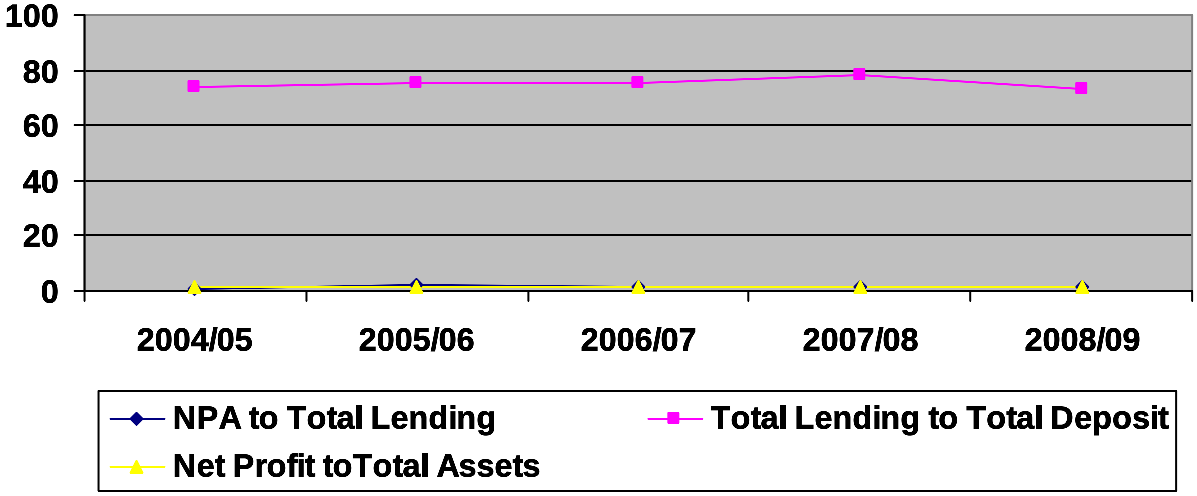
Relation between NPA, Net profit, Total lending and Total deposit

Ratio / year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**	**Mean**
NPA to Total Lending	1.04	2.20	1.70	1.60	1.27	1.56
Total Lending to Total Deposit	74.00	75.40	75.60	78.20	73.40	75.32
Net Profit to Total Assets	1.29	1.17	1.49	1.45	1.50	1.38

Source: Annual reports of the concern bank of fiscal year 2004/05 to 2008/09

Figure No. 4.1

Relation between NPA, Net Profit, Total Lending and Total Deposits



From Table and Figure 4.1, it can be said that the ratio between the Non performing assets and total lending was found to increasing over the five years period. In the fiscal year 2004/05 it was found to be at 1.04 %, which highly increased to 2.20 % to the following year, and in the fiscal year 2006/07 it was found to be decreased rather than previous year. In the fiscal year 2008/09 the non performing assets to total lending ration was found 1.27% and the average ratio between NPA and total lending of five years period was 1.56 %.

The total lending to total deposit ratio was following decreasing trend over five years period. In fiscal year 2004/05 it was found to be 74.00 % and was found to be increased in the following years and had reached to 75.40 %, 75.60 % and 78.20 % in the fiscal year 2005/06, 2006/07 and 2007/08 respectively. And finally it was increased to 73.40 %

for the end of year 2008/09. The average ratio between total lending to total deposit of five years period was 75.32 %.

And the net profit to total assets ratio was also found to be fluctuating over the five years period. It was found to be 1.29 %in the fiscal year 2004/05 and it becomes to 1.50 % for the fiscal year 2008/09. The average ratio between net profit to total assets of five years period was 1.38 %.

Table No. 4.2

Relation between Net Profit and Total NPA

Fiscal year	Net Profit	Total NPA
2004/05	85,347,446	42,388,116
2005/06	94,180,428	111,191,103
2006/07	143,566,683	104,764,369
2007/08	170,807,797	128,807,745
2008/09	237,290,936	129,235,790

Source: Annual reports of the concern bank of fiscal year 2004/05 to 2008/09

In Table 4.2, shows that the status of non-performing assets (NPA) and net profit of the bank in different years, in fiscal year 2004/05. The bank had NPA amount to Rs 42388116 and bank's net profit amount to be Rs 85347446. In fiscal year 2005/06 the NPA amount to Rs. 111191103 i.e. NPA increased by Rs 68802987 (i.e.162.32 %) in comparison of previous year. As the result the bank increase its profit by Rs 8832982 in comparison of previous year and net profit reached amounted to Rs 94180428 at the end of fiscal year 2005/06.

In fiscal year 2006/07, the NPA amount decreased by Rs 6426734 (i.e.5.78 %) in comparison of previous year. The net profit increased by Rs 49386225 (i.e.52.44 %) in comparison to previous year and reached amounted Rs.143556683 at the end of the fiscal year.

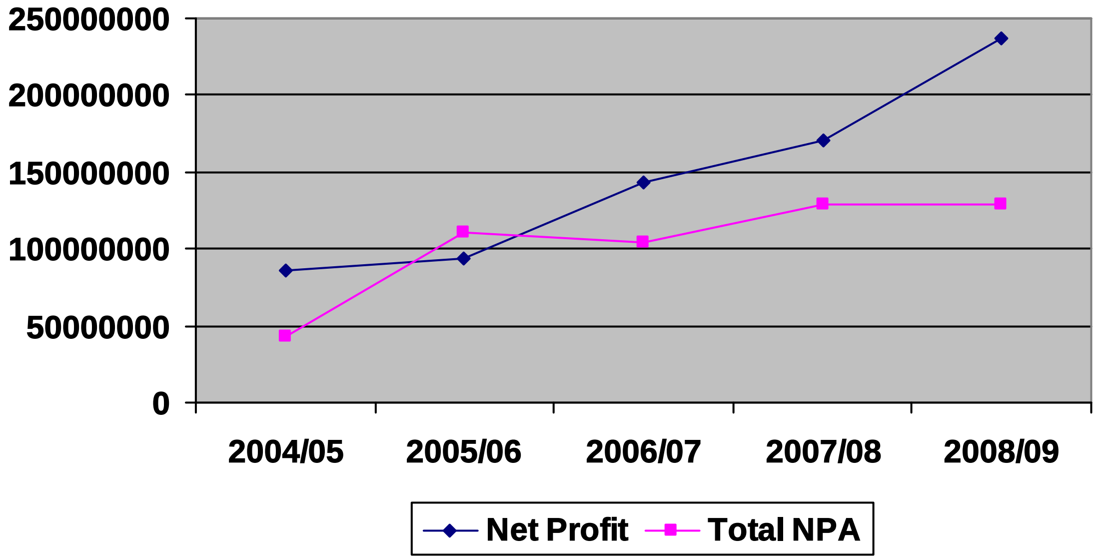
In fiscal year 2007/08 the banks NPA increased by 22.95 % i.e. Rs 24043376 and reached to Rs.128807745. As the result the net profit of the banks increased by 18.97 % at the end of fiscal year 2007/08.

Similarly, in fiscal year 2008/09, the NPA increased by 0.33 % i.e. Rs 428045 and reached to amount Rs 129235790. The net profit highly increased by amount Rs 66483139 i.e.38.92 % in comparison with previous year's net profit and reached to Rs 237290936. The bank is able to earn more profit although the level of NPA also increased.

To make clearer the data of table 4.2 also presented on the Figure 4.2:

Figure No. 4.2

Relation between Net Profit and Total NPA of Nepal Investment Bank Ltd:



The loan loss provision maintains by Nepal Investment Bank Ltd. is presented in the Table 4.3.

Loan loss provisioning of Nepal Investment Bank Ltd:

Table No. 4.3

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2004/05	2005/06	2006/07	2007/08	2008/09
Pass loan	1% of pass loan	1.72	1.63	2.26	1.00	1.00
Sub-standard loan	25% of sub-standard loan	25.00	25.00	25.00	25.00	25.00
Doubtful loan	50% of doubtful loan	50.00	50.00	50.00	50.00	50.00
Bad loan	100% of loss loan	123.78	100.00	100.00	100.00	100.00

Source: Annex 1

Commercial bank has to maintained loan loss provision as per the NRB's directives for the commercial bank. In fiscal year 2004/05, Loan loss provision for substandard loan and doubtful loan exactly met the NRB's directives, which was 25 % and 50 % of substandard loan and doubtful loan respectively. The bank made 1.72 %, and 123.78 % loan loss provision for pass loan and bad loan which was higher than requirement as per NRB's directives.

In fiscal year 2005/06, the bank provisioned 1.63 % for pass loan which was higher than the NRB's directives. Loan loss provision for substandard loan, doubtful loan and bad loan exactly met the NRB's directives, which was 25 %, 50 % and 100 percent of substandard loan, doubtful loan and bad loan respectively

In fiscal year 2006/07, the bank provisioned 2.26 % for pass loan which was higher than the NRB's directives. The bank made Loan loss provision for substandard loan, doubtful loan and bad loan exactly met the NRB's directives, which was 25 %, 50 % and 100 percent of substandard loan, doubtful loan and bad loan respectively

In fiscal year 2007/08 and 2008/09, the bank could able to maintain the loan loss provision perfectly in accordance to the NRB's directives.

4.2.2 Data Presentation and Analysis of " Himalayan Bank Limited":

Table No 4.4

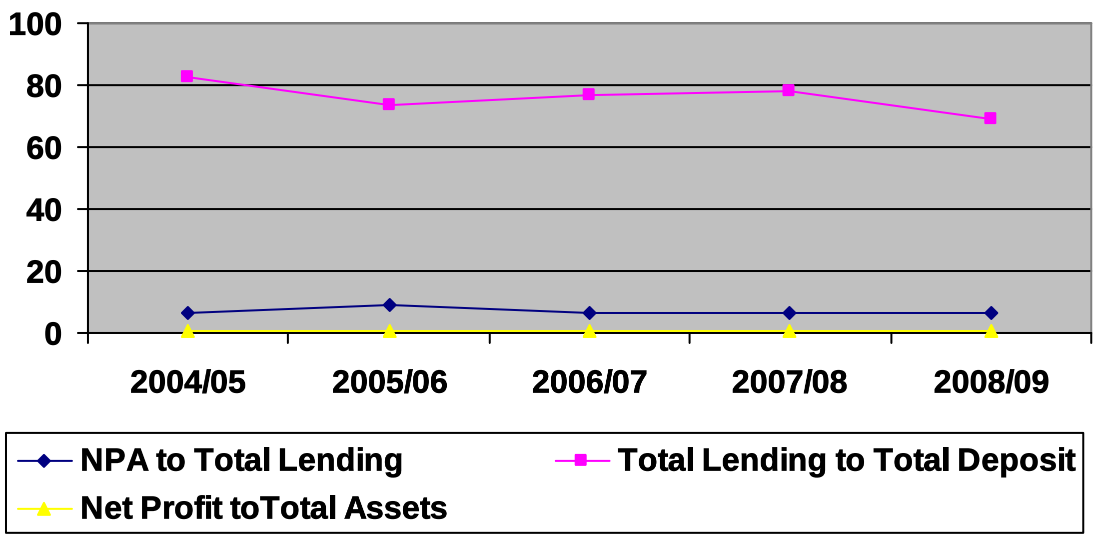
Relation between NPA, Net profit, Total lending and Total deposit

Ratio / year	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NPA to Total Lending	6.32	8.90	6.25	6.54	6.13	6.83
Total Lending to Total Deposit	82.27	73.27	76.85	77.87	69.32	75.92
Net Profit to Total Assets	0.58	0.64	0.72	0.55	0.90	0.68

Source: Annual reports of the concern bank of fiscal year 2004/05 to 2008/09

Figure No. 4.3

Relation between NPA, Net Profit, Total Lending and Total Deposit



From Table and Figure 4.3, it can be said that the ratio between the Non performing assets and total lending was found to fluctuating trend, although it has been increase to 8.9 % for the year 2005/06 and decreased to 6.25 % for the fiscal year 2006/07. Again it was found to be 6.54 % for the fiscal year 2007/08 and it was found to be 6.13 % at the end of fiscal year 2008/09. The average ratio between NPA and total lending of five years period was 6.83 %. The bank should continue to control over the non performing assets.

Similarly the total lending to total deposit ratio was following decreasing trend. It was found to be 82.27% for the fiscal year 2004/05 and it becomes to 69.32 % at the end of the fiscal year 2008/09. Although it was found to be increasing for the fiscal year 2006/07 and 2007/08. The average ratio between total lending to total deposit of five years period was 75.92 %.

And the net profit to total assets ratio was also found to be increasing, it was found to be 0.58 %in the fiscal year 2004/05 and it becomes to 0.90 % for the fiscal year 2008/09. It shows that the profit was increasing in comparison to total assets of the bank, showing the improvement in the profit of the bank and the average ratio between net profit to total assets of five years period was 0.68 %.

Table No. 4.5

Relation between Net Profit and Total NPA

Fiscal year	Net Profit	Total NPA
2004/05	40,843,769	289,766,401
2005/06	48,748,221	426,947,082
2006/07	60,851,673	345,821,458
2007/08	57,386,634	441,017,011
2008/09	117,001,973	505,336,919

Source: Annual reports of the concern bank of fiscal year 2004/05 to 2008/09

Table 4.5, shows that the status of non-performing assets (NPA) and net profit of the bank in different years, in fiscal year 2004/05. The bank had NPA amount to Rs 289766401 and bank’s net profit amount to be Rs 40843769. In fiscal year 2005/06 the NPA amount to Rs. 426947082 i.e. NPA increased by Rs 137180681 (i.e.47.34 %) in comparison of previous year. As the result the bank increase its profit by Rs 7904452 in comparison of previous year and net profit reached amounted to Rs 48748221 at the end of fiscal year 2005/06.

In fiscal year 2006/07, unfortunately the NPA amount decreased by Rs 81125624 (i.e. 19 %) in comparison of previous year. The net profit increased by Rs 12103452 (i.e.24.83 %) in comparison to previous year and reached amounted Rs.60851673 at the end of the fiscal year. In fiscal year 2007/08 the banks NPA increased by 27.53 % i.e. Rs 95195553 and reached to Rs.441017011. As the result the net profit of the banks decreased by 5.69% at the end of fiscal year 2007/08.

Similarly, in fiscal year 2008/09, the NPA increased by 14.58 % i.e. Rs 64319908 and reached to amount Rs 505336919. The net profit highly increased by amount Rs 59612339 i.e.103.88 % in comparison with previous year’s net profit and reached to Rs 117001973.

There is no doubt that the net profit of the bank affected by NPA. But NPA is not only a cause for increment and decrement of the net profit. There are many other causes that affect the profit of the bank. But NPA would be a major cause of decreasing profit of the bank so the bank has to control its NPA as efficiently as possible.

Loan loss provisioning of Himalayan Bank Ltd:

The loan loss provision maintains by Nepal Himalayan Bank Ltd. is presented in the Table 4.6

Loan loss provisioning of Himalayan Bank Ltd:

Table No 4.6

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2004/05	2005/06	2006/07	2007/08	2008/09
Pass loan	1% of pass loan	1.19	1.19	0.94	0.95	0.96
Sub-standard loan	25% of sub-standard loan	26.11	22.41	13.39	20.94	17.71
Doubtful loan	50% of doubtful loan	50.00	52.17	48.39	15.67	29.18
Bad loan	100% of loss loan	100.22	89.22	95.83	98.00	99.13

Source: Annex 2

Commercial bank has to maintained loan loss provision as per the NRB's directives for the commercial bank. In fiscal year 2004/05, Loan loss provision for doubtful loan exactly met the NRB's directives, which was 50 percent of doubtful loan. Similarly, the bank made 1.19 %, 26.11 % and 100.22 % loan loss provision for pass loan, sub-standard and bad loan which was higher than requirement as per NRB's directives.

In fiscal year 2005/06, Loan loss provision for pass loan and doubtful loan higher than the NRB's directives, which was 1 percent of pass loan and 50 percent of doubtful loan? The similarly, the bank made 1.19 %and 52.17 % loan loss provision for pass loan and doubtful loan. It was found that the bank unable to maintain loan loss provision for substandard and bad loan as per the NRB's directives.

Fiscal year 2006/07, It was found that the bank unable to maintain loan loss provision for all classes of loan as per the NRB's directives. The bank provisioned 0.94 %, 13.39 %, 48.39 % and 95.83 % for pass, substandard, doubtful and bad loan. In fiscal year 2007/08, It was found that the bank unable to maintain loan loss provision for all classes of loan as per the NRB's directives. The bank provisioned 0.95 %, 20.94 %, 15.67 % and 98.0 % for pass loan, substandard loan, doubtful loan and bad loan.

In fiscal year 2008/09, It was found that the bank unable to maintain loan loss provision for all classes of loan as per the NRB's directives. The bank provisioned 0.96 %, 17.71 %, 29.18 % and 99.13 % respectively for pass loan, substandard loan, doubtful loan and bad loan.

It is found that the bank could not maintained loan loss provision, perfectly in accordance to the NRB's directives. The bank maintained lower than requirement. Therefore, the bank should give priority to maintain loan loss provision as requirement as per NRB's directives.

4.3 Performing and Non performing assets of commercial banks in Total Assets, Total Lending and Total Deposit

Table No. 4.7

Performing and Non- Performing assets of commercial banks in Total Assets, Total Lending & Total Deposit

Bank	Assets		Lending		Deposit	
	% of PA to TA	% of NPA to TA	% of PA to TL	% of NPA to TL	% of PA to TD	% of NPA to TD
NIBL	62.64	1.00	98.43	1.57	74.15	1.19
HBL	60.12	4.40	93.17	6.83	71.84	5.25

Source: Annex 5, 6 & 7

Up to the fiscal year 2004/05, Himalayan Bank Ltd had performing assets amounted Rs 4294628538 which was increased every year during the study period and reached to Rs 7736119625 in the end of fiscal year 2008/09.

The total assets of the HBL were increasing during the five years period. The percentage of performing assets to total asset was 61.17%for the fiscal year 2004/05 which was decreased and reached to57.74 % for the year ended 2004/05. The percentage of performing assets to total assets was increased for the fiscal year 2006/07 and unfortunately it was decreased for the following two years and reached to 59.39 % for the fiscal year 2008/09. The average percentage of performing assets to total assets of the five years periods was found to be 60.12 %.

The total lending was increasing trend during the study period. The percentage of performing assets to total lending was 93.68 % for the end of the year 2004/05 and which was decreased in the year 2005/06 and reached 91.10 % The percentage of performing assets to total lending was increased for the fiscal year 2006/07 and it was slightly decreased for the year 2007/08. It was slightly increased for the year ended 2008/09 and reached to 93.87 % and average percentage of performing assets to total lending of five years was 93.17 %.

Similarly, the percentage of performing assets to total deposit was fluctuating over the five years period. It was 77.07 % for the year ended 2004/05 which was decreased in the fiscal year 2005/06 and there after it was increased for the following two fiscal year. Then it was decreased to 70.32 % at the end of the year 2008/09. 71.84 % was the average percentage of performing assets to total deposit of five years period.

This trend of performing assets indicated that the bank could able to increase its performing loan through regular control and supervision of its lending during the research period. But in fiscal year 2006/07 the bank could concentrate its non performing assets.

The total non performing assets (NPA) of HBL had Rs 289766401 at the end of fiscal year 2004/05 which was increased by 47.34 % and reached to Rs 426947082 in the fiscal year 2005/06. It was decreased for the fiscal year 2006/07 and reached to Rs 345821458. Unfortunately the total NPA of the bank was highly increased for the following two fiscal year and reached amount to Rs 505336919 for the fiscal year ended 2008/09.

The percentage of NPA to total assets of HBL for the year ended 2004/05 was 4.13 % which was increased in the end of fiscal year 2005/06 and reached to 5.64 %.It was decreased to 4.10 % at the end of F/Y 2006/07. It was slightly increased for the year 2007/08. The percentage of NPA to total assets was decreased and reached to 3.88 % at the end of F/Y 2008/09. The average percentage of NPA to total assets of five years was 4.40 %.

The percentage of NPA to total Lending of HBL for the year ended 2004/05 was 6.32 % which was increased in the end of fiscal year 2005/06 and reached to 8.90 %.It was decreased to 6.25 % at the end of F/Y 2006/07. It was slightly increased for the year 2007/08. The percentage of NPA to total assets was decreased and reached to 6.13 % at the end of fiscal year 2008/09. The average percentage of NPA to total lending of five years was 6.83 %.

The percentage of NPA to total deposit of HBL for the year ended 2004/05 was 5.20 % which was increased in the end of fiscal year 2005/06 and reached to 6.55 %.It was decreased to 4.80 % at the end of F/Y 2006/07. It was slightly increased for the year 2007/08. The percentage of NPA to total assets was decreased and reached to 4.59 % at the end of F/Y 2008/09. The average percentage of NPA to total deposit of five years was 5.25 %.

This trend of non performing assets indicates that the bank could able to control towards NPA during the five years period. But decreasing trend of percentage of non performing assets (NPA) indicates the good financial position.

Up to the fiscal year 2004/05, Nepal Investment Bank Ltd had performing assets amounted Rs 4001840315 which was increased and reached to Rs 4938390206 in the end of fiscal year 2005/06. It was further increased every year and reached amount to 100070018658 for the fiscal year 2006/07.The total assets of the Nepal Investment Bank were increasing during the five years period. The percentage of performing assets to total asset was increased from 60.57 % for the year ended 2004/05 to 66.24 % at the end of fiscal year 2007/08 but it was decreased in the fiscal year 2008/09 and reached to 62.70 %. The average percentage of performing assets to total assets of the five years periods was found to be 62.64 %.

The total lending was increasing trend during the study period. The percentage of performing assets to total lending was 98.95 % for the end of the year 2004/05 and which was decreased for the year 2005/06 and reached 97.80 %. It was increased to 98.28 % in the fiscal year 2007/08 and it was further increased and reached to 98.73 % for the end of fiscal year 2008/09. The average percentage of performing assets to total lending of five years was 98.43 %.

Similarly, like a percentage of performing assets to total lending, the percentage of performing assets to total deposit was increased to the fiscal year 2007/08 and reached to 76.96 %. Then it was decreased to 72.50 % at the end of the year 2008/09. 74.15% was the average percentage of performing assets to total deposit of five years period. This trend of performing assets indicated that the bank could able to increase its performing loan through regular control and supervision of its lending. But in fiscal year 2062/6 the bank could not control the percentage of performing assets

The total non performing assets (NPA) of Nepal Investment Bank Ltd had Rs 42388116 at the end of fiscal year 2004/05 which was increased and reached to Rs 111191103 in the fiscal year 2005/06. It was decreased to Rs. 104764369 at the end of fiscal year 2006/07. Unfortunately the total NPA of the bank was highly increased to Rs 128807745 in the fiscal year 2007/08 and it was further increased and reached amount to Rs. 129235790 at the end of fiscal year 2008/09. The percentage of NPA to total assets of Nepal Investment Bank ltd for the year ended 2004/05 was 0.64 % which was increased to 1.38 % in the end of fiscal year 2005/06.Tt was decreased to 1.09 % at the end of F/Y 2006/07. It was decreased in the fiscal year 2008/09 and reached to 0.81 % and the average percentage of NPA to total assets of five years was 1.00 %.

The percentage of NPA to total lending of Nepal Investment Bank ltd for the year ended 2004/05 was 1.05 % which was increased to 2.20 % in the end of fiscal year 2005/06. It was decreasing for the following three years and it was reached to 1.27 % in the fiscal year 2008/09 and reached to 0.81 % and the average percentage of NPA to total assets of five years was 1.57 %.

The percentage of NPA to total assets of Nepal Investment Bank ltd for the year ended 2004/05 was 0.78 % which was increased to 1.66 % in the end of fiscal year 2005/06.It was decreased to 1.30 % at the end of F/Y 2006/07. It was decreased in the fiscal year 2008/09 and reached to 0.94 % and the average percentage of NPA to total assets of five years was 1.19 %.

4.4 Percentage Performing and Non performing Assets of Commercial banks in Total loan

Table No 4.8

Percentage Performing and Non performing Assets of Commercial banks in Total loan

Banks	Performing Asset		Non Performing Asset		
	PL /TL	RL /TL	SL /TL	DL /TL	BL /TL
NIBL	97.13	3.25	0.64	0.36	0.91
HBL	87.09	6.08	0.94	1.24	4.65

Source: Annex 8 & 9

Up to fiscal year 2004/05 Nepal Investment Bank Ltd had total loan and advances amounted Rs 4044228431 which was increased every years during the study period i.e. five years period and it had become to Rs 10136254448 in the fiscal year 2008/09.The percentage of pass loan to total loan of Nepal Investment Bank had 98.95 % in the fiscal year 2004/05 which was decreased to 97.80 % in the fiscal year 2005/06. But it was slightly increased and reached to 98.28 % in the fiscal year 2006/07. In the fiscal year it was highly decreased and reached to 94.34 % and for fiscal year 2008/09 the percentage of pass loan to total loan was found 96.26 % which was increased with compare to previous year. The average percentage of pass loan to total loan of five years was 97.13 %.

The percentage of restructed loan to total loan of Nepal Investment Bank was 4.03 % in the fiscal 2007/08 which was decreased to 2.46 % in the fiscal year 2008/09. The average percentage of restructed loan to total loan of two years was 3.25 %.The percentage of substandard loan to total loan of Nepal Investment Bank had 0.39 % in the fiscal year 2004/05 which was decreased to 0.82 % in the fiscal year 2005/06.It was increased in the fiscal year 2061/61 and reached to 1.82 % and it was highly decreased to 0.06 % for the fiscal year 2007/08. It was 0.11 % in the fiscal year 2008/09 and the average percentage of substandard loan to total loan of five years period was 0.64 %.

The percentage of doubtful loan to total loan of Nepal Investment Bank had 0.33 % in the fiscal year 2004/05 which was increased to 0.75 % in the fiscal year 2005/06.It was highly decreased in the fiscal year 2061/61 and reached to 0.66 % and again it was highly decreased to 0.03 % for the fiscal year 2007/08. It was 1.56 % in the fiscal year 2008/09 and the average percentage of doubtful loan to total loan of five years period was 0.36 %.
The percentage of bad loan to total loan of Nepal Investment Bank had 0.33 % in the fiscal year 2004/05 which was increased to 0.62 % in the fiscal year 2005/06.It was further increased to 0.87 % and 1.55 % in the fiscal year 2006/07 and 2007/08 respectively. It was 1.56 % in the fiscal year 2008/09 and the average percentage of bad loan to total loan of five years period was 0.91 %.

Upto fiscal year 2004/05 HBL had total loan and advances amounted Rs 458394939 which was increased every years during the study period i.e. five years period it had become to Rs 8241456544 in the fiscal year 2008/09. The percentage of pass loan to total loan of Nepal HBL Bank had 85.33 % in the fiscal year 2004/05 which was increased to 86.43 % in the fiscal year 2005/06 but it was slightly decreased and reached to 86.09 % in the fiscal year 2006/07. For the fiscal year 2007/08 the percentage of pass loan to total loan was found 87.35 % and it was increased to 87.35 % in the fiscal year 2008/09. The average percentage of pass loan to total loan of five years was 87.09 %.

The percentage of restructed loan to total loan of HBL was 7.80 % in the fiscal 2004/05 which was decreased to 4.67 % in the fiscal year 2005/06. But unfortunately it was increased to 7.65 % for the end of the fiscal year 2006/07. Again the bank is able to decrease the percentage and it was reached to 4.16 % for the year ended 2062/62. The average percentage of restructed loan to total loan of five years was 6.08 %.

The percentage of substandard loan to total loan of HBL had 1.95 % in the fiscal year 2004/05 which was increased to 2.53 % in the fiscal year 2005/06.The bank could able to reduce the percentage of substandard loan to total upto 0.02 % for the year ended 2008/09 and the average percentage of substandard loan to total loan of five years period was 0.94 %.

The percentage of doubtful loan to total loan of HBL had 1.35 % in the fiscal year 2004/05 which was increased to 3.48 % in the fiscal year 2005/06 and it was decreased to

0.05 % in the fiscal year 2008/09. The average percentage of doubtful loan to total loan of five years period was 3.97 %. But unfortunately the percentage of bad loan to total loan of HBL was increasing during the study period. It was 3.02 % in the fiscal year 2004/05 which was increased to 6.06 % in the fiscal year 2007/08 though it was decreased in the fiscal year 2005/06 which was 2.89 % and the average percentage of bad loan to total loan of five years was 4.65 %.

4.5 Correlation Analysis

Correlation analysis is the statistical tool that can be used to describe the degree to which one variable is linearly related to other variable. Two or more variable are said to be correlated if change in the value of one variable appears to related or linked with the change in the value of other variable. Correlation is an analysis of the covariance between two or more variables and correlation analysis deals to determine the degree to the closeness of the relationship between the different variables. In the correlation analysis, only one variable is treated as the dependent variable and one or more variables are treated as independent.

Correlation Analysis generally used to describe the degree to which one variable is related to another, in statistics is used in order to depict the covariance between two or more variables. It helps to determine whether

- A positive or negative relation exists
- The relation is significant or insignificant
- Establishes cause and effect relation if any

4.5.1 Correlation between NPA and ROA of the commercial banks

The statistical tool, 'correlation analysis' is preferred in this study to identify the relationship between NPA and ROA and whether the relationship is significant or not. Here NPA denotes the percentage of NPA in total lending of the bank and ROA denotes the net profit as percentage of total assets of the banks.

Table No 4.9

Correlation between NPA and ROA of the commercial bank

Bank	coefficient of correlation (r)	Relationship	Coefficient of determination (r2)	Probable error (P.E.)	Significant/ insignificant
NIBL	-0.41	Negative	0.17	0.25	insignificant
HBL	-0.26	Negative	0.07	0.28	insignificant

Source: Annex 10 & 11

Table 4.9, the correlation coefficient between the Non Performing Assets to Returns on Assets shows that there is negative relationship between these two variables. The established theory also states that the Profit and Non Performing Assets also flow in the opposite direction. When the amount of NPA is lesser, profit would be high and whenever the amount of NPA is more then profit goes on decreasing, which is explained by the above table.

HBL and NIBL have the correlation coefficient of -0.26 and -0.41 which are categorized as having low degree of negative correlation. And 7 % and 17 % of the profitability is affected by the NPA to the respective banks and rest is affected by the other factor. Since the P.E. for the HBL is more than the coefficient of correlation bank indicating insignificant. Similarly P.E. of NIBL multiplied by is more than the coefficient of correlation NIBL indicating insignificant.

From the above calculations, it can conclude that the profitability of the individual bank is fully dependent in the Non-Performing Assets of the respective banks. Higher the NPA lower will be the net profit and vice versa.

4.5.2 Correlation between NPA and Total Lending of the commercial banks

The statistical tool, ‘correlation analysis’ is preferred in this study to identify the relationship between NPA and Total lending and whether the relationship is significant or not.

Table No 4.10

Correlation between NPA and Total Lending of the commercial bank

Bank	coefficient of correlation (r)	Relationship	Coefficient of determination (r2)	Probable error (P.E.)	Significant/ insignificant
NIBL	0.77	Positive	0.59	0.12	Significant
HBL	0.81	Positive	0.65	0.10	Significant

Source: Annex 12 & 13

Table 4.10, the correlation coefficient between Total Lending and NPA shows that there is positive relationship between these two variables. When the amount of Total Lending is increases the amount in NPA is more and vice versa.

NIBL and HBL have the correlation coefficient of 0.77 and 0.81 which are categorized as having high degree of positive correlation. And 59 % and 65% of the total lending is affected by the NPA to the respective banks and rest is affected by the other factor. And the test so made for these banks are found to be significant as the correlation is greater than Probable error (P.E.) multiplied by six times.

4.6 Major Findings

- The case of Himalayan Bank Limited (HBL), total NPA and net profit have been found to be increasing, NPA to total lending ratio have been found to be slightly decreasing over the years as it was 6.32 % in the fiscal year 2004/05 and increased to 6.13 % in the fiscal year 2008/09. The total lending to total deposit ratio is found to be decreasing over the five years period. The net profit to total assets ratio is found to be increasing over the years as it was 0.58 % in the fiscal year 2004/05 and decreased to 0.90 % in the fiscal year 2008/09.

- The case of Nepal Investment Bank Limited (NIBL), total NPA and net profit have been found to be increasing, NPA to total lending ratio have been found increasing over the years as it was 1.04 % in the fiscal year 2004/05 and increased to 1.27 % in the fiscal year 2008/09. The total lending to total deposit ratio is found to be decreasing over the five years period it was 74.0% in the fiscal year 2004/05 and slightly decreased to 73.40 %. The net profit to total assets ratio is found to be increasing over the years as it was 1.29 % in the fiscal year 2004/05 and decreased to 1.50 % in the fiscal year 2008/09.

- The percentage of performing assets to total lending was found higher in NIBL and lower in HBL which was 98.43 % and 93.1.7 % respectively. The percentage of non performing assets to total lending was found lower in NIBL and higher in HBL which was 1.57 % and 6.83 % respectively among the sample banks.

- The percentage of performing assets to total deposit of NIBL have been found to be 73.35 % which was higher than HBL. The percentage of non performing assets to total deposit was 1.19 % of NIBL.

- The percentage of performing assets to total lending was found higher in NIBL and lower in HBL which was 98.43 % and 93.1.7 % respectively. The percentage of non performing assets to total lending was found lower in NIBL and higher in HBL which was 1.57 % and 6.83 % respectively among the sample banks.

- The percentage of performing assets to total deposit of NIBL have been found to be 73.35 % which was higher than HBL. The percentage of non performing assets to total deposit was 1.19 % of NIBL.

- The level of NPA is found to be highest for the NIBL in the fiscal year 2008/09, which was Rs 129,235,790 where as the lowest, was found that of NIBL in the fiscal year 2004/05 which was Rs 42388116. The level of NPA is found to be highest for HBL In the fiscal year 2008/09, which was Rs,505,336,919 where as the lowest, was found that of HBL in the fiscal year 2004/05 which was Rs. 289,766,401. Overall, the performance of net profit is gradually increasing over the years covered by this study period. Followed by NIBL and HBL respectively.

- The average ratio of pass loan to total loan of five years have been found higher in NIBL. The average ratio of restructed loan to total loan of five years has been found higher in HBL which was 6.08 %.

- The average ratio of non performing assets to total loan of five years was found lower in Nepal Investment Bank Limited The average ratio of substandard loan to total loan and bad loan to total loan of five years have been found lower in NIBL. The average ratio of doubtful loan to total loan of five years was found higher in HBL and lower in NIBL.
- HBL and NIBL have the low degree of correlation coefficient. Only 7 % and 17 % of HBL and NIBL respectively on the profitability is affected by NPA and rest is affected by other factor.

- NIBL and HBL bank have high degree of positive correlation i.e. the total lending is directly dependent on the level of NPA, higher the NPA the more will be the total lending of banks and vice versa.

CHAPTER V

SUMMARY CONCLUSION AND RECOMMENDATIONS

5.1 Summary:

Although banking is a service, it has been a great business to the entrepreneurs in modern age. A commercial bank does same business to earn profit by its transaction. Generally, commercial bank does the functioning pool between the saving communities and need group of the society. They accept deposit from the public on the condition that they pay the deposit on demand or on short notice. The banks mobilize the funds to different need group on their demand of loan. Apart from accepting deposit, banks are engaged in the exchanging currency, operating other commercial transactions viz. purchase and discount of bills other financial instruments. Among the many items of transactions of the bank, accepting deposit and lending or giving loan and advances occupy major space in its transaction. So bank's major concern is found to be concentrated on the loan.

A commercial bank means the bank, which deals with exchanging currency, accepting deposits, giving loans doing other various commercial transactions. Therefore, the major function of commercial bank is to accept deposits and provide loans.

There is not so long history of commercial bank in Nepal. Nepal Bank Limited established in 1994 B.S. was the first commercial bank of the Nepal. But now there are twenty six commercial banks all over the country and they have been expanding their services by establishing branches in every corner of the country.

The assets of commercial bank indicate the manner in which the funds entrusted to the bank are employed. The successful working of the bank depends on ability of the management to distribute the fund among the various kind of investment known as assets outstanding loan advance of the bank. These assets constitute primary source of income to the bank. As being a business unit a bank aims at making huge profit since loan and advances are more profitable than any other assets of the bank, it is willing to lend as much as its fund as possible. But the bank has to be careful about the repayment of loan and interest giving loan. If the bank is too timid, it may fail to obtain the adequate return on the fund, which is confined to it for use. Similarly, if the bank is too liberal, it may easily impair its profits by bad debts. Therefore, bank should not forget the reality that most of the bank failures in the world are due to shrinkage in the value of the loan and advances.

Despites of being loan and advances more profitable than other assets, it creates risk of non repayment for the bank. Such risk is known as credit risk or default risk. Therefore, like other assets, the loan and advances are classified into performing and non performing assets on the basis of overdue aging schedule. If the dues in the form of principal and the interest are not paid, by borrower within a maturity period, that amount of principal and interest is called non performing loan or assets. It means NPA could wreak branch profitability both through loss of interest income and need to write off the principal loan amount. Performing assets have multiple benefits to the company as well as to the society while non performing assets erode even existing capital of the bank.

Escalating level of NPAs has been becoming great problem in banking business in the world. In this context, Nepal can not be run off from this situation. The level of NPA in Nepalese banking system is very alarming. It is well known fact that the bank and financial institution in Nepal have been facing the problem of swelling non performing assets and the issue of becoming more and more unmanageable day by day. it is well known from different financial reports, newspapers and news that the total NPA in Nepalese banking system is about 32 Billion while it is very worse in case of two largest commercial banks RBB and NBL.(Nepal Rastra Bank,Banking and fin`ncial statistics, 2006 : 06)

Therefore, this study)s concerned to find out the level of NPA and its effects on the returns on assets and the other factors of the Nep`lese ckmmercial bank. This study especially focuses ol two commercial banks of Nepal, viz. Nepal Investment Bank and Himalayan Bank only, out of the 26 commercial banks operatinr in the bankig industry of Nepal.

As per the nature and requirement of the study, secondary data are tsed with the descriptive and analytical research design, for this research study five years data from fiscal year 2004/05 to 2008/09 has been used. Data are tabulated and presented as per the requirement of the study.

For the analysis of data different statistical tools like arithmetic mean, standard deviation, coefficient of correlation, coefficient of variation, coefficient of determination, probable error of correlation, regression graph, diagrams and hypothesis testing have been used. Similarly, financial tools such as ratio analysis and variance analysis have also been used. This study has been organization in five main chapter consisting of introduction, review of literature, research methodology, presentation and analysis of data and summary, conclusion and recommendation. Besides this bibliography and appendix has also been included in this research study.

5.2 Conclusion:

- In case of Nepal Investment Bank limited and Himalayan Bank Limited, they able to increase net profit of the bank although they can not control the level of non performing assets. The level of NPA also increasing during the study period. The level of non performing assets plays vital role in increment and decrement of profit of the commercial banks.

- Every commercial Bank should follow the NRB directives. Commercial bank has to maintain loan loss provision as per NRB directives for the commercial bank. According to NRB directives, loan loss provision for pass loan should be 1 % of pass loan, for substandard loan it should be 25 % of substandard loan, for doubtful loan it should be 50 % of doubtful loan and for bad loan it should be 100 % of bad loan.

- The profitability of Nepalese commercial bank is affected by non performing assets of bank. When the level of non performing assets is increasing then the profit of the bank is decreasing and vice versa. Therefore the NPA and profitability of the bank have negative correlation.

- Every commercial bank is trying to exactly meet the NRB's directives regarding non performing assets. But the sample banks of the study could not maintained loan loss provision perfectly accordance to the NRB directives for all classed. The bank maintained higher the loan loss provision requirement for one class loan when lower another class loan.

- Nepal Investment Bank Limited could maintain loan loss provision, perfectly in accordance to NRB directives with compare to another sample bank of the study. Therefore it can conclude the NIBL able to maintain the loan loss provision. The remaining sample banks should give priority to maintain the loan loss provision as requirement as per NRB's directives.

- Between the sample banks the percentage of non performing assets to total assets of the NIBL was found low which was 1.00 % and it was found to be 14.27 %

- The percentage of performing assets to total lending was found higher in NIBL, which was 98.43 %. The percentage of non performing assets to total lending was found lower in NIBL.

- The percentage of performing assets to total deposit of NIBL has been found to be 73.35 % which was higher than HBL. The percentage of non performing assets to total deposit was 1.19 % of NIBL.

- Every commercial bank is trying to exactly meet the NRB's directives regarding non performing assets. In overall, Nepal Investment Bank Limited could maintain loan loss provision, perfectly in accordance to NRB directives with compare to HBL of the study. Therefore it can conclude the NIBL able to maintain the loan loss provision as per NRB's directives. The remaining sample banks should give priority to maintain the loan loss provision as requirement as per NRB's directives.

- The average ratio of pass loan to total loan of five years have been found higher in NIBL, which was 97.13 %. The average ratio of restructed loan to total loan of five years has been found higher in HBL which was 6.08 %.

- The average ratio of non performing assets to total loan of five years was found lower in Nepal Investment Bank Limited The average ratio of substandard loan to total loan and bad loan to total loan of five years have been found lower in NIBL. The average ratio of doubtful loan to total loan of five years Was found higher in HBL and lower in NIBL.

5.3 Recommendations:

- Lack of proper financial analysis of the borrower by the banks, is one of the major cause behind increasing NPA of Nepalese commercial banks. Therefore, proper financial analysis should be performed before giving loan to the borrower.

- Those banks, which have high level of NPA, should take necessary action towards recovering their bad loan as possible. In case of doubtful to repay the loan by the borrower, the bank should dispose off the collateral taken from them and recover the principal and the interest amount there of.

- Diversification of the loan should be managed by the individual banks. In the context of Nepal it is provided to the borrower so often go to the bank not in the new sector. Default by older borrower can be found, which should be avoided.

- Corporate structure of bank plays key role in the effective loan management. Being loan a risky asset, efforts should be made to have proper control in every steps of loan management. The banks should establish separate department for credit appraisal, documentation, disbursement, inspection and recovery of loan which have possibility of finding mistakes of one department by the others, so that the effectiveness can be achieved.

- Loan must be given if the banker is satisfied that the borrower can repay money from the cash flow generated from operating activities. However, the banks want to ensure that their loan is repaid even in case of failure of business. To prevent banks from such happenings, the bank take collateral is disposed for the recovery of loan. Therefore the bank should take proper valuation of collateral so that the bank at least will be able to recover its principal and interest amount in case of failure of the borrower to repay the loan.

  - Control mechanism of the bank should be managed properly. Black listed customers should not be given the new loan, as it would lead to the same situation to the bank.

  - Political influences in the loan disbursement should be avoided as it may lead to worse condition to the bank as it may increase the non performing loan of the bank.

  - Both commercial banks should maintain loan loss provision as per NRB's directives regarding non performing assets.

Bibliography

Bhandari, Dilli Raj, (2003), **Banking and insurance Principles and Practices,** Kathmandu.

Bidani, S.N., (2003), **Managing Non -Performing Assets**, New Delhi: Vision Books publisher.

Gupta, S.P. (1988), **Statistical Methods,** New Delhi: Sultan Chands and Sons.

Joshi, P.R**.,** (2000), **Research Methodology,** Kathmandu: Buddha Academic Publishers and Distributors (p) ltd..

Kothari, C.R., **Quantitative Techniques**, (1984) 3rd revised Edition, New Delhi: Vikash Publishing House.

Pandy, I.M., **Financial Managememt,** (1966), New Delhi: Vikas Publishing house Pvt. Ltd.

Sharma P.K. and Chaudhary A.K.,(2002) **Statistical Method**, Kathmandu: Khanal Books Prakashan.

Shrestha, K.N. And Manandhar K.D., **Statistics and Quantitative Techniques for Management**, Kathmandu: Valley Publishers.

Vaidya, Shakespeare, (1996), **Banking Management,** Kathmandu: Monitor Nepal

Weston, J. Fred and Engene F. Brigham, **Managerial Finance,** University of California.

Wolf, H.K. And Pant, P.R., **Social Science Research and Thesis Writing,** Kathmandu**:** Buddha Academic Enterprises Pvt. Ltd.

Journals, Reports, Articles and Thesis

Dinesh kumar Khadka, Non Performing Assets of Nepalese Commercial Bank, (2004), Master Degree Thesis, Shanker Dev campus, T.U. Kathmandu.

Nepal Investment Bank Limited, Annual Reports on Shareholders (fiscal year 2004/05 to 2008/09)

Govinda Ghimire, Non Performing Assets of Commercial Banks: Causes and Effects (2005) Master Degree Thesis, Nepal Commerce campus, T.U. Kathmandu

Koirala Subash, Non Performing Assets and Profitability of Commercial Banks in Nepal, (2006) Master Degree Thesis, Nepal Commerce campus T.U. Kathmandu.

Nepal HBL Bank Limited, Annual Reports on Shareholders (fiscal year 2004/05 to 2008/09)

Shrestha N., A Study on Non Performing Loan and Loan Loss Provisioning of Commercial Banks in, (2004) Master Degree Thesis, Shanker Dev campus T.U. Kathmandu.

Web sites:

http://www.google.com
http://www.nrb.org.com.np
http://www.nabilbankltd.com
http://www.himalayanbankltd.com
http://www.everestbankltd.com

Annex 1(b)

Nepal Investment Bank Limited

Loan Loss provision maintained by Nepal Investment Bank

Year	Pass loan(PL)			Sub-standard loan (SL)			Doubtful loan (DL)			Bad loan (BL)		
	P L	Provision for PL	%Provision for PL	S L	Provision for SL	%Provision for SL	D L	Provision for DL	%Provision for DL	B L	Provision for BL	%Provision for BL
	1	2	3=2/1*100	4	5	6=5/4*100	7	8	9=8/7*100	10	11	12=11/10*100
2004/05	4,001,840,315	68,657,091	1.72	15,732,509	3,933,127	25.00	13,328,276	6,664,138	50.00	13,327,331	16,496,033	123.78
2005/06	4,938,390,206	80,423,477	1.63	41,954,709	10,488,677	25.00	38,055,772	19,027,886	50.00	31,180,622	31,180,622	100.00
2006/07	5,991,085,718	135,522,405	2.26	11,082,572	2,770,643	25.00	40,494,733	20,247,366	50.00	53,178,064	53,178,064	100.00
2007/08	7,453,205,999	74,532,060	1.00	4,408,738	1,102,184	25.00	1,977,471	988,735	50.00	122,421,536	122,421,536	100.00
2008/09	9,757,195,136	97,571,951	1.00	10,669,326	2,667,331	25.00	683,784	341,892	50.00	117,882,680	117,882,680	100.00

Annex 1(d)

Nepal HBL Bank Limited

Loan Loss provision maintained by Nepal HBL Bank

Year	Pass loan(PL)			Sub-standard loan (SL)			Doubtful loan (DL)			Bad loan (BL)		
	P L	Provision for PL	%Provision for PL	B L	B L	B L	D L	Provision for DL	%Provision for DL	B L	Provision for BL	% Provision for BL
	1	2	3=2/1*100	4	5	6=5/4*100	7	8	9=8/7*100	10	11	12=11/10*100
2004/05	3,937,074,298	46,887,392	1.19	89,285,664	23,315,201	26.11	61,821,433	30,910,717	50.00	138,659,304	138,959,304	100.22
2005/06	4,144,846,125	49,521,539	1.19	121,498,598	27,225,697	22.41	166,868,350	87,053,186	52.17	138,580,134	123,639,748	89.22
2006/07	4,762,590,360	44,776,860	0.94	1,116,600	149,480	13.39	69,303,360	33,535,080	48.39	275,401,498	263,919,410	95.83
2007/08	5,886,791,147	55,863,325	0.95	11,912,170	2,494,642	20.94	6,515,490	1,020,691	15.67	422,589,350	414,128,352	98.00
2008/09	7,393,297,710	70,841,219	0.96	1,797,016	318,214	17.71	3,842,595	1,121,298	29.18	499,697,308	495,361,697	99.13

Annex: 1(b)

Loan loss provisioning of Nepal Investment Bank Ltd

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2004/05	2005/06	2006/07	2007/08	2008/09
Pass loan	1% of pass loan	1.72	1.63	2.26	1.00	1.00
Sub-standard loan	25% of sub-standard loan	25.00	25.00	25.00	25.00	25.00

Doubtful loan	50% of doubtful loan	50.00	50.00	50.00	50.00	50.00
Bad loan	100% of bad loan	123.78	100.00	100.00	100.00	100.00

Annex: 1(d)

Loan loss provisioning of Nepal HBL Bank Ltd

Types of loan	Requirement as per directives	Loan loss provision by the bank				
		2004/05	2005/06	2006/07	2007/08	2008/09
Pass loan	1% of pass loan	1.19	1.19	0.94	0.95	0.96
Sub-standard loan	25% of sub-standard loan	26.11	22.41	13.39	20.94	17.71
Doubtful loan	50% of doubtful loan	50.00	52.17	48.39	15.67	29.18
Bad loan	100% of bad loan	100.22	89.22	95.83	98.00	99.13

Annex 2 (b)

Nepal Investment Bank Limited

Calculation of Performing assets to Total Asset, Total Lending & Total Deposit

Year	Total assets	Total Lending	Total Deposit	Performing	% of PA	% of PA	% of PA

				assets	to TA	to TL	to TD
	T.A (1)	T.L.(2)	T.D. (3)	P.A. (4)	(4/1*100)	(4/2*100)	(4/3*100)
2004/05	6,607,170,724	4,044,228,431	5,466,609,805	4,001,840,315	60.57	98.95	73.21
2005/06	8,052,209,125	5,049,581,309	6,694,963,060	4,938,390,206	61.33	97.80	73.76
2006/07	9,608,570,861	6,095,841,087	8,063,902,086	5,991,076,718	62.35	98.28	74.30
2007/08	11,732,516,418	7,900,090,271	10,097,690,989	7,771,282,526	66.24	98.37	76.96
2008/09	15,959,284,687	10,136,254,448	13,802,444,988	10,007,018,658	62.70	98.73	72.50
				Summation	313.19	492.13	370.73
					62.64	**98.43**	**74.15**

Source: Annual Reports of concern bank fiscal year 2004/05 to 2008/09

Annex 2 (b)

Calculation of Non-Performing assets to Total Asset, Total Lending & Total Deposit

Year	Total assets	Total Lending	Total Deposit	Non Performing assets	% of NPA to TA	% of NPA to TL	% of NPA to TD
	T.A (1)	T.L.(2)	T.D. (3)	N.P.A. (4)	(4/1*100)	(4/2*100)	(4/3*100)
2004/05	6,607,170,724	4,044,228,431	5,466,609,805	42,388,116	0.64	1.05	0.78
2005/06	8,052,209,125	5,049,581,309	6,694,963,060	111,191,103	1.38	2.20	1.66
2006/07	9,608,570,861	6,095,841,087	8,063,902,086	104,764,369	1.09	1.72	1.30
2007/08	11,732,516,418	7,900,090,271	10,097,690,989	128,807,745	1.10	1.63	1.28
2008/09	15,959,284,687	10,136,254,448	13,802,444,988	129,235,790	0.81	1.27	0.94
				Summation	5.02	7.87	5.95
					1.00	**1.57**	**1.19**

Source: Annual Reports of concern bank fiscal year 2004/05 to 2008/09

Annex 2 (d)

Nepal HBL Bank Limited

Calculation of Performing assets to Total Asset, Total Lending & Total Deposit

Year	Total assets	Total Lending	Total Deposit	Performing assets	% of PA to TA	% of PA to TL	% of PA to TD
	T.A (1)	T.L.(2)	T.D. (3)	P.A. (4)	(4/1*100)	(4/2*100)	(4/3*100)
2004/05	7,021,141,146	4,584,394,939	5,572,470,018	4,294,628,538	61.17	93.68	77.07
2005/06	7,566,326,661	4,795,837,227	6,522,816,631	4,368,890,145	57.74	91.10	66.98
2006/07	8,440,405,808	5,531,833,738	7,198,327,428	5,186,012,280	61.44	93.75	72.04
2007/08	10,345,373,370	6,739,347,218	8,654,774,244	6,298,330,207	60.88	93.46	72.77
2008/09	13,035,839,124	8,241,456,544	11,002,040,633	7,736,119,625	59.35	93.87	70.32
				Summation	300.58	465.85	359.18
					60.12	**93.17**	**71.84**

Source: Annual Reports of concern bank fiscal year 2004/05 to 2008/09

Annex 2 (d)

Calculation of Non-Performing assets to Total Asset, Total Lending & Total Deposit

Year	Total assets	Total Lending	Total Deposit	Non Performing assets	% of NPA to TA	% of NPA to TL	% of NPA to TD
	T.A (1)	T.L.(2)	T.D. (3)	N.P.A. (4)	(4/1*100)	(4/2*100)	(4/3*100)
2004/05	7,021,141,146	4,584,394,939	5,572,470,018	289,766,401	4.13	6.32	5.20
2005/06	7,566,326,661	4,795,837,227	6,522,816,631	426,947,082	5.64	8.90	6.55
2006/07	8,440,405,808	5,531,833,738	7,198,327,428	345,821,458	4.10	6.25	4.80
2007/08	10,345,373,370	6,739,347,218	8,654,774,244	441,017,011	4.26	6.54	5.10
2008/09	13,035,839,124	8,241,456,544	11,002,040,633	505,336,919	3.88	6.13	4.59
				Summation	22.01	34.15	26.24
					4.40	**6.83**	**5.25**

Source: Annual Reports of concern bank fiscal year 2004/05 to 2008/09

Nepal Investment Bank Limited

Year	**Performing Assets**	**Non Performing Assets**

	Pass loan	PL/TL x 100	Restructed Loan	RL/TL*100	Sub-standard Loan	SL/TL*100	Doubtful loan	DL/TL*100	Bad Loan	BL/TL x 100	Total Loan
2004/05	4,001,840,315	98.95		0.00	15,732,509	0.39	13,328,276	0.33	13,327,331	0.33	4,044,228,431
2005/06	4,938,390,206	97.80		0.00	41,954,709	0.83	38,055,772	0.75	31,180,622	0.62	5,049,581,309
2006/07	5,991,085,718	98.28		0.00	110,822,572	1.82	40,494,733	0.66	53,178,064	0.87	6,095,841,087
2007/08	7,453,205,999	94.34	318,076,527	4.03	4,408,738	0.06	1,977,471	0.03	122,421,536	1.55	7,900,090,271
2008/09	9,757,195,136	96.26	249,823,522	2.46	10,669,326	0.11	683,784	0.01	117,882,680	1.16	10,136,254,448
Sum	**32,141,717,374**	485.64	**567,900,049**	6.49	**183,587,854**	3.20	**94,540,036**	1.78	**337,990,233**	4.53	**33,225,995,546**
Average		**97.13**		**3.25**		**0.64**		**0.36**		**0.91**	

Annex 3 (c)

Annex 3 (d)

Nepal HBL Bank Limited

Year	Performing Asset				Non Performing Asset						
	Pass loan	PL/TL*100	Restructed Loan	RL/TL*100	Sub-standard Loan	SL/TL*100	Doubtful loan	DL/TL*100	Loss Loan	BL/TL*100	Total Loan
2004/05	3,937,074,298	85.88	357,554,240	7.80	89,285,664	1.95	61,821,433	1.35	138,659,304	3.02	4,584,394,939
2005/06	4,144,846,125	86.43	224,044,020	4.67	121,498,598	2.53	166,868,350	3.48	138,580,134	2.89	4,795,837,227
2006/07	4,762,590,360	86.09	423,421,920	7.65	1,116,600	0.02	69,303,360	1.25	275,401,498	4.98	5,531,833,738
2007/08	5,886,791,147	87.35	411,539,060	6.11	11,912,170	0.18	6,515,490	0.10	422,589,350	6.27	6,739,347,217
2008/09	7,393,297,710	89.71	342,821,915	4.16	1,797,016	0.02	3,842,595	0.05	499,697,308	6.06	8,241,456,544
Sum	**26,124,599,640**	435.46	**1,759,381,155**	30.39	**225,610,048**	4.70	**308,351,228**	6.22	**1,474,927,594**	23.23	**29,892,869,665**
		87.09		**6.08**		**0.94**		**1.24**		**4.65**	

ANNEX 4(b)

Calculation of Karl person's correlation coefficient between ROA and NPA of Everest Bank Limited

X = Net Profit to Total Assets (ROA)

Y = NPA to Total Lending (NPA)

Fiscal Year	X	Y	X2	Y2	XY
2004/05	1.29	1.04	1.6641	1.0816	1.3416
2005/06	1.17	2.2	1.3689	4.84	2.574
2006/07	1.49	1.7	2.2201	2.89	2.533
2007/08	1.45	1.6	2.1025	2.56	2.32
2008/09	1.5	1.27	2.25	1.6129	1.905
Sum	ΣX = 6.9	ΣY = 7.81	ΣX^2 = 9.6056	ΣY^2 = 12.9845	ΣXY = 10.6736

Karl Person's correlation coefficient (r)

$$= \frac{N.\Sigma XY - \Sigma X.\Sigma Y}{\sqrt{N.\Sigma X^2 - (\Sigma X)^2}.\sqrt{N.\Sigma Y^2 - (\Sigma Y)^2}}$$

$$= \frac{5 \times 10.6736 - 6.90 \times 7.81}{\sqrt{5 \times 9.6056 - (6.90)^2}\sqrt{5 \times 12.9856 - (7.81)^2}}$$

$$= \frac{-0.521}{1.2811} \qquad = -0.41$$

Probable error (P.E.) = $\frac{0.6745(1 - r^2)}{\sqrt{n}}$

$$= \frac{0.6745\{1 - (-0.41)^2\}}{\sqrt{5}}$$

$$= \frac{0.5630}{2.2361} \qquad = 0.2518$$

ANNEX 4(d)

Calculation of Karl person's correlation coefficient between ROA and NPA of Nepal HBL Bank Limited

X = Net Profit to Total Assets (ROA)

Y = NPA to Total Lending (NPA)

Fiscal Year	X	Y	X2	Y2	XY
2004/05	0.58	6.32	0.3364	39.9424	3.6656
2005/06	0.64	8.9	0.4096	79.21	5.696
2006/07	0.72	6.25	0.5184	39.0625	4.5
2007/08	0.55	6.54	0.3025	42.7716	3.597
2008/09	0.9	6.13	0.81	37.5769	5.517
Sum	ΣX = 3.39	ΣY = 34.14	ΣX^2 = 2.3769	ΣY^2 = 238.5634	ΣXY =22.9756

Karl Person's correlation coefficient (r)

$$= \frac{N.\Sigma XY - \Sigma X.\Sigma Y}{\sqrt{N.\Sigma X^2 - (\Sigma X)^2}.\sqrt{N.\Sigma Y^2 - (\Sigma Y)^2}}$$

$$= \frac{5 \times 22.9756 - 3.39 \times 34.14}{\sqrt{5 \times 2.3769 - (3.39)^2}\sqrt{5 \times 238.5634 - (34.14)^2}}$$

$$= \frac{-0.8566}{3.2716} \qquad = -0.26$$

Probable error (P.E.) = $\frac{0.6745(1 - r^2)}{\sqrt{n}}$

$$= \frac{0.6745[1 - (-0.26)^2]}{\sqrt{5}}$$

$$= \frac{0.6283}{2.2361} \qquad = 0.2810$$

Calculation of Karl person's correlation coefficient between Total Lending and Total NPA of Nepal Investment Bank Limited

X = Total lending of Bank

Y = Total NPA of Bank   Amount in 10 million

Fiscal Year	X	Y	X2	Y2	XY
2004/05	404.42	4.24	163555.54	17.98	1714.74
2005/06	504.96	11.12	254984.60	123.65	5615.16
2006/07	609.58	10.48	371587.78	109.83	6388.40
2007/08	790.01	12.88	624115.80	165.89	10175.33
2008/09	1036.62	12.92	1074581.02	166.93	13393.13
Sum	ΣX = 3345.59	ΣY = 51.64	ΣX^2 =2488824.74	ΣY^2 =584.28	ΣXY = 37286.75

Karl Person's correlation coefficient (r)

$$= \frac{N.\Sigma XY - \Sigma X.\Sigma Y}{\sqrt{N.\Sigma X^2 - (\Sigma X)^2}.\sqrt{N.\Sigma Y^2 - (\Sigma Y)^2}}$$

$$= \frac{5 \times 37286.75 - 3345.59 \times 51.64}{\sqrt{5 \times 2488824.74 - (3345.59)^2}\sqrt{5 \times 584.28 - (51.64)^2}}$$

$$= \frac{13667.50}{17852.21} \qquad = 0.77$$

Probable error (P.E.) = $\frac{0.6745(1 - r^2)}{\sqrt{n}}$

$$= \frac{0.6745\{1 - (0.77)^2\}}{\sqrt{5}}$$

$$= \frac{0.2792}{2.2361} \qquad = 0.1248$$

ANNEX 5 (d)

Calculation of Karl person's correlation coefficient between Total Lending and Total NPA of Nepal HBL Bank Limited

X = Total lending of Bank

Y = Total NPA of Bank   Amount in 100 million

Fiscal Year	X	Y	X2	Y2	XY
2004/05	45.84	2.9	2101.31	8.41	132.936
2005/06	47.96	4.27	2300.16	18.2329	204.789
2006/07	55.32	3.46	3060.3	11.9716	191.407
2007/08	67.39	4.41	4541.41	19.4481	297.19
2008/09	82.41	5.05	6791.41	25.5025	416.171
Sum	ΣX = 298.92	ΣY = 20.09	ΣX^2 = 18794.6	ΣY^2 = 83.56	ΣXY = 1242.49

Karl Person's correlation coefficient (r)

$$= \frac{N.\Sigma XY - \Sigma X.\Sigma Y}{\sqrt{N.\Sigma X^2 - (\Sigma X)^2}.\sqrt{N.\Sigma Y^2 - (\Sigma Y)^2}}$$

$$= \frac{5 \times 1242.49 - 298.92 \times 20.09}{\sqrt{5 \times 18794.6 - (298.92)^2}\sqrt{5 \times 83.56 - (20.09)^2}}$$

$$= \frac{207.161}{256.284} \qquad = 0.81$$

Probable error (P.E.) = $\frac{0.6745(1 - r^2)}{\sqrt{n}}$

$$= \frac{0.6745\{1 - (0.81)^2\}}{\sqrt{5}}$$

$$= \frac{0.2338}{2.2361} \qquad = 0.1046$$