EFFECT OF NON- PERFORMING LOAN IN COMMERCIAL BANKS

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CERTIFICATION OF AUTHORSHIP

I certify that the work in this thesis has not previously been submitted for a degree nor has it been submitted as part of requirements for a degree as full acknowledged within the text.

I also certify that the thesis has been written by me. Any help that I have received in my research work and the preparation of the thesis itself has been acknowledged. In addition, I certify that all information sources and literature used are indicated in the reference section of the thesis.

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RECOMMENDATION LETTER

I recommended that the dissertation prepared "Effect of non-performing loan in commercial banks" prepared by Sushil Koirala has been completed under my supervision for partial fulfillment of the requirements for the degree of master of management. I hereby forward it for approval.

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ABSTRACT

Effect of non- performing loan In Commercial Banks is representative vision of the reality. Main thrust of the present study is to identify the relationship between non-performing loan and profitability of the commercial banks, to examine the effect of loan loss provision on profitability of commercial banks and to analyze the effect of loan and advances on profitability of commercial banks

The research design of this study is descriptive as well as analytical. Global IME bank, Nepal Investment Bank ltd and Agricultural Development Bank ltd. The study has financial as well as statistical tools used to make analysis easy and reliable.

Commercial banks are the backbone of the economic development of the country which flow the capital from various part of the country to deficit unit as an intermediary and ultimately promote and finance the industries, business, infrastructures and other welfare of the citizens. It collects the deposits from the surplus customer units and provide to those who are in need. Its service range and scope of activities are in wide range hence able to earn large profit.

The borrowers may or may not have reliable purpose that bankers surely believe the fund is going to be used in productive and regular earning sectors. Some borrowers may misuse the fund, and some may face the situation of bankruptcy though their intentions are not bad. Anyway the fund borrowed by the clients ceases to bring timely interest and principal to the bank stops cash inflows is known as non-performing loans (NPL) which is not good for banks performance efficiency. The problem should be minimized by the banks at the initial stage.

The study also reveals that in Nepal, NPL has negatively effect on the profitability indicators. So it will reduce investors interest towards the bank may reduce the goodwill of the banks. The bankers should be aware in time before it becomes a serious phenomenon for ruin the liquidity position and adverse effect on the profitability more than it. The remedial actions from the side of banks are mentioned as follows.

The risk assessment associated with the loans and advances by carefully knowing the customers, their attitude, income level and past regression analysis. Recovery agency should be established by the banks and financial institutions to decentralize the responsibility of the credit recovery from the borrower systematically. Motivating

clients by awarding the 'best loan performer of the year' by the bank that may encourage the others too. Main protection to be taken into consideration for this problem is to landed loans and advances safely by keeping worthy collateral against loan amount. Corporate governance is also a proactive action to prevent the fraud activities done by staffs, officers and other concerned members. Regular collection of credit information from credit information department and borrower also provide awareness for taking a corrective action. Lastly, even if the NPL has occurred in bank, it should be managed properly by keeping sufficient level of provision to recover its loss to maintain the liquidity at sufficient level.

There is statistically significant negative relationship between ROE and NLTTLR and statistically significant positive relationship of PMR with TLTTAR. The relationship of non-performing loan with profitability is negative. Higher the non-performing loan (NLTTLR) lower will be the ROE represents profitability ratio. Higher NPL ceases the interest earning to the bank and hence decrease net income and retained earning leads to the decrease in return to shareholder equity. From all regression models, there is no relationship of PLLCR with the

Profitability ratios but the correlation analysis of individual banks reveals that GIBL has positive relationship of PLLCR with PMR. There is positive relationship of loan and advances with PMR that is revealed by TLTTAR has significant positive relationship with PMR. Similarly, loans and advances negatively effect on ROE of the commercial banks. The loan and advances that invests in unproductive sectors can't generate satisfactory return that might also increase loan default.

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ABBREVIATIONS

ADBL	:	Agriculture development bank Ltd
AQ	:	Assets quality
B.S.	:	Bikram Sambat
BFIs	:	Banks and Financial Institutions
CA	:	Capital adequacy
CDM	:	Central Department of management
Dr.	:	Doctor
GIBL	:	Global IME bank Ltd
NI	:	Net income
NIBL	:	Nepal Investment Bank Ltd
NLTTLR	:	Non-performing Loan to Total Loan Ratio
NPA	:	Non-performing assets
NPL	:	Non-performing loan
PLL	:	Provision for loan loss
PLLCR	:	Provision for Loan loss coverage ratio
PMR	:	Profit margin ratio
Pro.	:	Professor
ROA	:	Return on assets
ROE	:	Return on equity
T.U.	:	Tribhuvan University
TL	:	Total loan
TLTTAR	:	Total loan to total assets ratio