

1. Background of the study:

In Nepal banking sector is flourishing in past few decades. Banking sector plays an important role in the growth of the economy. Commercial banks are those financial intermediaries that transfer the fund from surplus unit to deficit unit. Commercial banks are major supplier of fund. Bank act as a interface between borrower and supplier. It accepts deposit from public and supply loan to public. It gathers the scattered fund from the economy and mobilizes in productive sector. In the course of transaction heavy amount is invested in loan by commercial bank. Interest income is the major source of revenue for commercial. Sixty to seventy percent of operating income occupies interest income. In this regard default loan is major threat to commercial bank. Banking sector is exposed to number of risk such as interest risk, market risk, liquidity risk, credit risk, operation risk and so on. Among them credit risk is the major one. The risk of non-payment of loan leads to credit risk.

Non-performing loan is the sum of borrowed money upon which the debtor has not made schedule payment for at least three month. The delay in payment could be either interest or principle and can be both. Non-performing loan is categorized in three types. They are substandard loan, doubtful loan, and bad loan. The classification is done on the basis delayed time period. Non- performing is the real economic cost for commercial bank because they cannot use the fund in productive sector and repayment of deposit is disturbed. It also results in additional cost for realization of non-performing loan.

The figure of non –performing loan brings threat for commercial bank.. Heavy chunk of money is utilized in giving loan. As the return from loan is higher commercial banks are more concentrated in loan management. Commercial bank has flourished the investment in Nepalese economy. Heavy amount of investment is done by commercial bank. They formulate sound investment policies which support for the growth of the economy. It is vital role of bank to manage the loan so that they can invest properly. The major risk from non-performing loan is credit risk, liquidity risk, operating risk, earning risk, reputation risk, solvency risk, and legal risk.

Loan occupies the greater portion in the assets side of balance sheet .loan is the risky assets. The major reason behind non-performing loan is poorly managed loan portfolio. Non-performing loan reduces the liquidity of bank, credit expansion, and growth of the

economic activities and along with performance of bank. Non-performing loan can even erode the existing capital. (Sherpa, 2016)

As per the rule laid down by Nepal Rastra Bank those loan whose payment has not been received for 3 months or more is treated as NPL. As the over dues goes on provision of 25%, 50%, and 100% of loan amount is separated and it is treated as expenses and allocation of loan is reduced from capital. More impact of NPL is that the assets are not able to generate future income. It increases the opportunity loss to the bank. Similarly it increases the economic cost for bank to recover the money. It causes to decrease in employee morale, bank's image, and shareholder expectation. (NRB, 2010)

There is no standard form to define non-performing loans globally. Variation may exist in terms of the classification system, the scope, and contents as per country. Nepal Rastra Bank (the Central Bank of Nepal), as a regulatory financial institution of the country, has classified the loan basically into the pass loan, sub-standard loan, doubtful loan and loss or bad loan. Pass loan is that type of loan whose interest or principal payments are less than three months in arrears. Sub-standard loans whose interest or principal payments are longer than three months in arrears of lending conditions are eased. Doubtful is liquidation of outstanding debts appearing uncertain and the accounts suggest that there will be a loss, the exact amount of which cannot be determined. Loss loans are regarded as not collectable, usually loans to firms which applied for legal resolution and protection under bankruptcy laws. Pass loans are under the category of performing loans whereas sub-standard loan, doubtful loan and loss loan are under the non-performing loans (NRB, 2012). The amount of non-performing loan is one of the indicators of its performance. Less the NPL, better the financial health of the economy. If the non-performing loan is more, there will be poor financial health and crisis may result in the economy. In the past before 2001, Nepal bank limited and RBBL nearly collapsed. The main reason behind it was the non-performing loan in a larger chunk of over fifty percent. Because of which NRB with the support of IMF and World Bank adopted a reform program (Ahikary et al., 2007).

Non-performing loan carries significant threat to commercial bank as it can erode the capital. NPL management is the top priority of bank. The study is conducted to examine the non-performing loan of commercial bank with reference to Nabil Bank Limited and Everest Bank Limited. There are twenty eight commercial banks and the study is conducted with reference to two banks.

2 Statement of the Problem.

Commercial bank being the financial institutions plays significant role by collecting deposit and lending these fund in the productive sectors as lending and investment. Economic development of the country is directly related to the volume of investment made and return obtained by the bank. Due to lack of experts to analyze the risk and return of investment and maintain optimum portfolio investment problem has become very serious for the least development country like Nepal.

Due to home war lots of infrastructures had been destroyed. Nepalese commercial banks have been facing the problem of investment in manufacturing sector. The loans are not serviced in time and there is a risk of non-recovery of principle as well, therefore most of commercial banks have switched its portfolio in less risky government securities and non-fund base loan like L/C. This has significant impact in economic growth. This has stopped economic activities in country causing reduction in Gross Domestic Product and declining employment opportunity. It impacts there may be social disorder in the country.

There is increase in the number of commercial bank during the past decade. Different regulatory measure has been made by central bank for the effective performance of the commercial bank. However, actual performances of banks have not been enhanced. The major problem faced by commercial bank these days are competitive environment, limited investment opportunities, inadequate deposits, challenge to maintain authorized capital, non-performing loan and so on. Non-performing loan is increasing in bank's balance sheet. Granting loan against insufficient deposits, loan against undervalued collateral, ineffective credit monitoring and political pressure to the lender are the major reason behind the increasing non-performing loan. Liquidity risk, credit risk, operation risk, lost investment opportunities are some of the implication of non-performing loan.

The study is conducted to get the answer of the following question

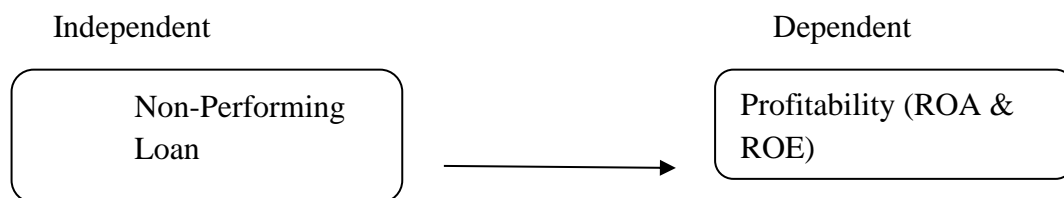
- What is the trend of Non-performing loan of selected bank?
- What is the overall effect of NPL on selected bank profitability?

3. Objective of the study.

The major objective of the study is to examine the non-performing loan of Everest Bank limited and Nabil Bank limited. The specific objectives of the study are:

- To examine the trend of Non-performing loan of selected bank.
- To investigate the impact of non-performing loan on financial profitability of selected bank.

4. Conceptual framework



Loan policies are believed to influence default of loans to a great extent. Well formulated loan policies are believed to have inversely proportional relationship with loan default. Whereas poor loan policies are believed also to have directly proportional relationship with loan default. Loan appraisal is prepared by credit service official. A credit appraisal deal with the approval of loan to appraisal defines whether the loan will be non-performing or not. Credit department should verify whether the documents given by customer are accurate and confidential. It can be ascertained from the above mentioned that initial loan appraisal includes the core five ingredients of loan appraisal. This comprise of tests on accuracy, collaterals, honesty, capacity and cash flow to determine loaner's credit worthiness and the probability of loans default.

5. Significance of the Study.

Commercial bank have huge amount of money invested in loan. Loan compromises heavy chunk in the assets side of bank's balance sheet. The source of revenue is generated from loan's interest. In this regard non-performing loan bring prominent threat to bank. Non-productive loan increases the non-performing loan. There can be high probability of loan loss provision. The possible threat from non-performing is credit risk, liquidity risk, operation risk, and overall effect on financial performance. With this regard, this research is conducted to examine the present issue of non-performing loan in selected bank.

This study will be beneficial to the shareholder, depositor, borrower, and other creditor to identify the productivity of their bank in Everest bank and Nabil bank limited. The report will be beneficial to identify the effectiveness of credit department and the selected course of action that bank has undergone to overcome the non-performing loan issues. This report will be helpful for the other organization interested in making these banks as a trading partner. Financial analyst, who is interested in the performance of these banks, would be grateful.

This comparative study will also be helpful to the management of bank to analyze the non-performing assets management and policies of the bank in comparison of these two banks. This study can be helpful in foundation of improved policies. With the help of this report bank can analyze the effectiveness of their credit department. This report could be equally helpful for the central bank for the amendment in policies.

6. Limitations of the Study.

The limitations of study are as follows:

- i) The time Period of study is limited from fiscal year 2008/09 to 2017/ 18.
- ii) The whole study is based on secondary data such as audited financial statement of both banks.
- iii) This study is concerned only the issue of Non-performing Loan management in Nepalese Commercial banks.

7. Literature Review.

Non-Performing Loans (NPLs) are regressed on three sets of factors in terms of credit, banks size induced risk preference and macroeconomic shocks (NSOBILLA, 2015). The report concluded based on the empirical results that NPLs have a negative statistically significant influence on the financial performance in the selected banks. This signifies that the greater the NPL, the lower the profit of the selected rural banks. The liquidity risk was not statistically significant. The nonperforming loans and cost-income ratio had a negative influence on financial performance whereas total revenue and loan recovered had a positive effect on financial performance.

(Brose, 2016) Published an article on the study of non-performing loan and its impact on return on assets of major Indian commercial bank. The study concluded on the moderately negative correlation between NPL and ROA. This means that increase in

NPL negatively affects the ROA. The study concluded that NPL is more affecting the public sector bank in India. Professor Brose says that effective credit monitoring; complying with the rule of monetary policy, computerization, and maintaining database could be the possible solution to reduce NPL.

Non-performing loans are defined as those financial assets from which banks no longer receive interest and/or installment payments. They referred to as non-performing because the loan ceases to generate income for the bank. (Choudhury, 2002) Has defined that Non-performing loan is not a single concept and it can be broadly defined. NPL can be classified into three parts such as substandard loan, doubtful loan, and Bad debt according to the time of being default.

A study by (Golcha, 2007) highlighted the NPA's of Nepalese finance sector. In his views the NPA's of three bank (NBL, RBB, NIDC) are highly discussed and published. After analyzing the report we can find that these banks had high figures in Non-performing loan and more amounts has been declared as loan loss provision. These banks are still operating the loan account despite having high figures in non-performing loan. It has led negative impact for business venture to operate transaction with these banks. The reason behind NPA's behind for these bank are ineffective credit monitoring and careless for credit policies.

Timilsina, (2017) focused about the determinant of commercial banks lending practices. Commercial banks constitute a major chunk of total assets in the banking system in Nepal and extension of credit is one of the major functions of banking institutions. If banks are not efficient in their lending behavior, it may not contribute to economic growth. On the other hand, their inefficient and imprudent banking practices may lead to riskier financial instability. The study has also focused about the lending practices and its effectiveness in lowering the non-performing loan.

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Commercial banks are affected by the vicious circle of non-performing loan. The major factor leading to non-performing loan are improper credit appraisal system, ineffective credit monitoring system, over valuation of collateral and political pressure to lender. Setting up recovery cells, effective laws to recover bad loans, and hiring asset Management Company can be some measure to recover non-performing loan. Pandey, (2016).

8. Research Methodology.

8.1. Research Design.

The research designed used for the study is comparative research design. It aims to explain the non-performing loan of selected commercial bank. The present facts and figure are collected. It uses the scientific method of collecting, classifying, and analyzing of data. Comparative analysis of selected bank helps to compare the result of two banks.

8.2. Population and sample

There are 28 commercial banks in Nepal. All the commercial banks operating in Nepal constitute the population of the study. Among them two bank, Everest Bank.ltd and Nabil bank.ltd are selected for study. Five year data are taken for the study.

8.3. Sources of data.

The Study is basically based on secondary data. Following are the secondary sources of data:

- Annual reports, newsletter, brochures etc of the concerned banks
- Relevant laws guidelines and directives of NRB
- Text books regarding the subject matter
- Articles published in newspapers, Journals, magazine etc.
- Unpublished thesis and dissertation related to subject matter.
- Various reports published by NRB, CIB etc

8.4. Data collection & Processing Procedure

The data collection from various sources are recorded systematically and presented in appropriate forms of tables and charts and appropriate mathematical, statistical, financial, graphical tools are applied to analyze the data. And data of five consecutive of the two selected banks are used to meet the objective of the study.

8.5. Data analysis tools and techniques

The data analysis will be done using statistical tools and financial tools.

Financial tools: The financial tools used in the study are trend analysis and ratio analysis.

A. Ratio Analysis

I. NPL ratio

Nonperforming loans are defined as loans overdue for more than 90 days. The NPL ratio measures the effectiveness of a bank in receiving repayments on its loans.

$$\text{Non – performing loan ratio} = \frac{\text{Non – performing loan}}{\text{loan}} * 100\%$$

II. Return on Assets

The Return on assets measures the overall effectiveness of management in generating profit with its available assets. The higher the firm's return on assets the better it is doing in operation and vice versa.

$$\text{Return on aassets} = \frac{\text{Net profit}}{\text{Total assets}} * 100\%$$

III. Return on Equity

The return on equity (ROE) measure the return on the owner's investment in the firm. Higher ratio of return on equity is better for owner.

$$\text{Return on equity} = \frac{\text{Net profit}}{\text{equity}} * 100\%$$

B. Trend analysis is used to show the changes in values of non-performing loan, loan and assets in different time period.

Statistical tools

I. Arithmetic mean

The mean is the arithmetic average of a variable. Arithmetic Mean of a series given by:

$$\text{Mean } (\bar{X}) = \frac{\sum X}{N}$$

Where, $\sum X$ = Sum of the variable 'X' and N = No. of observation

II. Standard Deviation (S.D)

Standard Deviation (S.D) is the most popular and the most useful measure of dispersion. It includes the ranges and size of deviance from the middle or mean. It measures the absolute dispersion. Higher the value of standard deviation higher is the variability and vice versa. It is the positive square root of average sum of squares of deviations of observations from the arithmetic mean of the distribution. It can be calculated as follows:

$$\text{Standard Deviation } (\sigma) = \sqrt{\frac{\sum (X - \bar{X})^2}{N}}$$

III. Karl Pearson Correlation coefficient is used under statistical tools.

The Karl Pearson's coefficient of correlation measures the degree of linear relationship between two variables. Let X and Y be two variables, the Karl Pearson's coefficient of correlation between X and Y is defined as:

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

The value of 'r' always falls between -1 to +1.

If, $r = 0$, there is no relation between the variables.

If, $r < 0$, there is negative relation between the variables.

If, $r > 0$, there is positive relation between the variables.

- IV. Regression is the statistical method that is used to predict the value of the dependent variable on the base of the independent variable.

9. Chapter plan

Chapter I: Introduction

The first chapter provides the background information of the study, focus of the study, statement of the problem, objectives of the study, significance of the study and limitations of study. Therefore, this chapter provides summary of overall study.

Chapter II: Review of Literature

Review of literature is very important part of every research. This chapter includes conceptual review, review of previous works (like, review of articles in journals, previous theses) and research gap.

Chapter III: Research Methodology

This chapter constitutes the methodology adopted to conduct the study, data analytical techniques, and processes. This chapter also contains research design, population and sample, sources of data, data collection methods and statistical tool.

Chapter IV: Result

This chapter is major part of the study, which is concerned with presentation, data analysis, interpretation of the data and sum up of result.

Chapter V: Conclusion

This chapter includes the discussion, conclusion and implication for the study.

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**A STUDY ON NONPERFORMING LOAN MANAGEMENT
OF COMMERCIAL BANKS IN NEPAL**

A Thesis Proposal

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