

CHAPTER-1

INTRODUCTION

1.1 Background of the study

Financial sector of any economy plays a vital role in its development and are currently viewed as catalyst in the process economic growth of a country .This sector is the backbone of developing county like Nepal .This sector has been gradually developed from the time of economic liberalization in Nepal. There is no doubt that a sound financial system will certainly boost the pace of development.

Financial sector of Nepalese economy is composed of two sectors i.e. banking sector and non-banking sector. Banking sector means which purely provides banking facilities like different range of short term and long term loans, collection of deposits(short term/long term), remittance service, LC etc. whereas Non Banking sector means which mainly does activities of deposits and loans and advances on narrow basis. Banking sector of Nepal comprises of Nepal Rastra Bank, Commercial banks and development banks. Nepal Rastra Bank is apex body of all financial institutions of Nepal. The establishment of Commercial Banks has reached unto 26 in Nepalese economy and there are a lot more commercials Banks to come in recent time. Non-Banking sector of Nepal mainly includes finance Companies, Cooperative units, micro credit development Banks, non government organization performing limited Banking transactions.

Financial sector in Nepalese economy is a symbol of customary organization, where other sector's organization portrays to be like that .Financial sector represents competition, transparency, financial discipline and self-governance. The main activity of financial sector is to play on interest rate whether it is on deposits or loans and advances. Besides this, it has to deal with statutory reserve

requirement, targeted credit programs, securities, trading insurance services, practice like maintaining capital adequacy, loan loss provisions, auditing etc.

Financial sector is a system on which whole body of an economy stands. It is applicable to any type of economy whether it is developing or developed. Furthermore, it also supports other sector. It works as lubricant for other sectors to grow. Financial intermediaries are gap fulfiller that bridges between borrower and lender or saver and investor. Financial intermediaries come up with different avenues to accept money of savers and provide to investors at competitive price to flourish.

A sound financial system fulfill requirement of all types of customers. In developed economy, financial institutions have to come with varieties of products and services so that all needs of particular economy can be fulfilled. Effectiveness and efficiency are key element for financial sector to survive in any economy. Moreover, any activity must be within a boundary line of central bank of that country or regulating body. Financial sector has to provide interest on its deposits therefore, has compulsion to lend money. Then, there is an issue of defaulter case.

Commercial Banks collect deposits from the public and the largest portion of the deposited money is utilized in disbursing loans and advances. The balance sheets of the commercial banks reflect deposits constitute a major portion of the liabilities and loans and advances constitute a major portion of the assets. Similarly the profit of the Bank depends upon the spread that it enjoys between the interest it receives from the borrowers and is paid to the savers. An average Bank generates 65-75% of its revenues through its lending activities. The return that the bank enjoys through loans and advances is very attractive but do not come free of cost and free of risk. There is risk inherent in lending portfolio. Banking sector is exposed to number of risk like interest rate risk, liquidity risk, credit risk, borrower's risk etc. Such risks in excessive form had led many banks to go bankrupt in a number of countries.

One of the most critical risks is the borrower's risk-The risk of non-payment of disbursed loan and advances. Failure to collect money lent may sometimes results in the banks in ability to make repayment of money to depositors and returned to the shareholders and stakeholders. The risk involved is so high that it can bring bank to a verge of Bankruptcy. The bankers have the responsibility of safeguarding the interest of the depositors, the shareholders and the society they are serving. If the bank behaves irresponsibility, the cost borne by the economy will be enormous.

Due to their central role in the economy, governments and central banks try their best to rescue bank from such situations. Hence, to protect the banks from such situation and protect the depositors and shareholders money, central bank issues various directives and guidelines from time to time with modifications and amendments for the sound regulation of banking system. All the banks have to abide by the rules and regulations issued by the central bank. Out of many directives, there are ten directives relating to the banking prudential regulation/ nerves to be followed by banks.

Financial institutions in Nepal are growing in an unexpected manner and no doubt they will compete for each other's market share and provide cut throat competition in the market. In this scenario, default rate is automatically going to increase either intentionally or unintentionally. Therefore, it is one of the greatest concerns for financial intermediaries to handle such issue. This default is technically known as non performing assets (NPA). This default may be on principle, interest on principle and interest. It is normally not received on maturity period.

1.1.1 Brief History of Evolution of Banking

The Lombards, who were originally from plains of Lombardy of Northern Italy, introduced banking practice to England. This Lombards brought this business to the city of London and their home, The Lombard Street, is still the center of British Banking. The Lombards, after a century or so off business in London, were eventually bankrupted because they lent money to kings who did not repay them.

After the Lombards, Banking was practiced by the Goldsmith as a sideline to their normal activities in the bullion and jewellery fields. The early goldsmith used to have large vaults, which were soundly built and heavily guarded. The person who deposited surplus funds with the goldsmith became as a “Depositor” and naturally paid for the privilege of having his money defended this way. These payments were called “Bank Charges”. The depositors who needed funds to pay wages or debts, could call at the bank and collect such sums as required.

In the East. It is believed that banking was practiced at the time of “Manu” as referred to in Manusmriti. There is an opinion that at the time of “Chanakya” also it was in practice, as banking has been mentioned in “Kautilya’s Arthasastra” which is the first book in economics. In the West, the history of banking begins in ancient Greece, Rome and Mesopotamia.

However as a public enterprise, banking made its first beginning around the middle of the twelfth century in Italy. The Bank of Venice, founded in 1157 was supposed to be the most ancient bank. Bank of Barcelona and the Bank of Geneva in 1401 and 1407 respectively followed. Subsequently Bank of Amsterdam set up in 1609, which was very popular then. The Bank of Venice and the Bank of Geneva continued to operate until the end of Eighteenth century. With the expansion of commercial banking activities in Northern

Europe, there sprang of a number of private banking houses in Europe and slowly spread throughout the world.

1.1.2 Banking System in Nepal

Nepal is one of the landlocked countries in Asia covered by the UN ESCAP region and is among the least developed of the developing countries. Landlockedness is the major geographic weakness that became the main hindrance in overall development of Nepal. 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 a long time it tendered a good service to government servants as well as to the general public. If we turn into the history, prime minister “Ranodip Singh” took initiative for financial and economic reforms. He introduced “Tejarath Adda” to provide credit facilities to general public at a very low rate. Basically concept of “Tejarath Adda” was to provide loan by undertaking collateral of gold and silver. Government employees have facilities to take loan and that loan was slowly redeemed from their salary. Furthermore, successive Prime Minister Chandra Shamsheer extended its service to outside Kathmandu valley. Legal provisions were made to prevent the practice of capitalization of Tejarath Adda. This step was towards modern banking in Nepal. But concept of “Kaushitosh Khana” brought by King Prithvi Narayan Shah was also step towards modern banking in Nepal.

Tejarath Adda was only subjected to provide loans to general public. It did not accept deposits .At one point of time it faces financial crisis and failed to meet demand of general public. Prior to the establishment of Nepal Bank Ltd, borrowers totally relied upon crooked lenders, who charged very high interest rates and other charges. Beside this, these money lenders also undertake valuable collateral in form of land, building, and precious metal. Nepal Bank Ltd came into existence under the Nepal Bank Act 1937.The prelude of the Nepal Bank Act 1937 states the objectives of setting up the Nepal Bank ltd as follows.

“In the absence of any Bank in Nepal, the economic progress of the country was being hampered and causing inconvenience to the people, and therefore, with the objectives of fulfilling that need by providing services for the people and for the betterment of the country. This law is hereby promulgated for the establishment of the Bank and its operation.”

Nepal Bank was the first Bank to play dual role as commercial Bank and central Bank. Till the establishment of Nepal Rastra Bank, Nepal Bank Ltd. carried out all the functions of Central bank. Nepal Bank Ltd was semi government Bank so it unwilling went to many sectors in spite of banking service needs. Because of this purpose, Rastriya Banijya Bank a fully government owned Bank was established on 23rd January 1966.

Till 1984, Nepalese financial sector was dominated by two commercial banks i.e. Rastriya Banijya Bank and Nepal Bank Ltd. The Commercial Bank act was amended in 1984 to increase growth of commercial Banks in order to provide Banking services to the needed sector. There was also provision for foreign investors to open commercial Banks in Nepal. In consequence, Nepal Arab Bank Ltd (Nabil Bank) was established on July, 1984, with the partnership of Dubai Bank Ltd, Dubai.

Before 1985 two Developed Banks i.e. NIDC and ADB were the Non-Banking financial institutions. Employees Provident Fund and National Insurance Corporation were established to increase the financial activities of the country. Finance Company Act 1985 was introduced which brought some 79 Financial Institutions in this country.

1.1.3 Brief Introduction of Commercial Bank

Commercial Bank Act 1974 defines, “A commercial Bank means Bank which deals in exchanging currency, accepting deposits, extending loans and doing commercial transactions”. Commercial Banks pools scattered fund and channels it to productive use. Banks undertaking business with the objective of earning

profits are Commercial Bank. Commercial Banks can be of various forms such as Deposits Banks, Saving Banks, Industrial Banks, Mixed Banks, Exim Banks etc. Commercial Banks render a variety of services. In absence of commercial Banks, it would have been impossible to meet the financial needs of the country.

A Commercial Bank is a type of financial intermediary and a type of Bank. After the Great Depression, the U.S. Congress required that Banks only engage in banking activities, whereas Investment Banks were limited to capital market activities. Since the two no longer have to be under separate ownership, some use the term “Commercial Bank” to refer to a Bank or a division of a bank that mostly deals with deposits and loans from corporations or large businesses.

Though the commercial Banks were established with the concept of supplying short term credit and working capital need of industries, they have been providing long-term loans for up to 15 years. After the enforcement to lend in priority and deprived sector, these Banks initiated to provide credit to small and cottage industries, Agriculture and Services. NRB has a provision of refinance facility also for such loan provided to priority and deprived sector including export credit. Having observed the success on NABIL Bank Ltd. Due to liberal economic policy in 1990, many commercial Banks were established. The Table No 1 shows the list of licensed commercial Banks as of Mid April 2008.

1.1.4 Brief Profile of the Selected Banks

Nabil Bank Limited (NABIL)

Nabil Bank Limited formerly named as Nepal Arab Bank Limited was established on July 12th 1984 under a technical service agreement with Dubai Bank Limited, Dubai, which was later merged with Emirates Bank, UAE. The share of Emirates Bank sold its share to “National Bank Ltd., Bangladesh” which was again transferred into “NB International, Ireland. It is the pioneer

joint venture Bank of Nepal. NABIL is the only joint venture Bank with 25 points of representation in various parts of the country.

Share Holding Pattern

NB International Limited, Ireland	50%
Local Financial Institution	20%
Nepalese Public	30%

NABIL is amongst the most successful Bank in Nepal registering strong growth. The initial capital of Rs 30 million has grown to Rs 2588 million (core capital and supplementary capital) as of mid April 2008. NABIL launched its operation with the marketing concept. NABIL has also been a pioneer in introducing modern Banking and innovative products in Nepal like working capital & Project financing, Trade finance, priority & deprived sector (financing or refinancing), mortgage loan, personal lending, remittance products & card products (Credit and debit card) etc. NABIL is the Banker to a multitude of International Aid Agencies, Non-Government Organization, Embassies and Consultants in the country. NABIL has been providing wide range of banking services to various parts of the society. NABIL Bank ranks among the top three financial institution in Nepal in terms of market share of handling Nepal's trade. NABIL Bank is being managed by a team of qualified and highly experienced professionals. There are altogether 427 permanent employees working in the Bank. (Annual Report 2007/08).

The Bank has total accumulated deposit of Rest 23,342 million and the investment of the Bank in form of loan and advances were Rs 15,903 million in the fiscal year 2007/08. Similarly, the total profit of the Bank in the same period was Rs 674 million. The NPL of the Bank in the Year 2006/07 was recorded at 1.12% against loan and advances.

Table No 1.

**Key Financial Of Nabil Bank as of Third quarter of F/Y 2007/08
(12/04/2008)**

Deposit	22,527 million
Loan and Advances	20,817 million
Profit	531 million
NPA against total loan	1.30%

Nepal Investment Bank Ltd. (NIBL)

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Limited, was established on 21 January 1986 as a third joint venture Bank between Nepalese and French Partners under the Company act, 1964.

The French partner holding (holding 50% of the capital) was Credit Auricle Indosuez, a subsidiary of one of the largest Banking groups in the World. With the decision of Credit Auricle Indosuez to divest, a group of companies comprising of Bankers, professionals, Industrialists and businessmen, in April 2002, acquired 50% of the holding of Credit Auricle Indosuez in Nepal Indosuez Bank. The name of the bank was changed to Nepal Investment Bank Ltd., upon approval of Bank's annual general meeting, Nepal Rastra Bank and company's registered office.

NIBL is headquartered in Kathmandu and as altogether 18 branches in different urban and semi urban parts of the country .The capital (core & supplementary capital) of the Bank is noted Rs.2, 550 million as of mid-april, 2008.

The main objective of the bank is to provide loans and advances to the agriculture , industries and commerce and to provide modern Banking services to the people.

The shareholders structure of the Bank comprises of :

- A group of companies holding 50% of the capital
- Rastriya Banijya Bank holding 15% of the capital
- Rastriya Beema Sanstha holding 15% of the capital
- The general public holding 20% of the capital

Performance review

Total accumulated deposit in the Bank was Rs.17,769 million and the investment of the Bank in form of loan and advances were Rs .24,488 million in the fiscal year 2007/08. Similarly, the total profit of the Bank in the same period was Rs.501 million. The NPL of the bank in the year 2007/08 was recorded at 2.37% against loan and advances .The brought level from 2.37% to 1.36% in the first 3rd quarter of fiscal year 2007/08.

Table No. 2

Key financial of NIB as of third quarter of F/Y 2007/08 (12/04/2008)

Deposit	30,468 million
Loan and advances	26,437 million
Profit	475.55 million
NPA	1.36%

Nepal Bangladesh Bank Ltd. (NBBL)

Nepal Bangladesh Bank Ltd., was established in June 1994 under the Company Act , 1964, with an authorized capital of Rs. 240 million and Paid up capital of Rs. 60 million as a joint venture Bank with IFIC Bank Limited of Bangladesh . Its Head Office is situated in Kathmandu.

The prime objective of this bank to render Banking services to the different sectors like Industries, traders, businessmen, priority sector, small entrepreneurs and weaker section of the society and every other people who need banking services. During the period of 10 years of its operation, it has accommodated a large number of clients and has been able to provide excellent services to its clients. With a network of 17 branches and a corporate office, the Bank commands the largest network amongst the joint venture commercial banks in Nepal. The bank has introduced its first ATM facility at Kathmandu Plaza, Putali Sadak Branch to give 24 hours and 365 days banking services to their valued customers.

Even being one of the joint venture banks of the country, the financial health of the bank was found ill. Due to its ill health, NRB, central bank of the country, had taken over its management under their custody & control and has been appointed management team to restructure the Bank's performance for one year contract.

Two month after the takeover of the management of financially-troubled NBBL by Nepal Rastra Bank, had successfully results. According to NRB, "The interim management had able to recover Rs 700.3 million during these last two months. The non-performing asset level has been reduced to 34 percent from an earlier 41 percent," said the coordinator of the management team. The central bank intervened in the NB Bank mid-November, 2007 and took over the management to avoid a possible financial catastrophe, and deputed a four-member management team to run the bank. Following, exposure of the bank's difficult financial position, NB Bank saw a run on bank resulting massive withdrawal. In the last two months, Rs. 463.30 million was recovered from loan investment and Rs. 237 million from NB Group.

Later, NRB handed over its management to a separate professional banker's management team to minimize the previous back log. The contract is being

matured on June 2008 and renewal of the contract for further one year is expected.

Share Holding Pattern

NB International Limited, Ireland 50%

Local Financial Institution 20%

NEPALESE PUBLIC 30%

Performance Review:

Total accumulated deposit in the bank was Rs. 9464 million and the investment of the Bank in the form of loan and advances were Rs. 5855 million in the fiscal year 2007/08. Similarly, the total profit of the bank in the same period was Rs. 393 million. The NPL of the bank in the year 2007/08 was recorded at 38.19% against loan and advances.

The bank has lowered its NPL level from 38.19% to 37.60% in the 3rd quarter of this current fiscal year (2007/08).

Table No. 3

Key financial of NBBL as of third quarter of F/Y 2007/08 (12/04/2008)

Deposit	9,656 million
Loan and Advances	6,379 million
Profit	542 million
NPA	37.60%

1.2 Focus of the study

A sound financial system plays an important role in economic development and reduction of poverty in a developing country like ours by creating a pool of resources, reducing cost of capital, minimizing risks, expanding and diversifying opportunities and increasing the efficiency of resources used. It not

only reduces the transaction cost but also interfaces with sound corporate governance. A healthy financial sector is crucial for attracting foreign capital as it creates confidence among the investors.

Financial institution is subjected to provide following activities like deposits, loans and advances, securities, insurance policies, corporate bonds and shares etc. The main earning of financial institutions is from loans and advances but all these loans are not paid in time and those uncovered loans are termed as **non-performing Assets (NPA)**. A high level of NPA is a serious burden to the financial system and to the economy as well. So, high level of NPA leads to the bank to the high bank risk. There are probably many reasons behind high level of NPAs. Sometimes it arises due to the external factors such as decrease in the market value of the collaterals, deterioration in the borrower's repayment capacity and economic slowdown. Sometimes, it is caused by the borrower's misconduct and sometimes by the weakness in internal management practices of the Bank, credit extended to non-viable projects and ineffective credit monitoring and supervision system.

NRB plays major role for protecting financial institutions from financial distress that automatically safeguard depositor's interest and ensure stability in the economy. NRB issues directives from time to time for overall controlling of financial institutions. As per the directives, commercial banks are supposed to categorize disbursed loans into four different categories on the basis of ageing of its past dues. Each category passes certain percentage of its loan to provisioned amount for probable loss. So, the level of this provisioned amount has direct impact upon profitability and performance of commercial banks. The higher this amount, the lower is expectation of net profit to the bank.

NPA and loan loss provision is one of the major concerns to solve this on timely basis, otherwise indirectly or directly it will certainly cost to Banks and even to economy. The financial institutions may become distracted with additional efforts required to manage these problem loans.

In this situation, financial institutions may lose sight of their core activities. In the light of the possibility of huge write offs on loan a loss, credit risk is calculated at the higher side. This phenomenon will certainly affect activities of financial intermediaries. These will definitely obstacle growth of financial institutions and economy as well. The economy will be affected because productive units will not get credit access that will hamper development process. Therefore, the level of NPA should be kept at the minimum level and the Banks should manage to even minimize and make the target to make it zero.

1.2.1 NPA(Non Performing assets) in Present Context

In our context, credits need to be classified in to four categories, namely pass, substandard, doubtful & loss. Out of these classifications, the loan of the last three categories is called non-performing assets. In other words , all loans classifies as substandard, doubtful & loss categories are called NPA(Non Performing assets/loan).Based on this, when the loan is classified as substandard due to non-payment of interest or installments for 3 months, it is converted into NPA. In banking business, all are normally exposed to credit risk. NPA is not fully avoidable in the Banking industry. However, it must be kept at a minimum level as far as possible. At the same time the possible loss must be provided immediately.

In spite of the internal conflict in the country, Nepal experienced substantial growth in credits during past five years. Table No 2 shows that the growth on credit substantially reduced the average level of NPA percentage, while total volume of NPA remains almost the same where it was five years back.

Table No: 4**Total NPA level of the commercial Banks****Figures in billion**

Year	Total Loan	NPA Amount	NPA %
2001	100.19	29.35	29.29
2001/02	103.13	31.36	30.41
2002/03	111.90	32.09	28.68
2003/04	127.06	28.93	22.77
2004/05	148.37	27.88	18.79
2005/06	188.31	26.77	14.22
2006/07	221.31	20.69	9.35
Mid April 08	271.19	20.37	7.52

The internationally acceptable level of NPA is said to be less than 5% on total loan and advances. The private sectors Bank have grown up with the improved/modern banking practice and it has enhanced Banking culture. The same culture applied in the credit operation and it enables to manage their credit with possible stringent manner in most of the private sector Banks. However, all private sector Banks are not at par which have been seen from the above table. Even private sector Banks are also carrying their NPA up to almost 38.19% of their credit portfolio.

1.3 Statement of The Problem

Although financial institution is the backbone or engine of the growth of economy of Nepal, it has several problems like lack of smooth functioning of economy, different policies and guidelines of Nepal Rastra Bank, political instability, security problem, poor information system, over liquidity caused by lack of good lending opportunities, increasing non-performing assets etc. Out of these problems, NPA is one of the serious problems faced by the commercial Banks. So every Bank has now put the NPA management under top priority. It is because; the NPA in the Banking system does not generate adequate revenue

for the Bank, reduces the profitability and ultimately may **lead** to the failure of the Bank. So, in the recent days, not only government owned Banks but some of the Banks under private ownership are also suffering from NPA burden. This question regarding to NPA with special reference to Nabil Bank Ltd., Nepal Investment Bank Ltd and Nepal Bangladesh Bank Ltd. is stated below.

- What is the impact of NPA on the profitability in the selected commercial Banks?
- What is the proportion of NPA in selected Commercial Banks?
- What is the level of NPA in total assets, total deposits and loans and advance in selected Commercial Banks?
- What are the trend line of the non-performing assets, loan and advance, loan loss of selected Commercial Banks?

1.4 Importance of the Study

The study has its own significances in various perspectives. These perspectives are as follows:

- This study will be helpful in providing some of the present issues, latest information and data regarding the NPA of the selected Commercial Bank
- This study also gives the real picture of the current nonperforming assets to its stakeholders.
- The study will be helpful for the Banking industry to identify and to trace the contributing factors causing NPA and to reduce its level.
- This report will be helpful for regulating authority to know existing recovery problem so as to have some modification of directives, laws and other proceeding.
- This report may also be helpful in providing information to future researchers in overcoming the problems that they may face while doing research in the similar type of the research work.

1.5 Objective of the Study

General objectives of this study are to analyze and identify the impact, cause and consequences of nonperforming loan. Besides this, there are some specific objectives that are listed below:

- To find the impact of NPA on the profitability in the selected Commercial Banks.
- To know the proportion of NPA in the selected Commercial Banks.
- To examine the level of NPA in total assets, total deposit and loans and advances.
- To present the trend line of the non-performing assets, loan and advance, loan loss of selected Commercial Banks.

1.6 Limitation of the Study

This research is subject to certain limitations as stated below:

- The research focuses only on the non-performing assets of Nepalese Commercial Banks. So various other aspects of the Banks remain unexplored.
- The period of the study is limited from fiscal year 2004/2005 to 2007/2008.
- Due to time, resources and financial constraints, some of the issues are ignored.
- The another limitation of this study is that, this study is mainly based on secondary data, interviews, published books, unpublished reports, public documents, annual reports of the selected Banks, articles of different writers and so on.

CHAPTER –TWO

REVIEW OF LITERATURE

In this chapter effort has been made to examine and review some of the related books, article published in different economic journals, bulletins, dissertation papers, magazines, newspapers and websites. The literature review shares the reader the results of other studies that are closely related to the study being reported and to the larger, outgoing dialogue in the literature about a topic, filling in gaps and extending prior studies. It also provides a framework for establishing the importance of the study, as well as a benchmark for comparing the results of a study with other findings. In brief, this chapter includes review of following:

- 2.1 Conceptual/Theoretical Review
- 2.2 Review of Books
- 2.3 Review of Relevant NRB Directives
- 2.4 Review of Relevant Articles/Journals
- 2.5 Review of Previous Relevant Thesis
- 2.6 Research Gap

2.1 Conceptual/Theoretical Review

Under This heading the concept and meaning of some of the terms used in the study has been discussed.

2.1.1 Loans, Discounts and Overdrafts (LDO)

Commercial Bank's main function is to create credit from its borrowed fund. The Bank doing so converts its liability into active asset. Loans and advances are the assets coming from such activities. Loans and advances dominate the asset side of the balance sheet of any bank and also constitute the primary sources of income to the banks. They are also the least liquid of the Bank's entire

asset. Loans and advances may take different forms and are allowed against various types of securities .Loans, overdrafts, discounting bills of exchange etc are some of the forms of Bank's lending. Granting loans and advances always carries a certain degree of risk. This loans and advances are also regarded as risky assets of banks.

2.1.2 Loan Classification

Loan classification refers to the process that banks use to review their loan portfolio and assign loans to categories or grades based on the perceived risk and other relevant characteristics of loans and as pr guidelines of central banks. The process of continual review and classification of loans enables banks to monitor the quality of their loan portfolios and when necessary to take remedial action to counter deterioration in the credit quality of their portfolios. In most of the countries, a number of days a past due payments represents a minimum condition for loan classification purposes. However some criteria which exhibit forward looking features are also considered. In the context of Nepal, as per guidelines of NRB, loans are classified into four categories namely Pass, Substandard, Doubtful and Loss.

2.1.3 Past Due/Overdue

An amount due under any credit facility is treated as past due or overdue when is has not been paid on the due date fixed by the bank.

2.1.4 Performing Assets (Loans)

Performing Loans are those loans that repay principle and interest timely to the bank from the cash flow it generates. In the context of Nepal, the loans classified as "Pass" category is termed as performing loan.

2.1.5 Non-performing Assets/Loans (NPA/NPL)

These loans do not repay principle and interest timely to the bank. NPL has many different meanings, which varies from country to country. In some countries, non-performing loans means, the loan is impaired. In some countries, it means that the payments are past due, but there are significant differences among countries how many days a payment should be in arrears before past due status is triggered. Nevertheless, a rather common feature of NPL appears to be that a payment is more than 90 days past due. In Nepal also, if the loan is past due for over 3 months, it is non-performing loans. Hence the loans falling under Substandard, Doubtful and Loss categories are regarded as Non-performing loans.

2.1.5.a. Reason behind high level of NPL

The following points are the important factors that contributed for creating NPA and retention of high level of NPA for long period of time.

- Inadequate project appraisal
- Inadequate mitigation of credit risks (especially for new project)
- Lack of internal control and credit operation.
- Lending on unviable project
- Inadequate equity injection
- Poor credit monitoring
- External factors (business failure to conflict and some other reasons.)
- Not limiting concentration risks.

2.1.5.b. Loan Loss Provision

Loan loss provision is the accumulated fund that is provided as a safeguard to cover possible losses upon classification of risk inherited by individual loans. There is risk inherent in every loan. Hence provisioning is made as cushion against possible losses and to reflect the true picture of the Bank's asset. Hence

there is practice of showing net loan (Total Loans - Loan Loss Provision) in financial statements. The amount of loan loss provision is directly correlated to total credit of the Bank. The amount required for provisioning depends upon the level of NPAs and their quality. High amount of provision is an indication of that Bank's credit portfolio needs serious attention. One percent provision of total credit is an ideal position as it is the minimum requirement for all good loans. In Nepal, 1%, 25%, 50%, & 100% provisioning should be made for Pass, Substandard, and Doubtful and Loss loans respectively.

2.1.6 Why Loans go bad.

Below mentioned are the major reasons that gets loan into bad loans.

1. Lack of Credit policy and culture:

While dispensing credit, commercial Banks have to thoroughly examine the inherent risk elements in a credit proposal in line with their credit policy. This contains the risk to manageable level and also ensures that the Bank does not fall into an assets liability mismatch position. In order to safeguard Bank's assets with respect to market situation a clear cut written credit policy is must in every financial institution. Policy guides the institution to diversification on its own priorities and its portfolios with emphasis on highest quality. Credit culture decides behaviors of credit team. If behavior of credit team is not aligned with institution's priorities, then the credit culture of the institution is worthless. Credit culture also reflects institution's system and procedure. A good credit will definitely help in attainment of management priorities with minimum errors.

2. Risk Management Strategy:

There are so many risks associated with a lending. An extensive list of risk is given below. Most of the time of the Bankers of our society tend to compromise in analyzing all the risks properly and then loan turns into bad.

Some risks can be measured with the help of mathematical credit tools; however, some risks like regulatory, defalcation risks are quite difficult to measure and therefore needs in depth examination before finalizing a loan.

<u>Characteristics</u>	<u>Risk Class</u>	<u>Risk Category</u>
1. Environment	Environment Risk	(a) Legislative Risk (b) Economic Risk (c) Competitive Risk (d) Regulatory Risk
2 .Human Resources	Management risk	(a) Defalcation Risk (b) Organizational Risk (c) Ability Risk (d) Compensation Risk
3. Financial Service	Delivery Risk	(a) Operational Risk (b) Technological Risk (c) New Product Risk (d) Strategic Risk
4 .Balance sheet	Financial Risk	(a) Credit Risk (b) Liquidity Risk (c) Interest Rate Risk (d) Leverage Risk (e) International Risk

3. Know Your Customer (KYC)

KYC is the modern mantra in the Banking practices which needs to be followed strictly weather it is deposit or lending. If we don't know our customer in terms of his capacity, managerial ability, past track record, market reputation, business background, then the loan extended to such customer may get default and attract NPA (Non performing assets) at any time.

4. Lack of proper Financials

One of the common and serious problem of the market is that most of the borrowers do not furnish the financials or even if furnish genuine or authentically of the information is questionable. This results difficulty in analyzing various risk associated. Due to this Bankers of our market are forced

to make name/security based lending, whereas financial based lending system is the only tested and proved system of lending.

5. Stiff Competition and size of the market

The mushrooming financial institution has created stiff unhealthy competition amongst the institution on the one hand and other hand the size of the market in proportion to the number of institution has not increased. Rather, in recent years some international and national events have shirked the Nepalese market. No sign of improvement is observed, instead problems seems aggravating. Having this, the customers have been taking advantage of above situation and taking loan from more than one Banks showing common security. This is called multiple Banking which is a common problem being faced by commercial Bank. Competition is indispensable in an open economy and it cannot be avoided. However, atmosphere of healthy completion can be created by dissemination information amongst the financial instruction.

6. Undue influence

One of the major factors contributing for bad loan is undue influence exerted by politician, bureaucratic and sometimes even by members of the board and seniors executives of the Bank itself. The list of the factors contributing bad loans are many more apart from enumerated above. It is not possible to address all of them in short time.

2.1.7 Challenges

1. Market

As said above market situation of the country is worsening which is likely to increase bad loans. Recent categorization of some industries as “sick” is likely that performing units will also turn into NPA s. Further, the present market situation should untidily come forward with innovative ideas of expansion of the market.

2. Amendment of Relevant law:

Under the present legal system, financial institutions are spending years and years to realize the values of assets securitized with them by borrowers by way of auctions. Whenever, auction of securitized assets is initiated, the borrowers are taking undue advantage of buying pretty long time due to poor legal system, in order to curb this situation, relevant laws need amendments in such a way that the documents executed by the borrowers in favor of financial institutions be treated as “proven debts” unless the elements of mollified intention on the part of borrowers is apparent.

3. Credit Information Bureau (CIB)

Present legal status of CIB needs immediate change, as in some cases, decision of CIB blacklisting some defaulting borrowers has been reserved by the court. It has also been observed time and again that financial institutions themselves tend to ignore the spirit of disseminating information with CIB. Therefore, CIB should be established under a separate act as a nonprofit making organization and every financial institution should be its member compulsory. Any institution not cooperating with CIB should be penalized. This will help in disseminating information amongst the financial institutions.

4. Control and monitoring.

One of the factors for growing bad loans is weak control and monitoring of a borrowing account institutions. Control and monitoring of borrowing accounts starts right from appraising the loan request and ends up on settlement of loan in full. Therefore, credit and monitoring job is a regular process of every financial institution. The loan does not go bad at once, initially some symptoms of sound healthiness (warning signs) on loan accounts surface, and if the situation is not addressed, it is for sure that loan will turn into bad. Some of the system as follows:

- Excessive use of demand of funds over and above the agreed limits.
- Pending settlement of government or preferential creditors and authorities.
- Loss of sales or sales proceeds not coming to financial institutions.
- Erosion of the values of stocks or security of dead stocks.
- Several lines of credit from the other lenders which, if fully utilize, could make the level of funding unacceptable.
- Failure to meet orders.
- Reliance on one consumer /suppliers.
- Unmanageable diversification of business.
- Request for release of securities, especial guarantee.
- Delays in coming cash.
- Two businesses in one set of premises.
- Management changes, etc.

2.2 Review of Books

(Bhuwan Dahal and Sarita Dahal: 2000) in their book “A Hand Book to General Banking” have dealt with difficult aspects of Banking. As per their view, Bank has gained paramount trust in the public and they are rendering wide range of services covering different strata of society.

“A Bank is judged on the basis of Capital, Assets quality, Management, Earning, Liquidity and Sensitivity to market risk (CAMEL). Almost all the government Banks are running at loss. Though almost all the private sector Bank are showing profit, it is very difficult to call them sound if appraised from CAMELS approach. Some Banks have very low Capital Adequacy Ratio (CAR) while some Banks have piled up Non Performing Assets (NPA s). Similarly Banks don’t have proper system in place for management of market risks. The people have been raising question over the correctness of credit classification and provisioning of some Bank. Should the suspicion come true, it will prove very costly to the depositors, creditors and national economy as a

whole. It would be prudent to advise NRB to strictly implement its recently introduced directive so that other Banks avert the fate of NBL, RBB & NIDC. (Bhuvan Dahal and Sarita Dahal, 2002:21).

They stated that loans and advances dominate the assets side of the balance sheet of any Bank and earnings from such loans and advances occupy a major space in income statement. “Most of the Banks 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 or default risk. Performing loan has multiple benefits to the society while non-performing loan erodes even existing capital. If loan is given to viable project not only lenders and borrower but also the whole society gets benefit but society loses its scarce capital if loan is given to project while is not viable.”

As per their view, there is risk inherent in every loan and efforts should be made to have proper control in every step of loan management. They further suggested that Bank should not take risk above certain degree irrespective of returns prospects. “Though all the loans are good at the time of disbursement, with the passage of time, they show the sign of problem. Based on the health of his loan, the loan should be classified and provided accordingly. Provisioning is made as cushion against possible losses and to reflect the true picture of Bank’s assets. Hence there is practice of showing net loan (Total Loan-Loan Loss Provision) in financial statements. The Bank should comply with the statutory regulation relating to loan classification and provisioning.”

(Shakespeare Vaidya) in his book “Project Failures and Sickness in Nepal, Challenges to investors for Investment Risk Management” has discussed about the early warning system for investment risk management. In this book, the author has also envisaged number of examples about crisis create by the Banks in the world. As per his view, banking sector cannot ignore any sector of the economy on the basis of its good and bad and there is vital role of financial institutions in regard to bad accounts.

“Nepalese financial institutions have made significant progress especially during this decade, although they are still far behind the development markets. In spite of having great risk management i.e. focused on collateral rather than on project, credit culture is a new aspect both to the investors and corporate. Unless we have a credit culture, they will end up nowhere. How to identify a good Bank? Huge deposits, high technology, strong marketing, broad branching network etc? Finally we arrive the point-collection of the loans, on the whole, private sector. Banks have lower nonperforming assets (NPAs) than their public sector counterparts. NPAs are the loans that cannot be or haven't been recovered. The government owned Banks suffer acutely from this, as they have to lend to various priority sectors, at the whims of their political masters and then forget everything about the money forever.”

With the growing number of financial institutions, market economy, economic liberalization etc. industrial sickness in Nepal has phenomenal proportions in the last few years. Much of the amounts of almost all leading financial institutions are blocked in sick company, which can be witnessed from the auction notice published regularly in newspaper. Credit risk is the first risk, which keeps the Bank moving in the market. The loans provided against the securities are simply a promise to pay. When borrowing customer fails to make part or all of their promised interest and principal payments, these defaulted loans and securities result in losses that can eventually erode Bank's capital. Because owner's capital is usually no more than ten percent of the volume of loans and risky securities, and often much less than that, it cannot absorb too many defaults on loans and securities before bank capital simply becomes inadequate to absorb further losses. At this point .the Bank fails and will close unless the regulatory authorities elect to keep it afloat with government loans until a buyer can be found or until the Bank becomes viable by reducing its nonperforming assets.

“Banks and financial institution invoke penal measure when an installment of a term loan is defaulted. This is simply a Banking procedure to offend the

borrowers in case of default; however it is not the complete panacea for project failures. The follow up machinery to enquire into the reason for the default is generally slow in movement or maximum time would have already been consumed when banks normally acknowledge the failure of the projects. The consequence is that by the time, lending institution is able to ascertain the causes for the first default, more installment are overdue.

Delays in implementation schedule, cost escalation in mid stream, inadequate cash generation or siphoning of fund are few of the factors responsible for default. A lending institution unless, it has an effective monitoring system, may miss these signs of potential sickness. The first default should be ample evidence that something is out of order and the term lending institution should take immediate steps to review the position in detail before go out of hand”

Finally he concludes “In order to safeguard the Banks from the financial crisis likely to be arise from the project failures and sick units, that is, non performing loans, the government needs to do a number of things and fast. It must bring broad rules for poor financial institution, transferring bad loans to bridge bank or loan recovery agency, removes many non-performing loans from even healthier bank’s balance sheets, beef up regulation, supervision and disclosure, improve ability to banks to sell collateral that backs secured loans , and recapitalize the Banking system.”

2.3 Review of Relevant NRB Directives

NRB issues various directives relating Banking regulations and prudential norms. Among various directives issued in 2001 directives No. 2 is relating to loan classification and provisioning.

Directives relating to loan Classification and Provisioning (Directive No.2)

Effective FY 2058/59 (2001/02), Banks shall classify outstanding loan and advances on the basis of again of principal amount into the following 4 categories.

Pass

Loans and advances whose principal amount are not past due and past due for a period up to 3 (Three) months shall be included in this category. These are classified and defined as performing loans.

Substandard

All loans and advances which are past due for a period of 3 months to 6 months shall be included in this category.

Doubtful

All loans and advances which are past due for a period of 6 months to 1(one) year shall be included in this category.

Loss All loans and advances which are past due for a period of more that 1 (one) years as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

Loans and Advances failing in the category of Sub-standard, Doubtful, and loss are classified and defined as Non-performing Assets (loan)

Table no. 5**Time table of Loan Classification**

Classification	
Pass	Loan not past due and past due up to 3 (three) months.
Sub-standard	Loan and advances past due for a period of over 3 months to 6 months.
Doubtful	Loan and advances past due for a period of over 6 months to 1 years
Loss	Loan and advances past due for a period of over 1 years

The respective overdue periods of pass, Sub-standard and Doubtful loans shall be considered for higher classification from the next day of date of expiry of the overdue period provided for each class.

Additional arrangement in respect of Pass Loan

Loans and advances fully secured by gold, silver fixed deposit receipts and HMG securities shall be included under "Pass category. However, where collateral of fixed deposit receipt of HMG securities or NRB Bonds is placed as security against loan for other purposes, such loan has to be classified on the basis of ageing. Loans against FDRs (Fixed deposits receipts) of other Banks shall also qualify for inclusion under pass loan.

Additional arrangement in respect of "Loss" Loan

Even if the loan is not past due, loans having any or all of the following discrepancies shall be classified as 'Loss'.

- a) NO security at all or security that is not in accordance with the borrower's agreement with the Bank.
- b) The borrower has been declared Bankrupt.
- c) The borrower is absconding or cannot be found.
- d) Purchased or discounted bills are not realized within 90 days from the due date.
- e) The credit has not been used for the purpose originally intended.
- f) Owing to non-recovery initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation.
- g) Loans provided to the borrowers included in the blacklist and where the credit information Bureau blacklists the borrower.

Note: Bills purchased/Discounted are to be classified into Loss loan where they are not realized within 90 days from due date. This is departure from the normal classification rules applicable to other loan, accordingly, it Bills would have only two classification Viz. Pass and Loss.

Additional arrangement in respect of term loan.

In respect of term loan, the classification shall be made against the entire outstanding loan on the basis of the past due period of overdue installment.

For Contingent Items

In the events of conversion of contingent liabilities of the Bank e.g. LC or immature Guarantee into the liabilities of the Banks such amount becomes recoverable from the customers and such amounts also has to be classified as per the classification norms applicable to loan and advances and accordingly be provided with required provisioning.

Loan Loss Provisioning

The loan loss provisioning, on the basis of the outstanding loan and advances and bills purchases classified as per this directives, shall be provided as follows:

Classification of Loan	Loan Loss provision
Pass	1%
Substandard	25%
Doubtful	50%
Loss	100%

Note: Loan loss provision for loan is known as "General Loan Loss Provision" and Loan loss provision set aside for non performing loan is defined as "Specific loan loss provision"

Where the Banks provide for loan loss provisioning in excess of the proportion as required under the directives of NRB, the whole amount of such additional provisioning may be included in General Loan Loss provision under the supplementary Capital.

Additional provisioning in the case of Personal Guarantee Loans

Where the loans is extended only against personal guarantee, a statement of the assets, equivalent to the personal guarantee amount not climbable by any other shall be obtained . Such loans shall be classified as per above and where the loans fall under the category of Pass, substandard and doubtful, in addition to the normal loan loss provision applicable for the category , and additional to the normal loan loss provision applicable for the category, and additional provision by 20-percentage point shall be provided. Classification of such loan and advances shall be prepared separately.

Classification of Loan	Loan Loss Provision
Pass	21%
Substandard	45%
Doubtful	70%
Loss	100%

Rescheduling and restructuring of Loan

In respect of Loans and advances falling under the category of substandard, Doubtful or Loss, Banks may reschedule or restructure such loans only upon receipt of a written plan of action from the borrower citing the following reason.

- a) The internal and external caused contributing to deterioration of the quality of loan
- b) The reduced degree of risk inherent to the borrower/enterprise determined by analyzing its balance sheet and profit and loss account in order to estimate recent cash flows and to project future ones, in addition to estimate recent cash flows and to project future ones, in addition to assessing market conditions.
- c) Evidence of existing of adequate loan documentation.
- d) An evaluation of the borrower/enterprise's management with particular emphasis on efficiency, commitment and high standards of business ethics.

Loan Loss provisioning in respect of rescheduled, restructured or swapped loan

- a) Except for priority sector, in respect of all types of rescheduled or restructured or swapped loan, if such credit falls under pass category according to NRB directives, loan loss provisioning shall be provided at minimum 12.5%
- b) In case of rescheduling or restructuring or swapping of insured or guaranteed priority sector credit, the loan loss provisioning shall be provided at one fourth of the percentage mentioned in clause (a) .
- c) In respect of swapped loans, the Bank accepting the loans in swapping has to provide loan loss provision classifying the loan under the same classification as were existing. The Bank accepting the loan in swapping shall obtain certification from the concerned Bank of financial institution.

Provisioning Against Priority Sector Credit

For uninsured priority sector credit full provisioning shall be made but for insured priority sector credit provisioning shall be 25% of the percentage of normal classification. This is because DCGC bears 75% of the loan amount in case of defaults.

Classification of Loan	Loan Loss Provision
Pass	0.25%
Substandard	6.25%
Doubtful	12.50%
Loss	25.00%

(For Rescheduled /Restructured loan of Priority Sector)

Classification of Loan	Loan Loss Provision
Pass	3.125%
Substandard	
Doubtful	
Loss	

Note: In case of rescheduling, restructuring or swapping of insured or guaranteed priority sector credit, the proportion of loan loss provision would be 3.125% (being 25% of 12.5%)

2.4 Review of Relevant Articles /Journals

"Modus Operandi of Risk Appraisal in Bank Lending"

(Shiba Raj Shrestha) Executive Director of NRB in his article titled as above has tried to highlight different aspects of credit risk management. As per his view, as the effective risk management is central to good Banking the tradeoff between risk and return is one of the prime concerns of any investment decision whether long-term or short-term. He concludes, "Effective credit risk management allows a Bank to reduce risks and potential NPAs. It also offers other benefits. Once Banks understand their risks and their costs, they will be able to determine their most profitable business, thus, price products according to the risk. Therefore, the Banks must have an explicit credit risk strategy and supported by organizational changes, risk measurement techniques and fresh credit process and system's There are five crucial areas that management should focus on;

- a) Credit sanctioning and monitoring process.
- b) Approach to collateral.
- c) Credit risk arises from new business opportunities.
- d) Credit exposures relative to capital or total advances
- e) Concentration on correlated risk factors.

Apart from these, the Bank management should regularly review all asset quality issues including portfolio composition, big borrower exposure, and development in credit management policy and process. “He is hopeful that the Banks adopt good risk management practices and will be able to reap both strategic and operational benefit.

Write –Offs behind fall in Banks' NPL level.

In the report titled "Write –Offs behind fall in Banks NPL level " published in the Himalayan times, the reporter has attempted the crucial issues of nonperforming Loan (NPL) ailing financial sector in Nepal may appear to have been sorted out. The level of NPL which stood at a whopping 60% prior the financial sector reforms in 2002 and hovered around 30% in 2004, has come down to 14.22% in 2006 . However, thereby hangs a story of massive write – off loans and interest on loans, Nepal Bank Ltd, written off loan amounting to amount Rs. 4 billion and an interest of around Rs. 8 billion, pointed out Nepal Rastra Bank. And according to the Bank regulatory, even Rastriya Banijya Bank is planning to write of a total of Rs. 12 billion loans (The Himalayan Times, Dec. 20, 2007)

The reporter further states that the big borrowers have been avoiding loan repayment by getting stay order from courts. While the recently promulgated Bank and financial institutions act 2063 demarcates the role of NRB and in handling the NPL issues of the Banks, the regulator still clearly lacks the teeth to deal with defaulters with an iron hand. For instead of being authorized directly initiates action against them, NRB can request the government of Nepal to take necessary steps against the defaulters when approved by the commercial Banks.

The reporters concludes, the three steps NRB directives to Banks on handling bad loans entails : follow up, blacklisting borrowers and then request NRB for

enforcement action in term of seizing the passport of attaching of property for auction. (Maha Prasad Adhikari) in his article titled, non performing loan and its management" has tried to highlight the NPL refers to those loans and advances which are not able to serve the interest and the installment within the given period of time. And the internationally acceptable level of NPA is said to be less than 5% on total loan and advances. But, out of 17 commercial Bank, 11 Banks have less than 5% NPL and one have marginally above 5% NPL. NPL level of other five Banks is quite high and above the standard as well as industry average. Similar situation is the agriculture development Bank and some other non Bank financial institution. He said that the private sectors Banks have grown up with the different and improved Banking culture. The same culture is applied in the credit operation and it enables to manage their credit with possible stringent manner in most of the private sectors Bank. However, all private sectors Bank are not at par. Even private sector Banks are also carrying their NPA up to almost 40% of their credit portfolio. The average NPA level of the private sector Bank is 6.58%, which is higher than the standard but far below the industry's average. Public sector Banks are still exposed to high risks on credit and hold huge amount of NPA. The recent attempt to write off of dead account would minimize the level of NPA substantially. However, other risks of one time writes off is still high to the individually entity.

He concludes, the process of credit risk management starts from the formation of appropriate credit policy guidelines rules and also comprises of credit appraisal, mitigation of the credit, credit documentation, processing credit control, monitoring, follow ups, counseling board over sight and timely recovery actions. When any of these steps is compromised, the loan may convert into the NPL. Once the loan is converted into the NPA, it must be resolved on time with appropriate NPL management strategy and methodology.

"Non-Performing Assets: A need for rationalization"

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

As stated by the writer, the definition of NPA differs from country to country. In some of the developing countries of Asia Pacific Economic Cooperation (APEC) forum, a loan is classified non-performing only after it has been arrear for at least 6 months. Similarly, it is after three months in India. Loans thus defaulted are classified into different categories having their differing implication on the asset management of financial institution. He also stated that NPAs are classified according to international practice into 3 categories namely substandard, Doubtful and loss depending upon the temporal position of loan default. "Thus the degree of NPA assets depends solely on the length of time the asset has been in the form of non obliged by the customer(debtors).The more time it has elapsed the worse condition of assets is being perceived and such assets are treated accordingly." As per Mr. Chhetri's view, failure of business for which loan was used defective and below standard credit appraisal system, credit program sponsored by Government, slowdown in economy/recession, diversion of fund are some of the factors leading to accumulation of NPAs.

He said that there is serious implication of NPAs, on financial institution. He further added that the liability of credit institution does not limit to the amount declared s NPA but extend to extra amount that requires by regulation of

supervisory authority in the form of provisioning as the amount required for provisioning depends upon the level of NPAs and their quality. As per his view, rising level of NPAs create a psyche of worse environment especially in the financial sector. He mentioned that by reviving the activities of the financial institution like waiving interest, rescheduling the loan, writing off the loan, appointing private recovery agent, taking help of tribunals and law of land etc NPAs can be reduced.

Finally he concluded that financial institutions are beset with the burden of mounting level of NPAs in developing countries. "Such assets debar the income flow of the financial institution while claiming additional resources in the form of provisioning thereby hindering gainful investment. Rising level of NPAs cannot be taken as stimulus but the vigilance demanded to solve the problems like this, eventually will generate vigor to gear up the Banking and financial activities in more active way contributing to energizing growth.

Why Asset Management Co. is considered the best option to resolve the non performing loan problem?

(Mr. Bhishma Raj Dhungana) in the article titled has highlighted one of the approach mainly asset Management Company (AMC) for resolving the problem of NPL. As per him, AMC is the specialized financial intermediary to manage the non-performing and distress loans of Banks and financial institution who buy the NPL from financial institution and take necessary steps to recover the maximum value from the acquired assets. As per his view, if NPLs are not resolved in time there would be inherent director indirect costs to the economy. as stated by him NPL may arise due to the external factors like decrease in market value of collateral , deterioration in borrower's misconduct, improper credit appraisal system lack of risk management practice, ineffective credit monitoring and supervision system . Hence he suggested that, NPL should be

kept at minimum level and the specialized institution such as AMCs should manage the distressed loans.

He says that, both traditional approach and AMC are available to deal with NPL problem. Under traditional approach, Bank handles the NPL's in its own way especially through recovery unit who focus on continuing negotiation with the borrower and give top priority to the loan recovery. As opined by the writer, this approach is useful in dealing with small business loans where personal touch is adopted but for big loans this approach does not work. "AMCs seem as the only realistic option when the financial sector recovery is the underlying objective in financial system where the institution fails to resolve the NPL problem through their own effort" He states that the main advantage of establishing AMC is that AMC is able to move in an expeditious manner removing the distraction of managing NPAs from the Banking system and frees up resources within the financial institutions allowing them to concentrate on their core activities.

He concludes, "As in most of the countries, Nepalese Financial system is largely dominated by the Banking sector, The banking sector is severely affected by the NPL problem, it is estimated that the NPL of the Nepalese Banking system is around 16% of the country. It will be the eclipse in the development of financial soundness in the economy, if not controlled in time. However, traditional or AMC rot can be practiced to get recovery from this sickness of the financial system, the AMC rot may be more effective approach to be quick recovery as it has been experienced around the world."

“Asset Management Company; East Asia's Experience”

The article titled above was published in editorial of Nepal Bank Limited Newsletter of Magh 2060. In this editorial, the writer has expressed some views regarding asset Management company models to resolve NPA problems in the context of East Asian countries. He has stated that, East Asia's financial systems are burdened with a large volume of non-performing assets which impede the

ability of financial institution to serve the prudent intermediation need of their communities. "To resolve NPA problems and help restore the health and confidence of the financial sector, the countries in East Asia have used one or more asset management company (AMC) models. The most common AMC model used centralizes this activity in a government agency. However, some countries have opted for a more decentralized approach involving the creation of several 'Bank based' AMCs." as per his view of the country's NPA problems are limited or concentrated and government can afford to take a gradual approach, a bank based AMC would be appropriate where as if NPA problem is more pervasive and the country's business culture and legal infrastructure are less developed, then centralized government based strategy would be more appropriate.

"In Thailand, the government dealt promptly and decisively with NPA problems in finance companies but has not done the same for the Banking sector where NPA problems are still pervasive. The government policy of encouraging state owned and private Banks to establish their own AMCs appears overly optimistic and is likely to require substantial government coordination and financial support. In Indonesia, the NPA problems appear to be the most severe by far, of all the countries surveyed. in Malaysia, the government promptly reduced NPA problems by transferring them to a centralized, government –run AMC . While t is too early to tell, the approach appears well coordinated and comprehensive. The Korean government has achieved major strides in addressing the loan problems in the financial sector, The government AMC faces an important challenge but is actively working to improve its management of distressed assets. In Philippines, problem assets are significant in the extent but substantially less than in other East Asian countries. The experience of the AMC in the Philippine provides valuable insights into the importance of operational independence."

2.5 Review of Related Thesis

(Dinesh Kumar Khadka) in his thesis Non-performing Assets of Nepalese Commercial Banks with an objectives to examine the level of NPAs in total assets, total deposit and total lending of Nepalese Commercial Banks. He has also showed that the effect of non-performing assets on return on assets and return on equity of Nepalese commercial Banks.

He said that despite of being loans and advances more profitable than other assets, it creates risk of non-payment for the Bank. Such risk is known as credit risk or default risks. Therefore, like other assets the loans and advances are classified into performing and non performing assets on the basis of overdue schedule. Escalating level of NPAs has been becoming great problem in banking business in the world. In this context Nepal cannot be run off from such situation, the level of NPAs is Nepalese Banking business in very alarming. It is well known fact the problem of swelling nonperforming assets and the issue is becoming more and more unmanageable day by day. We are well known different financial reports, news paper and news that the total NPA in Nepalese Banking system is about 35 billion, while it is very worse in case of two largest commercial Banks RBB and NBL.

Finally he concludes that the level of NPA in sampled Nepalese commercial Banks is not so alarming. The situation is quite satisfactory. But the increasing trend remain continue in coming days, the situation will be unmanageable and alarming. The commercial Banks could not give full attention towards supervising their lending and toward recovering their bad loan perfectly level of NPA has been increasing. The level of NPA of Nepal Bangladesh Bank Ltd. Nepal SBI Bank Ltd. and Bank of Kathmandu seems very unsatisfactory, if the situation not handing right now, it will be unmanageable and difficult to handle.

He recommends that the Banks should have to take enough collateral while lending loan appropriate financial analysis, supervision, monitoring and control

should be done. Lastly those banks having high level of NPA should take immediate action towards recovering their bad loan as possible as soon. In case of default to repay the loan by borrower, the Banks should dispose off the collateral taken from the borrower and recover principal and interest amount.

(Lila Prasad Ojha) has carried out research on "Lending Practices : A study on Nabil Bank Limited, Standard Chartered Bank Nepal Limited and Himalayan Bank Limited" His main objectives of study are to analyze, the various aspects of Bank's lending in various sector of economy, the individuals Banks' performance regarding the lending quantity, quality, efficiency and its contribution in total income. The problems, conclusion and recommendation figured out by him in this thesis are discussed as below.

He stated that, over liquidity caused due to lack of good lending opportunities, risk arising due to mismanagement of lending portfolio, increasing non-performing assets etc is come of the problems that is facing by Nepalese Banking sector. His main objective is to analyze the various aspects of Bank's lending in various sector of economy, the individual Bank's performance regarding the lending quantity and quality.

He concludes "The highest growth rate, proportionately high volume of loan and advances, the best contribution in priority and agricultural sector and the high level of deposits mobilization of HBL has put this Bank in the top position in the lending function. However the better activity ratio of CSBNL has proved this Bank the best in managing the lending portfolio according to the demand of profit oriented business. The high volume of lending activities and high volume of productive sector loan of NABIL has put the Bank in the top position in absolute terms. The increasing provision on loan loss and high volume of non-performing assets in NABIL & HBL certainly attracts the high attention of any person interest with these Banks. The high volume of NPA of HBL may have caused due to the failure of industrial and agricultural sector. NABIL's increased

NPA may have caused due to the accumulated bad debts that is kept behind the curtain to show the high efficiency of management.

He suggested that following the normal guidelines of NRB and acting upon this also reduce many of the credit risk arising from borrowers. He recommended Banks to be more cautious and realistic while granting loans and advances. As suggested by him, the major solution of redacting the risk is to avoid lending in more risky area until the Bank does not fully satisfy itself regarding the future viability of the project. He further suggested that the establishment of Asset Management Co. (AMC), which helps commercial Banks in collecting their debts and improving their credit rating efficiency, should be initiated. As per his opinion, lack of proper credit appraisal, default by blacklisted borrower and professional defaulter, the over confidence in commercial Banks regarding credit appraisal efficiency and negligence in taking information from credit information bureau has caused many of the bad debts in these Banks.

(Shama Bhattarai) in her study "Implement of Directives Issued by Nepal Rastra Bank: A comparative study of Nepal SBI Bank Limited and Nepal Bangladesh Bank Limited" has made an attempt to analyze various aspects of NRB Directives with respect to Capital Adequacy and Loan classification and providing. As per her view the process of continual review and classification of loan and advances enables Banks to monitor the quality of their loan portfolios and to take remedial action to counter deterioration in the credit quality of their portfolios.

She concluded that with the new provisions the Banks will have its provision amount increasing in coming years and subsequently profitability of the Banks will also come down. However, the true picture of the quality of the assets will be painted in the coming years to come. She recommends, "The Banks should be very careful while analyzing the paying capacity of its credit clients. With

longer period of past due, the Bank will end up increasing its provisions which will keep the bottom line low if the Bank is not careful."

(Raja Ram Khadka)" in his thesis on "A study on the Investment policy of Nepal Arab Bank Limited in comparison to other Joint Venture Banks of Nepal " has concluded that NABIL is comparatively less successful in on balance sheet utilization as well as off balance sheet operations than that of other JVBs. Mr. Khadka warned that in coming days NABIL may be behind in the competitive market if it cannot mobilize its resource as efficiently as other JVBs. He recommended, "Three Bank must utilize depositor's money s loans and Advances to get success in competitive Banking Environment. The largest item of the Bank in the asset side is Loan and Advances Negligence in administrating this asset could be the main cause of a liquidity crisis in the Bank and one of the main reasons of a Bank failure"

(Sabitri Shrestha) in her thesis "Impact and implementation of Nepal Rastra Bank (NRB)'s Guidelines (Directives) on Commercial Bank: A study of Nabil Bank Limited and Nepal SBI Bank Limited" has tried to find out the impact of NRB directives on commercial Banks. She has also made effort to find out whether the directives are actually implemented and are being monitored by NRB or not. She has stated that both NABIL and Nepal SBI are implementing the NRB directives.

She concludes "All the changes in NRB directives made both positive and negative impacts on the commercial Banks. Even though this study is limited to only two samples i.e. Nabil Bank and Nepal SBI Bank, among entire population, it clears the new directives issued by NRB make good impact more than bad impact on the various aspects of the Banks. It can be seen that the provision has been changed and the increased provisioning amount has decreased the profitability of commercial Banks apart from , loan exposure has been cut down to customers due to the borrower limits have been brought down

by NRB. Therefore reduction in loan amount results to decrease the interest income from loans, which will decrease the profits of the Banks in coming years. Decreasing profitability push toward lesser dividend to shareholders and lesser bonus to employees. Not only the negative sides but also there positive sides of new directives. Recently the problems of Banks are increasing operating cost and decreasing loan amount resulting decrease in profits of the Banks. But is a show it is only for short term because the directives are more effective to protect the Banks from bad loans, which protect the Banks from Bankruptcy as well as protection of deposits of depositors. Increase in capital adequacy ratio strength the Bank's financial position, loan related provision will made safety of loans except the risk reducing provision will protect the bank from liquidation. Above all, it can be concluded that newly issued directives are more effective than previous one although it has brought come problems toward Banks. To decrease the decreasing profits of the Banks, they should research the alternatives such like more investments in other business; Bank should adopted new technology according to the demand of item and must not depend on only interest income for profits."

(Anju Khadka) has carried out research on "A Comparative study on Investment Policy of Commercial Banks" with an objective to find out the relationship between deposits, investment, loan and advances and net profit she has made the following conclusion while comparing the performance of NBL with NABIL, SCBNL and NIBL.

She concludes "NBL is comparatively less successful in on balance sheet as well as off balance sheet operations than that of other CBs. It predicts that in the coming days if it could not mobilize and utilize its resource as efficiently as other CBs to maximize the returns. it would lag behind in the competitive market of Banking Profitability positions of NBL are comparatively worse than that of other CBS. It predicts that NBL may not maintain the confidence of

shareholders, depositors and its all customers if it cannot increase its volume even in future."

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

The internationally acceptable level of NPA is said to be less than 5% on total loan and advances. Based on the table no.2 out of 18 commercial Banks (excluding new 5 Banks), 12 Banks have less than 5% NPA, NPA level of other five Banks is quite high and above the standard average. Similar situation is the agricultural development Bank and some other non Bank financial institutions. The private sectors Bank have grown up with the different and improved Banking culture. The same culture is applied in the credit operation and it enables to manage their credit with possible stringent manner is most of the private sectors Bank. However, all private sector Banks are not at per which have been seen from the above table. Even private sector Banks are also carrying their NPA up to almost 40% of their credit portfolio.

2.6 Research Gap

From the study it has been found that the high level NPAs can be regarded as a serious burden to the Banks and economy as well. So high level of NPAs is the early symptom of Bank failure and NPAs are one of the serious problems faced by the commercial Banks. Some researcher were done in which matters relating to loan loss provisioning has been discussed but no research was found in detailed analysis of non-performing loan and loan loss provisioning of commercial Banks. Hence the researcher had attempted to fill this research gap by taking reference of Nabil Bank Limited, Nepal Investment Bank Ltd. and Nepal Bangladesh Bank Ltd. This research will be able to deliver some of the present issues, latest information and data-regarding loan classification and loan loss provisioning. After reviewing the relevant literatures, the next chapter concentrates in the research methodology applied in the study.

CHAPTER – III

Research Methodology

Research Methodology is a diagnostic approach of research and is a way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. It helps in studying the entire research work in easy manner and also in presenting report in an understandable way. It includes wide range of methods, including a quantitative technique for analysis of data and information collected. Therefore, research methodology refers to the methods and techniques used in collection, tabulation and analysis of data and information collected to achieve the objective of the study. The main objective of this research is to analyze, examine and interpret the data and information to come at appropriate decision by giving conclusions and suggestions. The major components of research methodologies followed in the course of this study are

-) Research design
-) Size of population and sample
-) Source of Data
-) Data collection techniques.
-) Data analysis tools.

Research is a systematic inquiry of any particular topic and methodology is the method of doing research in a well manner. Hence research methodology is the systematic study of research problem that solves them with some logical evidence. The research methodology adopted in the present study as discussed as below.

3.1 Research Design

Research design is the specification of methods and procedures for acquiring the information needed. It is the plan; structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance. This research will follow analytical and descriptive research design.

3.2 Size of Populations and Sampling

Population refers to the entire group people, events or things of interest that a researcher wishes to investigate. A sample represents only a part of a universe (Quantity). In sampling method only tiny part of the whole aspect of matter is considered and conclusion about the entire aspect is done on that basis. Since this study is about loan classification and loan loss provisioning of commercial Banks, the population for this study comprised all the licensed commercial Banks of the country. Therefore, all the commercial Banks are the population of the study. The census of the population is neither feasible nor desirable for the study of this nature that is why a sample from the population has been selected for the study of this nature that is why a sample from the population has been selected for the purpose of this study.

A list of licensed commercial Banks was obtained from NRB. There are altogether 23 commercial Banks in Nepal. The commercial Banks of Nepal can be categorized into two type's namely public sector and private sector. Public sector Banks include two old Banks NBL and RBB and private sector Banks comprise remaining 21 Banks. Out of the total population following 3 commercial Banks were selected as samples for this study by using judgmental sampling method.

- **Nabil Bank Limited (NABIL)**
- **Nepal Investment Bank Limited (NIBL)**
- **Nepal Bangladesh Bank Limited (NBBL)**

3.3 Sources of Data

Both primary and secondary data has been used in this study . Bank employees are the primary sources of data and following are the secondary sources of data used in the study.

- Annual reports, newsletter of the subjected Banks.
- Laws, guidelines and directives regarding the subject matter.
- Text Books
- Articles polished in newspapers, Journals, Magazines, and other publication.
- Unpublished thesis and dissertation
- Various reports published by NRB, CIB etc .
- Various related websites.

3.4 Data Collection Techniques

Primary data has been obtained through questionnaire, direct interviews, field visit and telephonic inquires. The annual reports of NABIL, NIBL & LBL were collected from concerned Banks. Various publication of NRB was collected form branch office of NRB Birgunj. The reference of NRB directives and guidelines has been executed from Nabil Bank Limited and website of NRB. Various reports, textbooks, journals, and unpublished dissertation have been obtained by visiting TRM College, Birgunj and TU Central Library.

3.5 Data Analysis Tool

The available information is grouped as per the need of the research work in order to meet research objectives. The collected data are presented in appropriate forms of table and charts. For analysis purpose different kinds of appropriate mathematical, statistical and financial tools have been applied. Further to represent the data in simple form diagrams and graphs have also been used. The data collected from different sources are recorded systematically and identified.

3.5.1 Financial Tools

Financial tools are used as a benchmark for evaluating the financial position and performance of any firm. "Financial analysis is the process of identifying the financial strength and weakness of the firm by properly establishing relationship between the items of the balance sheet and profit and loss account". "Financial analysis is the used of financial statements to analyze a company's financial position and performance and to asses future financial performance."

3.5.1.1 Ratio Analysis

Ratio Analysis is the widely used tool of financial analysis. A ratio is simply one number expressed in terms of another and as such it expresses the numerical or quantitative relationship between two variables. Ratio analysis reflects the relative strengths and weakness of any organization and also indicates the operating and financial growth of the organization. "Ratios help to summarize large quantities of financial data and to make quantitative judgment about the firms' financial performance. The relationship between two accounting figures expressed mathematically is known as financial ratios" Even though there are many ratios, only those ratios have been calculated which are related to the subject matter. Following ratios have been computed and analyzed in this study.

Loans and Advances to Total Assets Ratio

Loans and advances of any commercial Banks represent the major portion in volume of total assets. The ratio of loans and advances to total assets measures the volume of loans and advances in the structure of total assets. The high degree of ratio indicates the good performance of the Banks is mobilizing its fund by way of lending functions. However in its reverse side, the high degree is representative of low liquidity ratio. Granting loans and advances always carries a certain degree of risk. Thus this asset of banking business is regarded as risky assets. Hence this ratio measures the management attitude towards risky

assets. The low ratio is indicative of low productivity and high degree of safety in liquidity and vice versa this ratio is calculated as follows.

$$\text{Loans and advances to total assets ratio} = \frac{\text{Loans and advance}}{\text{Total Asset}}$$

Loans and Advances to Total Deposit Ratio (CD Ratio)

The core banking functions is to mobilize the funds obtained from the depositors to borrowers and earn profit and CD ratio is the fundamental parameter to ascertain fund deployment efficiency of commercial Bank. In other words this ratio is calculated to find out how successfully the Banks are utilizing their total deposits on credit or loans and advances for profit generating purpose as loans and advances yield high rate of return. Greater CD ratio implies the better utilization of total deposits and better earning, however, liquidity requirements also needs due consideration. Hence 70%-80% CD ratio is considered as appropriate. This ratio is calculated by dividing total credit by total deposit of the Bank.

$$\text{Loans \& Advances to Total Deposit Ratio} = \frac{\text{Loans and advance}}{\text{Total Deposit}}$$

Non-Performing Loans to Total Loans and Advances Ratio

This ratio determines the preparation of non-performing loans in the total loan portfolio. Higher ratio implies the bad quality of assets of Banks in the form of loans and advances. Hence lower NPL to total credit ratio is preferred. As per international standard only 5% NPL is allowed but in the context of Nepal 10% NPL is acceptable. It is calculated s follows:

$$\text{Non- Performing loans to total loans and advances} = \frac{\text{Non Performing Loans}}{\text{Total Loans Advances}}$$

Loan Loss Provision to Total Loans and Advances Ratio

This ratio describes the quality of asset in the form of loans and advance that a Bank is holding. Since there is risk inherent in loans and advances, NRB has directed commercial Banks to classify its loans into different categories and accordingly to make provision for probable loss. Loan loss provision signifies the cushion against future contingency created by the default of the borrower in payment of loans and ensures the continued solvency of the Banks. Since high provision has to be made for non-performing loan, higher provision for loan loss reflects increasing non-performing loan in volume of total loans and advances. The low ratio signifies the good quality of assets in the volume of loans and advances. It indicates how efficiently it manages loan and advances and makes efforts to cope with probable loan loss. Higher ratio implies, higher portion of NPL in the total loan portfolio. This ratio is calculated as follows;

$$\text{Loan loss provision Ratio} = \frac{\text{Loan Loss Provision}}{\text{Total Loans Advances}}$$

Provision Held to Non – Performing

This ratio determines the proportion of provision held to non-performing loan of the Bank. This ratio measures up to what extent of risk inherent in NPL is covered by the total loan loss provision. Higher ratio signifies that the banks are safeguarded against future contingencies that may create due to non-performing loan or in other words Banks have cushion of provision o to cope the problem that may be cause due to NPL. Hence higher the ratio better is the financial strength of the Bank. This ratio is calculated as follows:

$$\text{Provision Held to Non Performing Loan} = \frac{\text{Total Loan Loss Provision}}{\text{Non Performing loan}}$$

Return on Loans and advances

This ratio indicates how efficiently the banks has employed it resource in the form of loan and advances. It is the ratio of net profit and total loans and advances of Bank net profit refers to that profit which is obtained after all types of deduction like employee bonus, tax, provision etc . Hence this ratio measures Bank's profitability with respect to loans and advances. Higher the ratio better is the performance of the Bank. It is calculated as below:

$$\text{Return On loans And Advances} = \frac{\text{Net Profit}}{\text{Total Loans Advances}}$$

3.5.2 Statistical Tools

Statistical tools are the mathematical techniques used to facilitate the analysis and interpretation of numerical data. "Statistical Analysis is one particular language, which describes the data and makes possible to talk about the relations and the difference of the variables." Following statistical tools have been used in this study.

3.5.2.1 Percentages

A percent is a number of hundredth parts one numbers to another. Uses of percentages make the data much simpler and grasp. It is the simplest statistical device used in interpretation of phenomenon. It can reduce everything to a common base and thereby helps in meaningful presentation. Mathematically, let A represent the base used for comparison, B represent the given data to be compared with the base, then the percentage of given number in the base may be calculated as

$$\text{Percentage (P\%)} = \frac{B}{A} | 100$$

3.5.2.2 Measures of Central Tendency

Measures of Central value are simple statistical treatments of distribution that attempts to find the single figure to describe the entire distribution. It is the best possible value of a group of variables that singly represents to whole group. In the statistical analysis the central value falls within the approximately middle value of the whole data. Among the several tools of measuring central value the mean has been used in this analysis where and when necessary. The mean is the arithmetic average of a variable. Arithmetic Mean of a series is given by:

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

3.5.2.3 Measures of Dispersion

Dispersion measures the variation of the data from the central value. The central value alone is not enough to analyze the quality of data regarding its variability. With the light of dispersion and average becomes more powerful and meaningful. Following tools of measuring dispersion has been used in this study.

3.5.2.4 Standard Deviation

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

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

3.5.2.5 Coefficient of variation

The percentage measure of coefficient of standard deviation is called coefficient of variation. The less is the C.V. the more is the uniformity and consistency and vice versa. Standard deviation gives an absolute measure of dispersion hence where the mean value of the variable is not equal it is not appropriate to compare two Paris of variables based in S.D. Only the coefficient of variation measures the relative measures of dispersion, hence capable to compare two variables independently in terms of their variability.

$$\text{Coefficient of variation (C.V)} = \frac{\dagger}{X} | 100$$

3.5.2.6 Correlation Coefficient (r)

Correlation refers to the degree of relationship between two variables. Correlation coefficient determines the association between the dependent variable and independent variable. If between the variables, increase or decrease in one cause increase or decrease in another, then such variables are correlations variables. "Correlation may be defined as the degree of linear relationship existing between two or more variables. Two variables are said to be correlated when the change in the value of one is accompanied by the change of another variable." There are different techniques of calculating correlation coefficient. Among various techniques we have used Karl Pearson coefficient of correlation.

It is calculated as follows:

$$\text{Correlation Coefficient (r)} = \frac{xy}{N\dagger_x\dagger_y}$$

Where ,

$$x \text{ XX Z}\bar{X} \qquad y \text{ XY Z}\bar{Y}$$

\dagger_x = Standard Deviation of Series X

\dagger_y = Standard Deviation of Series Y

N = No. of pairs of observation

On simplification of the equation of r, we obtain the following formula for computing r.

$$r = \frac{\sum xy}{\sqrt{\sum x^2 \cdot \sum y^2}}$$

The Karl Pearson Coefficient of correlation always falls between -1 to +1. The value of correlation in minus signifies, the negative correlation and in plus signifies the positive correlation if,

$r=0$, There is no relationship between the variables.

$r<0$, There is negative relationship between the variables.

$r>0$, There is positive relationship between the variables.

$r=+1$, The relationship is perfectly positive.

$r=-1$, The relationship is perfectly negative.

The reliability of the correlation coefficient is judged with the help of probable error (P.E.) . It is calculated as follows:

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

Where,

r = correlation coefficient

N = No of pairs of observation

If $r > 6 \text{ P.E.}$, then the correlation coefficient is significant and reliable.

If $r < \text{P.E.}$, then the correlation coefficient is insignificant and there is no evidence of correlation.

3.5.3 Trend Analysis

Trend Analysis is one of the statistical tools which is used to determine the improvement or deterioration of its financial situation. Trend analysis informs about the expected future values of various variables. The least square method has been adopted to measure the trend behaviors of these selected Banks. This

method is widely used in practices. The formula of least square method for the straight line is represented by the following formula.

$$Y_c = a + bX$$

Where,

Y_c = Trend values

a = Y intercept or the computed trend figure of the Y variable, when $X=0$

b = slope of the trend line of the amount of change in Y variable that is associated with change in 1 unit in X variable.

X = Variable that represent time i.e. time variable

The value of the constants a and b can be determined by solving the following two normal equations.

$$\sum Y = N a + \sum X b \quad \dots\dots\dots(i)$$

$$\sum XY = a \sum X + b \sum X^2 \quad \dots\dots\dots(ii)$$

Where, N = number of years

But for simplification, if the time variable is measured as a deviation from its mean i.e. mid point is taken as the origin, the negative value in the first half of the series balance out the positive values in the second half so that $\sum X = 0$

The values of constant a and b can easily be determined by using following formula.

$$a = \frac{\sum Y}{N}$$

$$b = \frac{\sum XY}{\sum X^2}$$

3.5.4 Diagrammatic and Graphical Representation

Diagrams and graphs are visual aids that give a bird eye view of a given set of numerical data. They represent the data in simple and readily comprehensive form. Hence various bar diagrams, pie charts and graphs have been used for presentation and analysis of data.

After highlighting the research methodology, the next chapter concentrates on presentation and analysis of the study.

CHAPTER-IV

PRESENTATION AND ANALYSIS OF DATA

In this section, raw form of data collected from various sources changed into an understandable presentation using financial as well as statistical tools tool supported by diagrams and graphs as mentioned in the previous chapter. This chapter is the heart of the study as all the findings, conclusions and recommendation are going too derived from the calculations and analysis done in this section.

4.1 Ratio analysis

4.1.1 Loans and Advances to total Asset Ratio

Loans and advances of any commercial Banks signify the portion in volume of total assets. The ratio of loans and advances to total assets measures the volume of loans and advances in the structure of total. The high degree of ratio indicates the good performance of the Banks in mobilizing its fund by way to lending functions. However in its other side the high degree is representative of low liquidity ratio. Loans and advances always carry a certain degree of risk. Thus this assets of banking business is regarded as risky assets .Hence this ratio measure the management's attitude towards risky assets. The low ratio is indicative of low productivity and high degree of safety in liquidity and vice versa.

Table No.6**Loans and Advances to Total Asset Ratio (%)****In Million Rs.**

Year(Mid July)	NIBL			NABIL			NBBL		
	Loans & Advances	Total Asset	Ratio (%)	Loan & Advances	Total Asset	Ratio (%)	Loans & Advances	Total Asset	Ratio (%)
2004	5921	9014	65.69	8114	16563	48.99	7962	11919	66.80
2005	7338	13255	55.36	8549	16745	51.05	9645	14258	67.65
2006	10453	16064	65.07	10947	17064	64.15	9627	13283	72.48
2007	13178	21330	61.78	13279	22330	59.47	9796	12959	75.59
2008	17769	27591	64.40	15903	27253	58.35	5855	10118	57.87
Mean			62.46	Mean		56.50	Mean		68.08
S.D.			4.24	S.D		6.26	S.D.		6.74
C.V			6.79	C.V		11.10	C.V.		9.90

(Source: Annual Reports & Websites of Concerned Banks)

The table no.6 exhibits the loans and advances to total asserts of three banks for five consecutive years This ratio shows fluctuating trend of all three banks The overall ratio to the three banks has been ranged from 48.99% of NABIL IN 2004 to 64.40% of NIBL IN 2008.The mean ratio of NIBL NABIL and NBBL stand for 62.46%, 56.40% and 68.08% respectively. Hence among the three banks, NBBL has the highest proportion of loans and advances in the total asset structure followed by NIBL and then NABIL .This refers that NABIL has the

lowest degree of investment in risky assets. The management of NABIL has managed to minimize the risk asset as they have invested higher proportion of their asset in risk free zone or nominally risky assets like treasury bills debentures National saving bonds (NSB s) etc.

The standard deviation of NIB NABIL and NBBL are 4.24, 6.26 & 6.74 and C.V.S are 6.79%, 11.10% & 9.90% respectively (Appendix 2) Thus it can be interpreted that NABIL and NBBL has higher deviation with higher degree of variation in this ratio. Even though this ratio is least of NIBL it has the most consistent ratio and the least deviation during the study period however NABIL is considered to be moderate in terms of deviation and variability of ratio during the study period.

4.1.2 Loans and Advances to Totals Deposit Ratio (CD ratio)

This ratio often called CD ratio (credit Deposit ratio) in Banking terms. The core banking function is to mobilize the funds obtained from the depositors to borrowers and earn profit thus CD ratio is the fundamental parameter to ascertain fund deployment efficiency of commercial Bank. In other words these ratio were calculated to find out how successfully the bank are utilizing their total deposits on credit or loans and advances for profit generating purpose as loans and advances yield high ratio of return Greater CD ratio implies the better utilization of total deposits and better earning However liquidity requirements also needs due consideration to safe guard the bank image banks have to maintain liquidity so as to pay off depositor money on demand thus a balance of assert must be stroked to ensure both profitability and liquidity As per Banking practice and followed by standard norms 70%-80% CD ratio is considered as appropriate. This ratio is calculating by dividing total credit or loans and advances by total deposit of the Bank.

Table No7**Loan and Advances to Total Deposit Ratio (%)****in Million**

Year(Mid July)	NIBL			NABIL			NBBL		
	Loans & Advances	Total Deposit	Ratio (%)	Loan & Advances	Total Deposit	Ratio (%)	Loans & Advances	Total Deposit	Ratio (%)
2004	5921	7923	74.73	8114	13348	60.79	7962	10591	75.18
2005	7338	11525	63.67	8549	14119	60.55	9645	12807	75.31
2006	10453	14255	73.33	10947	14587	75.05	9627	12125	79.40
2007	13178	18927	69.63	13279	19347	68.64	9796	13015	75.27
2008	17769	24488	72.56	15903	23342	68.13	5855	9464	61.87
Mean			70.78	Mean		66.63	Mean		73.41
S.D.			4.39	S.D		6.09	S.D.		6.69
C.V			6.20	C.V		9.14	C.V.		9.12

(Source: Annual Reports & Websites of Concerned Banks)

The above **Table no.7** exhibits the loans and advances' to total deposit of three banks for five consecutive years. This ratio show increasing trend of two banks (NIBL & NAIL) and decreasing trend of NBBL. NBBL has the highest ratio for the whole period except in 2007 the mean ratio of NIBL, NABIL and NBBL is 70.78%, 66.63% & 73.41% respectively. Hence among the three banks NBBL has the highest proportion of loans and advances in the total deposit followed by NIBL and NABIL. It signifies that NBBL and NIBL have been ahead in

utilizing depositor's money on loans and advance with the objective to earn profit. This consists that NABIL has low investment in the form of loans and advances in comparison to them the management of NABIL is highly concerned over risk as they have invested higher proportion of their deposit in risk free or nominally risky assets like treasury bills, debentures, National Saving Bonds (NSBs) etc.

The standard deviation of NIBL, NABIL and 4.39, 6.09 & 6.69 and CVs are 6.20%, 9.14% & 9.12% respectively.(Appendix 2) Thus it signifies that NABIL & NBBL have higher deviation with higher degree of variation in this ratio .Even though this ratio is least of NIBL; it has the most consistent ratio and the least deviation during the study period.

4.1.3 Non-Performing Assets (Loans) to Total Loans and Advances Ratio.

This ratio determines the proportion of non- performing assets in the total loan portfolio As per NRB directives the loans falling under category of substandard doubtful and loss are regarded as non performing loan Higher ratio entails the bad quality of assets of banks in the form of loans and advances hence lower NPA to total credit ratio is preferred As per international standard only 5% NPL allowed but in the context of Nepal maximum 10%NPA is acceptable.

TABLE NO.8**Non performing Loan to Loan and Advances Ratio (%) in Million**

Year(Mid July)	NIBL			NABIL			NBBL		
	NPL	Loans & Advances	Ratio (%)	NPL	Loan & Advances	Ratio (%)	NPL	Loans & Advances	Ratio (%)
2004	117	5921	1.98	450	8114	5.55	1013	7962	12.72
2005	181	7338	2.47	287	8549	3.36	1042	9645	10.80
2006	281	10453	2.69	145	10947	1.32	1832	9627	19.03
2007	272	13178	2.06	183	13279	1.38	2927	9796	29.88
2008	422	17769	2.37	178	15903	1.12	2236	5855	38.19
Mean			2.31	Mean		2.55	Mean		22.12
S.D.			0.29	S.D		1.91	S.D.		11.67
C.V			12.69	C.V		74.99	C.V.		52.74

(Source: Annual Reports & Websites of Concerned Banks)

Table no.8 exhibits the ratio of nonperforming loans to loans and advances of NIBL, NABIL and NBL for five consecutive years .The figure represented in the above table no 8 shows that NBBL has the highest ratio throughout the study period and also shows increasing trend. NABIL shows the least ratio during the study period .NIBL is moderate in this ratio and strive to maintain the NPA ratio below 3% NABIL. Decreasing trend of NPA is the result of effective credit management of bank and its efforts of recovering bad debts through establishment of recovery cell the mean non performing loan to total

loan ratio of NIBL, NABIL & NBBL are 2.31%, 2.55%, and 22.12% respectively. This ratio of NBBL is significantly high in comparison to other two banks and portrays the critical condition of the banks. NPA of NBBL is must higher than the acceptable standard of 10% NIBL and NABIL have been able to maintain the NPA level below 5% which is with in prescribed international standard.

The standard deviation of NIBL, NABIL and NBBL are 0.29, 1.91 & 11.67 and CVs are 12.69%, 74.99% & 52.74% respectively. (Appendix 2). Thus it signifies that NIBL has the least deviation but highest degree of variation in this ratio. Among the three Banks, NABIL is moderate in terms of deviation & variability and NBL has the highest deviation but the least variability of ratio during the study period. Since NPA is one of the causes of banking crisis, NBBL, declared problematic and has been given series attention to come over from high NPA The central Bank (Nepal Rastra Bank) has taken their management from last years.

4.1.4 Loan loss provision to Total loans and Advances Ratio

This ratio describes the quality of assets in the form of loans advances, NRB has directed commercial banks to classify its loans into different categories and accordingly to make provision for probable loss loan loss provision signifies the cushion against future contingency created by the default of the borrower in payment of loans and ensures the continued solvency of the Banks Since high provision has to be made for nonperforming loan, higher provision for loan loss reflects increasing non-performing loan in volume of total loans and advances. The low ratio signifies the good quality of assets in volume of loans and advances. It indicates how efficiently it manages loan and advances and makes efforts to copy with probable loan loss. Higher ratio implies, higher portion of NPL on the total loan portfolio.

Table No 9**Loan Loss Provision to Loans & Advances Ratio (%) in Million Rs.**

Year(Mid July)	NIBL			NABIL			NBBL		
	LLP	Loans & Advances	Ratio (%)	LLP	Loan &Advance s	Rati o (%)	LLP	Loans & Advances	Ratio (%)
2004	150	5921	2.53	358	8114	4.41	713	7962	8.96
2005	208	7338	2.83	359	8549	4.20	995	9645	10.32
2006	327	10453	3.13	361	10947	3.30	1839	9627	19.10
2007	402	13178	3.05	356	13279	2.68	2971	9796	30.33
Mean			2.85	Mean		3.37	Mean		20.96
S.D.			0.24	S.D		0.94	S.D.		12.01
C.V			8.55	C.V		27.90	C.V.		57.30

(Source: Annual Reports & Websites of Concerned Banks)

The above **table no.9** exhibits the ratio of provision to loans and advances of NIBL, NABIL and NBBL for five consecutive years. The figure represented in the above table no.6 shows that NBBL has the higher ratio throughout the study period and also shows increasing trend NBBL show the least ratio during the study period however NABIL has been performing well from last five year as above ratio observed in decreasing trend the mean loan loss ratio NIBL, NABIL &NBBL are 2.85%, 3.37% and 20.96% respectively. This ratio of NBL is significantly high in comparison to other two banks higher LLP is indicative of

poor and ineffective credit policy, higher proportion of nonperforming asset and peer performance of the economy. Hence the greater ratio of NBBL suggest that there is high proportion of NPA in total loans and advances & decreasing trend of loan loss provision ratio of NABIL explains that NABIL has been successful to reduce its non performing loan resulting to decreasing LLP.

The standard deviation of NIBL NABIL and NBBL are 0.24,0.94&12.01 and CVs are 8.55%, 27.90% & 57.30% respectively (Appendix2) Thus it signifies that NBBL has higher deviation with higher degree of variation in this ratio Among the three Banks NABIL is moderate in terms of variability and NIBL has the least variability of ratio during the study period.

4.1.5 Provision held to non performing loan ratio

This ratio determines the proportion of provision held to non performing loan of the bank this ratio measure up to what extent of risk inherent in NPL is covered by the total loan loss provision .higher ratio is signifies that the banks are safeguarded against future contingencies that may create due to in performing loan or on their words banks have sheen of provision to cope the problem that may be cause due to NPL hence higher the ratio better is the financial position of the bank.

Table No 10**Provision held to Non- Performing loan (%)****In million Rs.**

Year(Mid July)	NIBL			NABIL			NBBL		
	LLP	NP L	Ratio(%)	LLP	NPL	Ratio (%)	LLP	NPL	Ratio(%)
2004	150	117	128.21	358	450	79.56	713	1013	70.38
2005	208	181	114.92	359 356	287	125.09	995	1042	95.49
2006	327	281	116.37	361	145	248.97	1839	1832	100.38
2007	402	272	147.79	356	183	194.54	2971	2927	101.50
2008	483	422	114.45	357	178	200.56	2112	2236	94.45
Mean			124.35	Mean		169.74	Mean		92.44
S.D			14.27	S.D		67.02	S.D		12.70
C.V			11.48	C.V		39.48	C.V		13.74

The above **table no.10** exhibits the ratio of provision held to non performing loan of NIBL, NABIL and NBBL for five consecutive years. The figure represented in the above table no.7 shows that NABIL has the highest ratio throughout the study period except in 2004. NIBL is moderate in this ratio and shows increasing trend except in the year 2007. NBBL shows least ratio in compared to other three banks.

The mean ratio of NIBL, NABIL & NBBL are 124.35, 169.74%, and 92.44% respectively this ratio of NABIL is significantly high in comparison to other two banks and portrays that the bank has adequate provision against non performing loan but this ratio of NBBL is comparatively lower.

The standard deviation of NIBL, NABIL and NBBL are 142,767.02 & 12.70 and CVs are 11.48%, 39.48% & 13.74% respectively (Appendix 2). Thus it signifies that NABIL has the highest deviation along with the highest degree of variation in this ratio. Among the three banks NIBL is moderate in terms of variability and NBBL has the least variability of ratio during the study period.

4.1.6 Return on loans and advances

This ratio indicates how efficiently the banks has employed its resources in the form of loans and advances this ratio is calculated by dividing net profit of the banks by total loans and advances net profit refers to that profit which is obtained after all types of deduction like employee bonus tax provision etc. hence this ratio measures banks profitability with respect to loan and advances Higher the ratio better is the performance of the banks.

Table no 11**Return on loans & advances(%)**

In Million Rs.

Year (Mid July)	NIBL			NABIL			NBBL		
	Net profit (loss)	Loans & Adv.	Ratio (%)	Net profit	Loans & Adv.	Ratio (%)	Net profit	Loans & Adv.	Ratio (%)
2004	117	5921	1.98	416	8114	5.13	71	7962	0.89
2005	152	7338	2.07	455	8549	5.32	3	9645	0.03
2006	232	10453	2.22	520	10947	4.75	(650)	9627	(6.75)
2007	351	13178	2.66	635	13279	4.78	(1456)	9796	(14.86)
2008	501	17769	2.82	674	15903	4.24	393	5855	6.71
	Mean		2.35	Mean		4.84	Mean		-2.80
	S.D		0.37	S.D		0.41	S.D		8.26
	C.V		15.77	C.V		8.55	C.V.		-295.53

(Source: Annual Reports & Websites of Concerned Banks)

The **above Table no.11** exhibits the ratio of return on loan and advances of NIBL, NABIL and NBBL for five consecutive years the figure represented in the above table no11 show that NABIL has the highest ratio throughout the study period however the said ratio is on decreasing trend from last five years NIBL is moderate in this ratio and shows increasing trend consistently for last

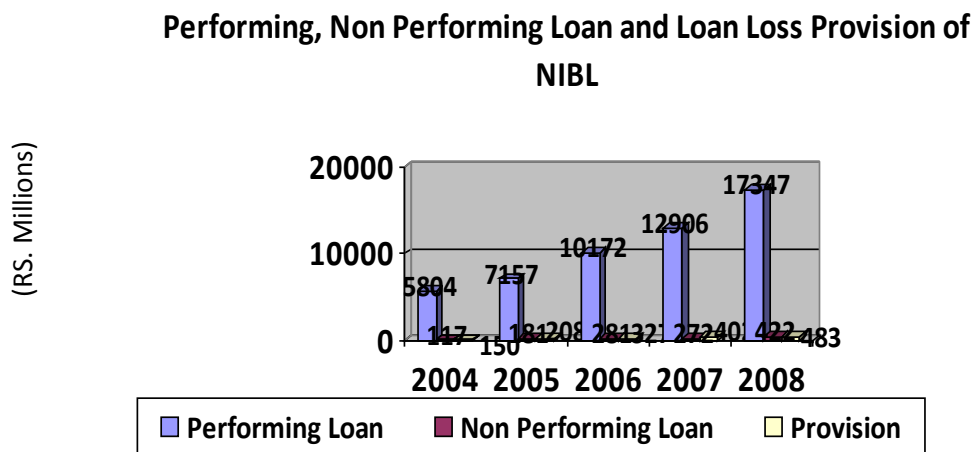
five years. Since NBBL is in loss in the year 2005 and 2006 it shows negative return in these periods. The ratio was not at par in the year 2004 and 2005 however after changed management NBL has shown good return @ 6.71% in the year 2007. In the changed scenario, NBBL will also provide positive return on loans and advances in the near future.

The mean ratio of NIBL, NABIL & NBBL is 2.35%, 4.84% and (2.80%) respectively. Since NABIL's net profit is the highest among all the three banks this ratio is also the highest.

The standard deviation of NIBL, NABIL and NBBL are 0.37, 0.41, & 8.26 and CVs are 15.77%, 8.55% & (295.53%) respectively (Appendix 2). Thus it signifies that along with the higher return NABIL as the least deviation with the least degree of variation in this ratio. Among the three banks NIBL is moderate in terms of deviation & variability NBBL has the highest deviation with the highest variability of ratio during the study period. Thus it can be concluded that even though NBBL has the highest exposure on loans and advances the bank has failed to earn return on loans and advances.

Following figure no.1, 2 & 3 represents five years performing loans, Non performing loans and loan loss provision of NIBL, NABIL & NBBL.

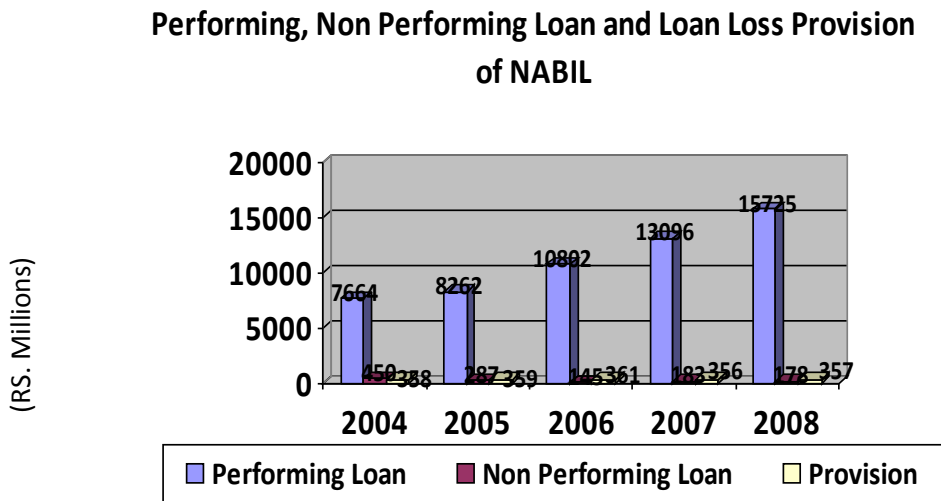
Figure No. 1



The above figure exhibits the position of Performing Loan, Non Performing

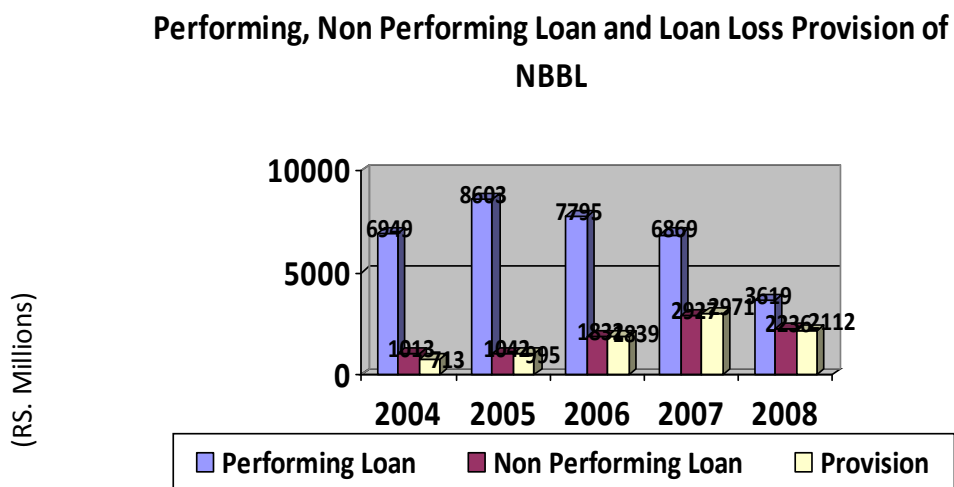
Loan and Loan Loss Provision for five consecutive years. NIBLs Performing Loan is also in increasing trend from 2004 to 2008. Likewise Nonperforming Loan and LLP is in fluctuating trend.

Figure No. 2



The above figure exhibits the position of Performing Loan, Non Performing Loan and Loan Loss Provision for five consecutive years. The Performing loan of NABIL is in increasing trend from 2004 to 2008. Likewise Non performing loan and LLP is in fluctuating trend..

Figure No. 3



The above figure exhibits the position of Performing Loan, Non Performing Loan and Loan Loss Provision for five consecutive years. This figure shows the fluctuating trend.

4.2 Correlation Analysis

4.2.1 Correlation between Loan Loss Provision and Loans and Advances

The correlation between LLP and loans and advance shows the degree of relationship between these two items. How a unit increment in loans and advances affect the loan loss provision is measured by this correlation. Here loans and advances is independent variable and LLP is dependent variable.

Table No. 12

Correlation between LLP & Loan and Advances

Banks	Correlation Coefficient (r)	Probable Error (P.E.)	6*P.E.
NIBL	0.9836	0.0098	0.05853
NABIL	0.4931	0.2283	1.3698
NBBL	-0.0298	0.3014	1.8013

Above table no12 explains the relationship between loans and advances and LLP (Appendix 3). Here the correlation coefficient of NBBL is -0.0298 and it is less than 6 times the value of its PE and even lesser than PE the correlation coefficient of the banks seems insignificant. In other words, the total LLP of the above banks is not correlated with the loans and advances during the study

period. The correlation. Coefficient of NIBL is 0.9836 and its PE is 0.0098 and 6PE is 0.05853 .Since r is greater than PE & 6PE there is positive correlation between LLP and loans and advanced of NIBL. Hence there is positive correlation between LLP and loans and advances of NIBL and its correlation coefficient is significant and reliable.

4.2.2 Correlation between loan loss provision and Non performing loans

The correlation between LLP describes the relationship between LLP and NPL how a unit increases in NPA effect the LLP is exhibited by this correlation here non performing loan is independent variable and LLP is dependent variable. As earlier mentioned NPA are the loan falling on the category of substandard, doubtful and loss loan and the respective provisioning requirement is 25%, 50% and 100% higher the NPA higher will be the provisioning amount.

Table no.13

Correlation between loan loss provision and Non performing loan

Banks	Correlation coefficient (r)	Problem Error (P E)	6* P E
NIBL	0.9592	0.0241	0.1444
NABIL	-0.0736	0.3000	1.8001
NBBL	0.9929	0.0043	0.02558

The Above **Table no 13** explains the relationship between LLP and NPL. (Appendix 3) .Here all the three banks except NABIL bank have positive correlation between LLP and NPL .The positive correlation between LLP and NPL of two banks i.e NIBL & NBBL Connote the increment in NPL leads to increment in LLP .The negative correlation of NABIL clearly indicates that the banks has low volume of NPA provision the loan loss provision includes 1% of good (PASS) Categories too.

The correlation coefficient of NIBL is 0.9592 and its PE and 6PE are 0.0241 and 0.1444 .Since correlation coefficient r is greater than 6 times the value of PE the correlation coefficient is significant and reliable .In other words the total LLP of NIBL is highly correlated with the non performing loan during the study period and the increase in LLP of NIBL is due to increase in NPL for the bank .The correlation coefficient of NABIL is -0.0736 and its PE is 0.30 and 6PE is 1.8001. In case of NABIL r is lower than 6 times the value of PE .Hence its correlation coefficient is said to be insignificant as the provision increment is not due to NPA as provision increases due to 1% provision under good loan. So it can be interpreted that there is good sign for the health of NABIL banks. The correlation coefficient of NBBL is 0.9929 .It is less than six times the value of PE and 6 PE .Hence there is positive correlation between NPL and LLP of NBBL from this also we can understand that NIBL and NBBL have high degree of NPL in comparison to NABIL.

4.2.3 Correlation between loans and advances and Deposit

Deposit is one of the major items of liability side and loans and advances is the major item of asset side of balance sheet of any commercial bank .Bank's disburses loans and advances through the funds received from the depositors. The correlation coefficient between loans and advance and deposit describes the degree of relationship between these two variables. Here deposit is independent variable and loans and advances is dependent variable. Hence how a unit

increase in deposit impact in the volume of loans and advances is exhibited by this correlation coefficient.

Table no 14

Correlation between Loans and Advances & Deposit

Banks	Correlation coefficient r	Problem Error (P E)	6* P E
NIBL	0.9940	0.0036	0.0213
NABIL	0.9170	0.0480	0.2881
NBBL	0.9681	0.0189	0.1134

The above table no 14 shows the correlation coefficient probable error and six times the value of three banks (Appendix 3).It shows there is high degree of positive correlation between loans and advances and deposit in all three banks. The respective values of correlation coefficient of NIBL, NABIL and NBBL are 0.9940,0.9170 and 0.9681 which are greater than 6 times the value of their respectively probable error. Hence it can be interpreted that the correlation between these three variables in NIBL NABIL & NBBL are certain and significant. That means increase in volume of deposit leads to increment in loans and advances of above three Banks.

4.3 Trend Analysis

Trend analysis is a statistical tool which helps to forecast the future values of different variable on the basis of past tendencies of variable. Trend analysis informs about the expected future values of various variables. Amongst the various methods to determine trend the least square method is widely used in practices. Hence in this study also least square method has been adopted to measure the trend behaviors of these selected banks. However trend analysis is based on the assumption that past tendencies continues in the future. Under this heading the effort has been made to calculate trend variables from mid July

2004 to mid July 2008 and forecast is done for next five years from mid July 2008 to mid July 2012.

4.3.1 Trend Analysis of loans and Advances

The values of average loans and advances (a), rate of change of loans and advances (b) and trend values of loans and advanced of three banks for 10 years from mid July 2004 to mid July 2013 are as follows (Appendix 4)

Table no. 15

Trend Values of Loan & Advances

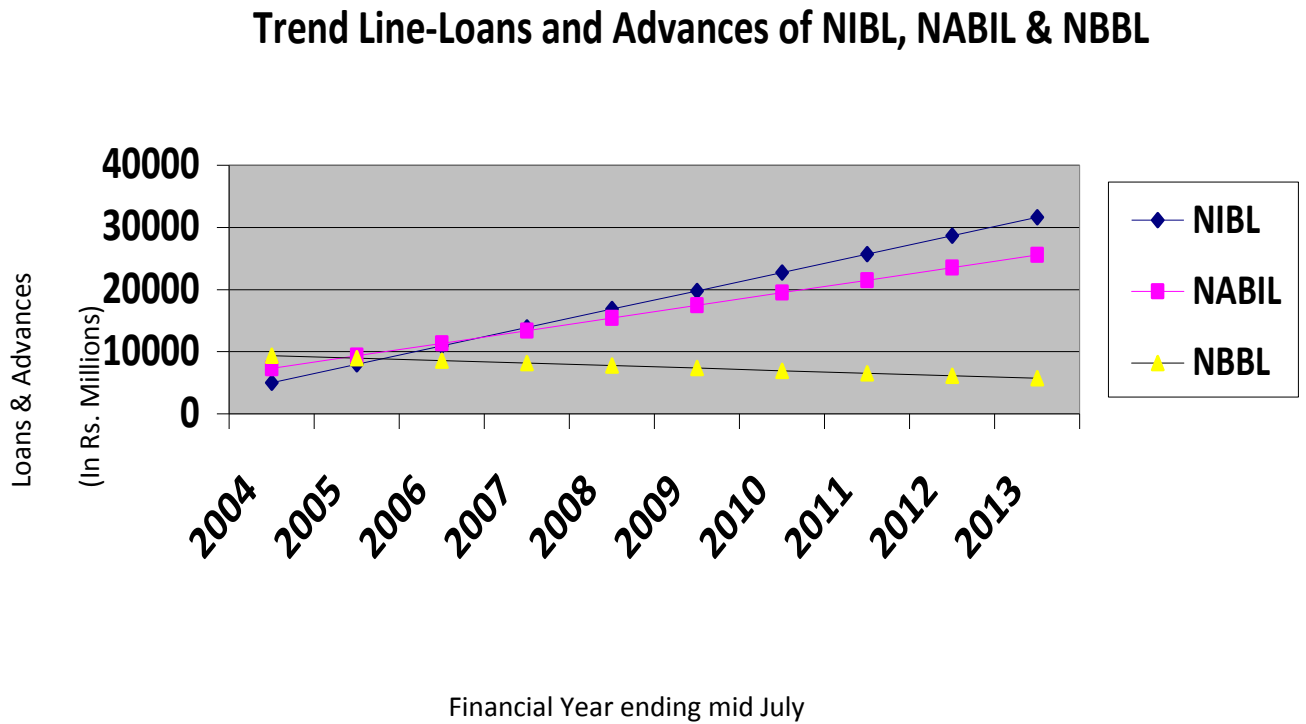
Years	Banks		
Mid July	NIBL	NABIL	NBBL
	a = 10,931.80 b=2,953.60	a=11,358.40 b=2,030.80	a=8,577 b= (406.30)
2004	5,025	7,297	9,390
2005	7,978	9,328	8,983
2006	10,932	11,358	8,577
2007	13,885	13,389	8,171
2008	16,839	15,420	7,764
2009	19,793	17,451	7,358
2010	22,746	19,482	6,952
2011	25,700	21,512	6,546
2012	28,653	23,543	6,139
2013	31,607	25,574	5,733

The above table no 15 shows that NBBL has decreasing trend but NIBL and NABIL have increasing trend of loans and advances. The average loans and

advances of NIBL is Rs10, 931.80 which is increasing at the rate of Rs 2953.60 million every year. Loan and advances are expected to increase from Rs. 19793 in 2009 to Rs. 31607 million in 2013 NABIL average loans and advances is Rs11,358.400 and are increasing every year at the rate of Rs 2030.80 million Hence the expected loans and advances of NABIL are supposed to increase from Rs 17451 in 2009 to Rs 25574 million in 2013 however the average loans and advanced of NBBL is Rs 8577 million which is decreasing every year at the rate of Rs 406.30 million. According loans and advances of NBBL is expected to be decrease from Rs 7,358 million in 2009 to Rs 5,733 million in 2013.

As NBBL is suffering from the problems of nonperforming loans and single obligor limit problem due to capital constraints they are concentrating more on recovering bad debts and there was no further investment in the form of loans and advances. Hence its loans and advances show decreasing trend. Even though NIBL & NABIL show increasing trend rate of increment of NABIL is lower than that of NIBL like the proportion of loan and advances in total assets structure its increment rate is also low from this it can be interpreted that NABIL has policy of investment in loans and advance following figure no.4 represents the trend line of loans & advance of three banks for 10 consecutively years.

Figure No. 4



4.3.2 Trend Analysis of nonperforming Assets (loan)

The calculated values of average non performing loan (a) rate of change of NPA (b) and trend value of NPA for 10years from mid july2004 to mid july2013 are as follows (Appendix 4)

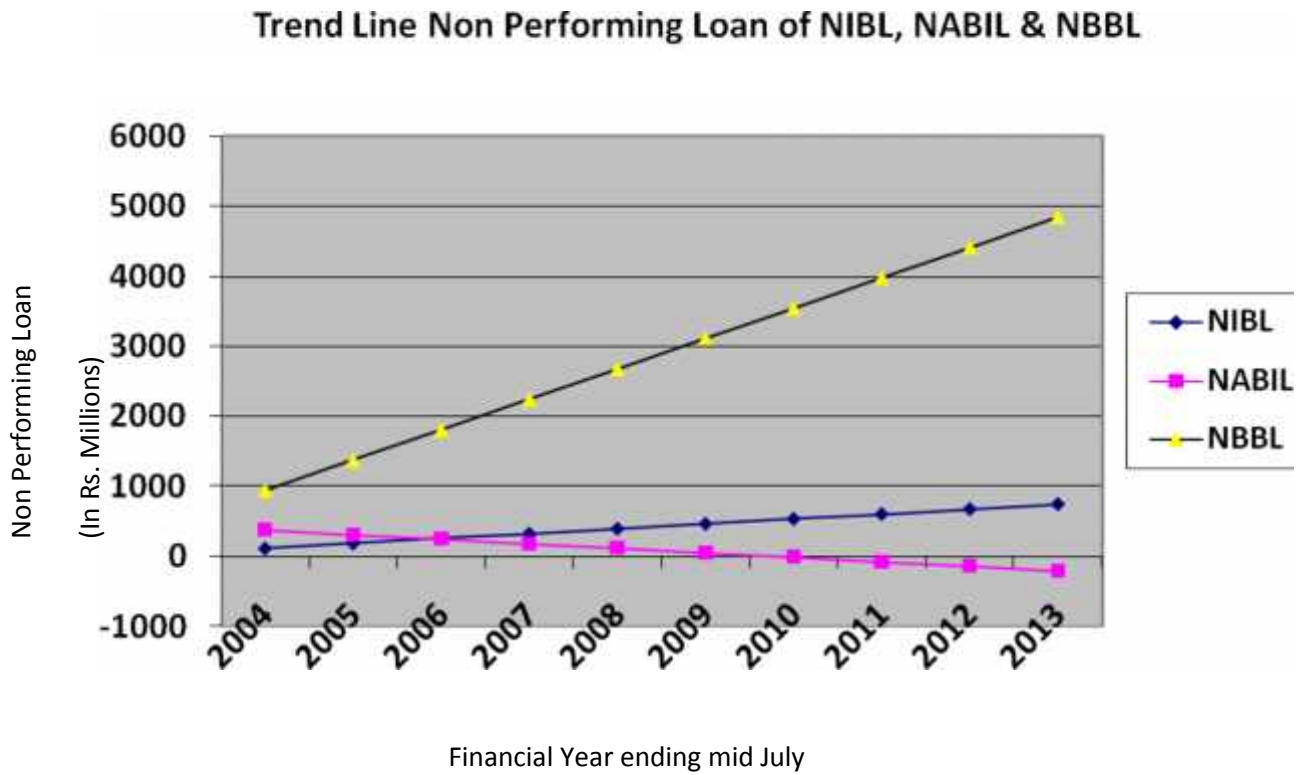
Table no.16**Trend values of Non Performing loan****In million Rs**

Years	Banks		
	NIBL	NABIL	NBBL
(Mid July)	a=254.60 b=70.10	a=248.60 b=(64.80)	a=1810 b=433.10
2004	114	378	944
2005	185	313	1,377
2006	255	249	1,810
2007	325	184	2,243
2008	395	119	2,676
2009	464.90	54	3,109
2010	355	(11)	3,542
2011	605	(75)	3,976
2012	675	(140)	4,409
2013	745	(205)	4,842

The above Table No 16 show that NABIL has decreasing trend but NIBL and NBBL have increasing trend of NPL. The average NPA of NIBL is Rs154.60, which is increasing at the rate of Rs70.10 million every year. NPL is expected to increase from Rs 464.90 million in 2008 to Rs745 million in 2012. NABIL's average NPA is Rs248.60, which is decreasing every year at the rate of Rs. 64.80 million. Hence the expected NPA of NABIL is supposed to decrease from Rs54 million which is increasing every year at the rate of Rs433.10 million. According NPA of NBBL is expected to increase from Rs3109 million in 2008 to Rs4842million in 2012.

NBBL has significantly higher non performing loan in the total volume of loans and advances and its rate of increment is also very high. If this trend continues it would lead the banks to the verge of banking affecting several parties of the society. Hence immediate reform should be initiate Due to NABIL recovery efforts through establishment of recovery cell its NPL has come down in recent years. Hence NABIL show decreasing trend if this trend of NPA even though NPA of NIBL is relative lower it. Increasing trend if this trend continuo not only NBBL but also NIBL will also be severely affected by the problem of increasing non performing loan .following figure no 5 represents the trend lone of non performing loan of three banks for 10 consecutive year.

Figure No.5



4.3.3 Trend Analysis of loans loss provision

The calculated values of average loan loss provision (a), rate of change of LLP (b) and trend values of LLP for 10 years from mid July 2004 to mid July 2013 of the three banks are as follows (Appendix 4):

Table no. 17

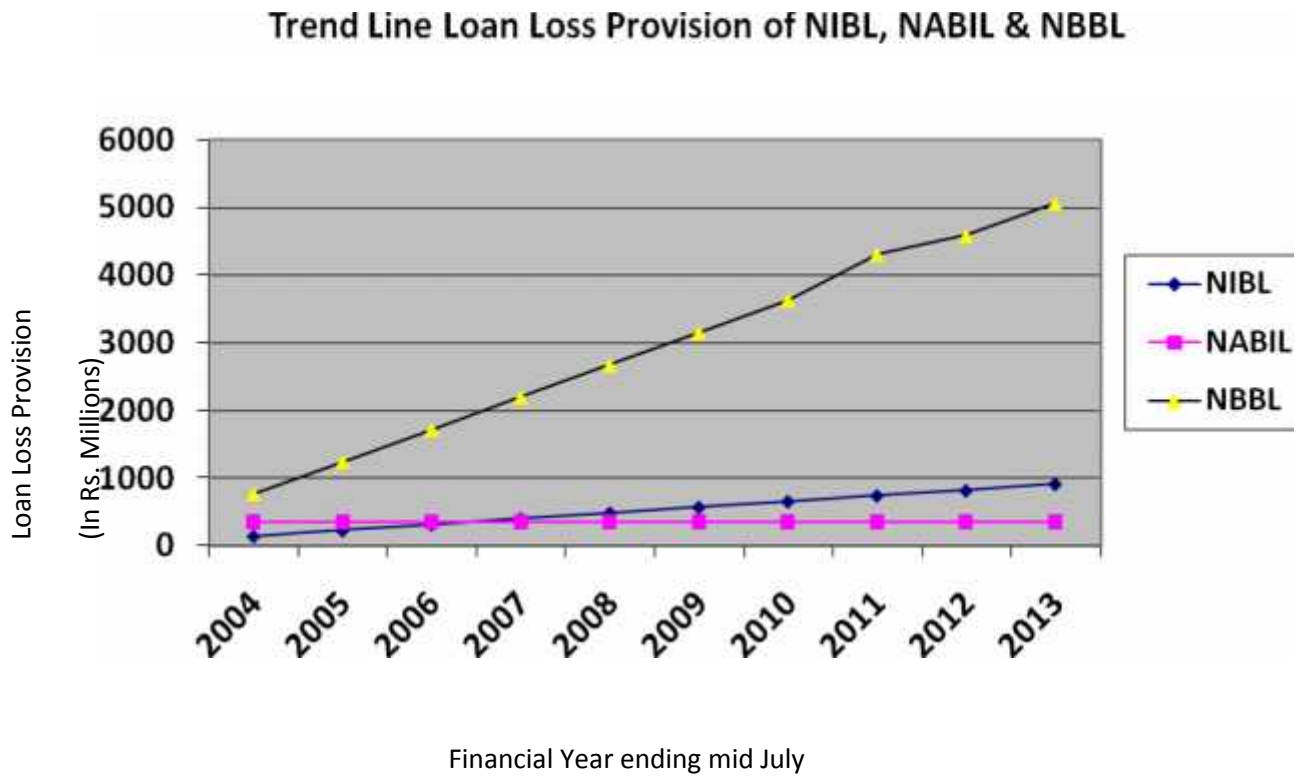
Trend values of loan loss provision

In million Rs

Years	Banks		
	NIBL	NABIL	NBBL
(Mid July)	a=314 b=86	a=358.20 b=(0.5)	a=1726.20 b=477.20
2004	142	359.20	772
2005	228	359	1249
2006	314	358	1726
2007	400	358	2203
2008	486	357	2681
2009	572	357	3158
2010	658	356	3635
2011	744	356	4112
2012	830	355	4589
2013	916	355	5067

The above [table no.17](#) shows that NABIL has decreasing trend but NIBL and NBBL have increasing trend of LLP. The average LLP of NIBL is Rs3314, which is increasing at the rate of Rs86 million every year. LLP is expected to increase from Rs 572 million in 2008 to Rs916 million in 2012. The average LLP of Nabil is Rs 358.20.20, which is decreasing every year at the rate of Rs0.50 million. Hence the expected LLP of NABBL is supposed to decrease from Rs357 million in 2008 to Rs355 million in 2012 considering above ratio we can say that NABIL average LLP would be almost constant in the period of five years from 2008 to 2012. The average LLP of NBBL is Rs1726.20 million which is increasing every year at the rate of Rs477.20million. According LLP of NBBL is expected to increase from Rs3158 million in 2008 to Rs5067 million in 2012. as NBBL is suffering from the problem of bad debts they have huge amount of non performing loan higher the non performing loan higher would be the LLP hence its LLP shows increasing trend. NABIL decreasing trend of LLP avows that it is successful in reducing the non performing loans of the bank even though LLP of NIBL is lower than NBBL it shows increasing trend which is an indication of increment of NPA in the total asset quality. following figure no 6 represents the trend line of loan loss provision of three banks for 10 consecutive years.

Figure No. 6



The calculate values of average net profit (a), rate of change of net profit (b) and trend values of net profit for 10 year from mid july 2004 to mid july 2013 of the three banks are as follows (Appendix 4):

Table no.18

Trend values of net profit

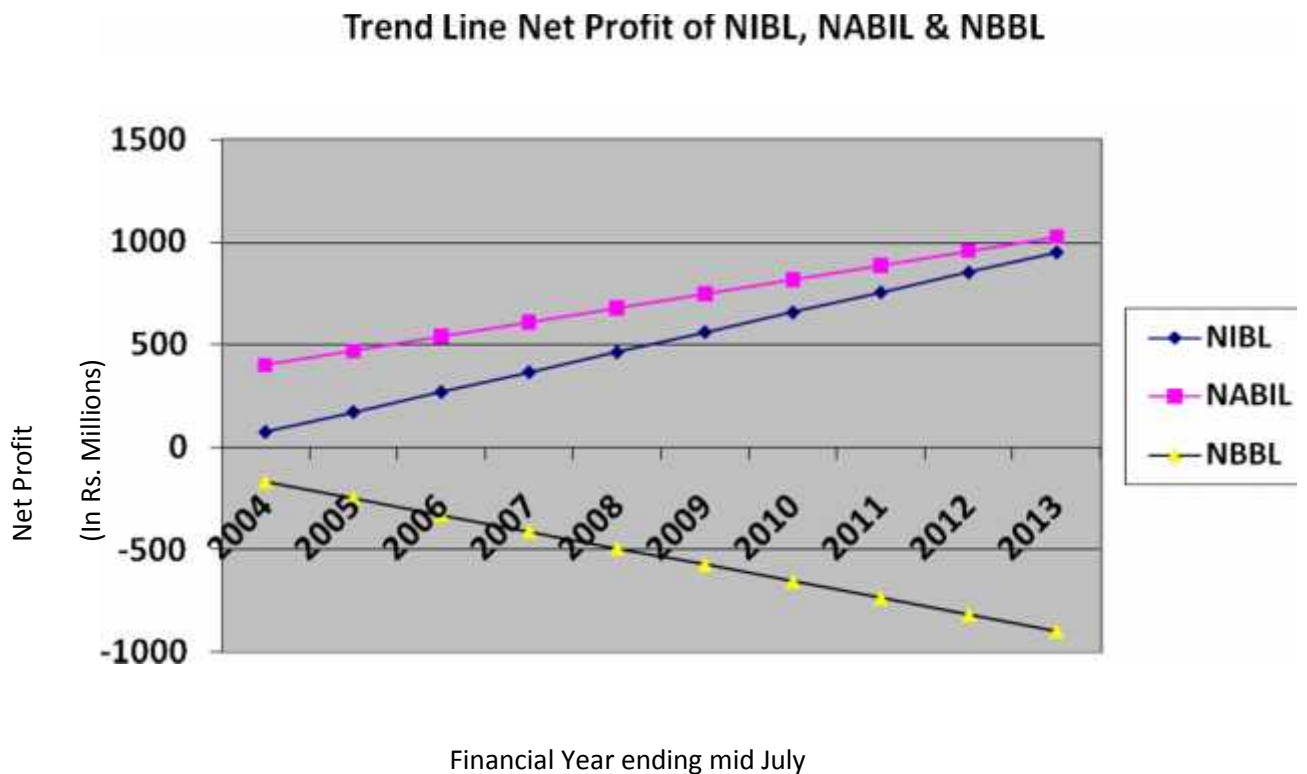
In million Rs

Years	Banks		
	NIBL	NABIL	NBBL
(Mid July)	a=270.60 b=96.70	a=540 b=69.60	a=(327.80) b=(81.50)
2004	77	401	(165)
2005	174	470	(246)
2006	271	540	(328)
2007	367	610	(409)
2008	464	679	(491)
2009	561	749	(572)
2010	567	818	(654)
2011	754	888	(735)
2012	851	958	(817)
2013	948	1027	(898)

The above **table no.18** shows that except NBBL,NIBL and NABIL Banks have increasing trend of net profit NIBL average NP is Rs314 million. Which is increasing ever year at the rate of Rs86 million. Hence the expected NP of NIBL is supposed to increase from Rs561 million in 2008 to Rs948million in

2012 NABIL average NP is Rs540 million which is increasing every year at the rate of Rs69.60 million. Hence the expected NP of NABIL is supposed to increase from Rs749 million in 2008 to Rs1027 million in 2012. Since NBBL is in loss if this trend is to continue the average net loss of NBL is Rs327.800 million which is increasing every year at the rate of Rs81.50 million. The expected net loss of NBBL in to in the year 2012 would reach at Rs898 million. NBBL may come in to the profit if the present NPA gets realized. The above figures depicts respects that NABIL is ahead in generating net profit however among the three banks NBL has the highest growth rate following figure no 7 represent the trend lone of net profit of three banks for 10 consecutive years.

Figure No. 7

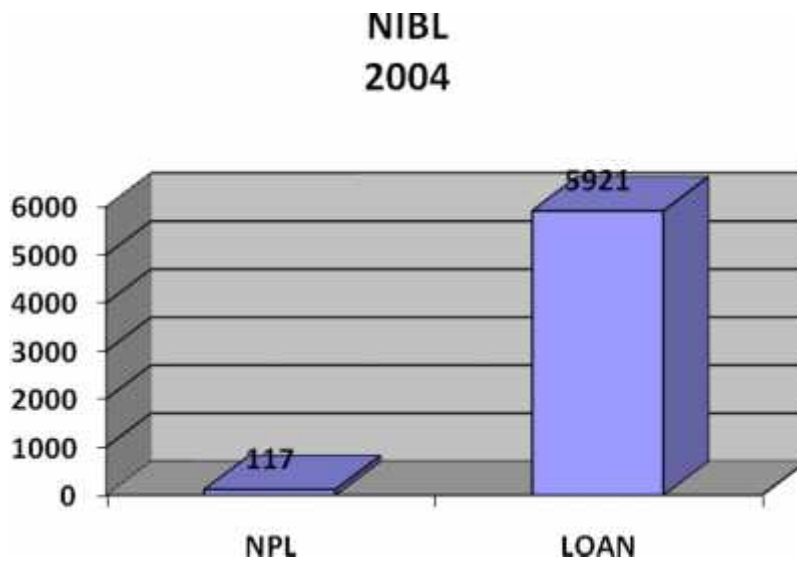


4.4 Comparison of Credit Quality of subjects Banks

In the following figure there is comparison between the year 2004 and 2008 that what had happened within five years.

Figure no. 8

Comparison of credit quality of NIBL JULY 2004 (Volumes in millions)



July 2008 (Volume in Millions)

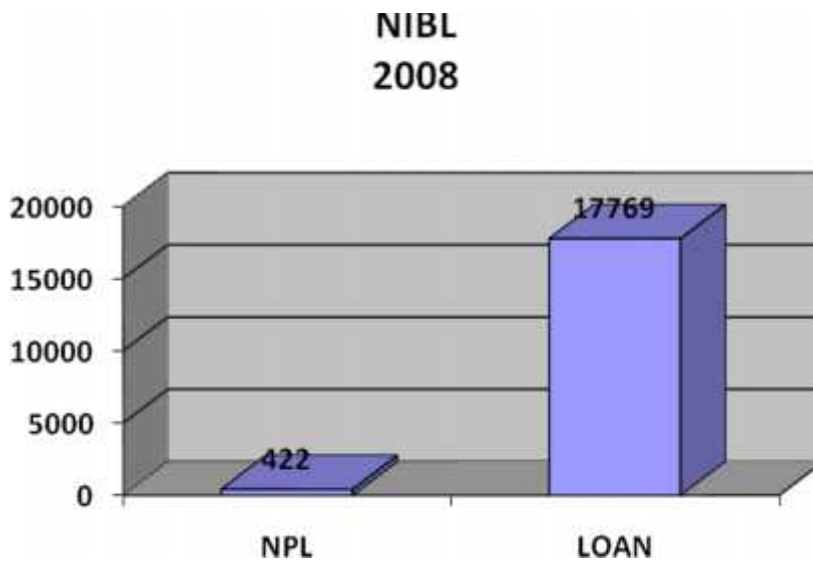
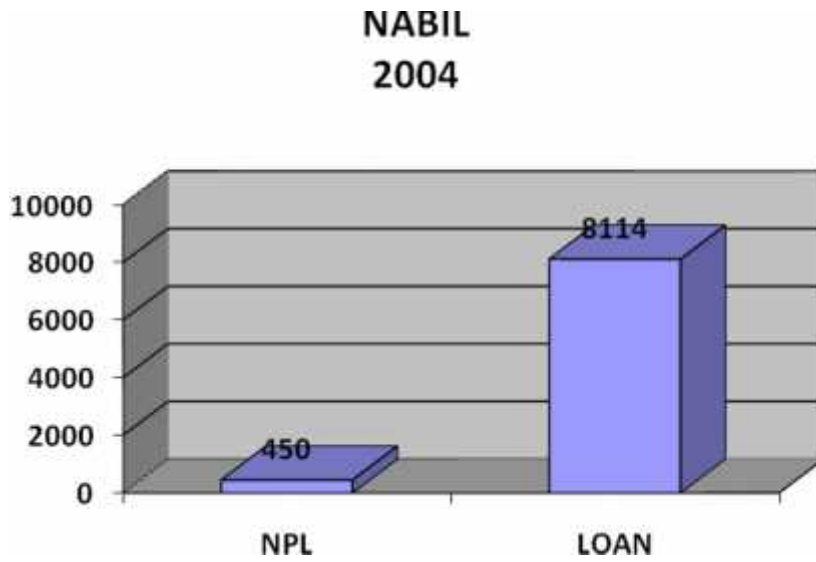


Figure no. 9

Comparison of credit quality of NABIL JULY 2004 (Volumes in millions)



July 2008 (Volume in Millions)

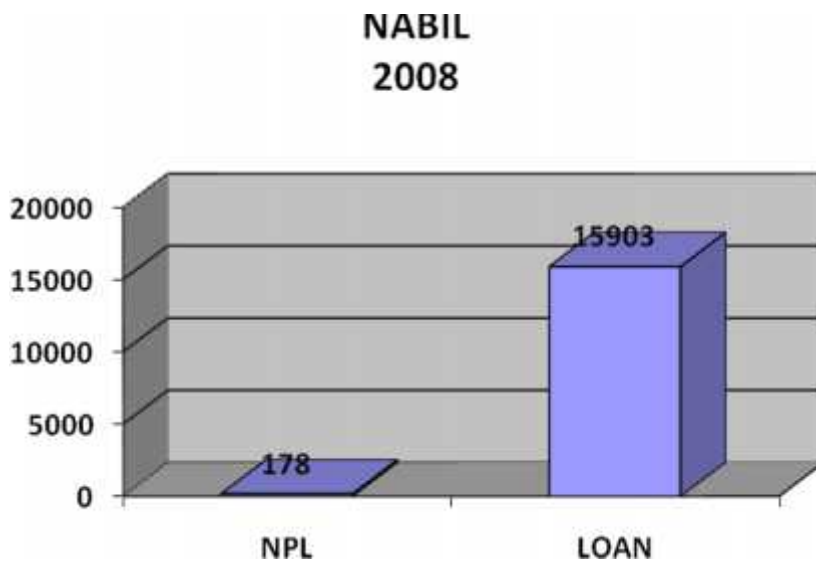
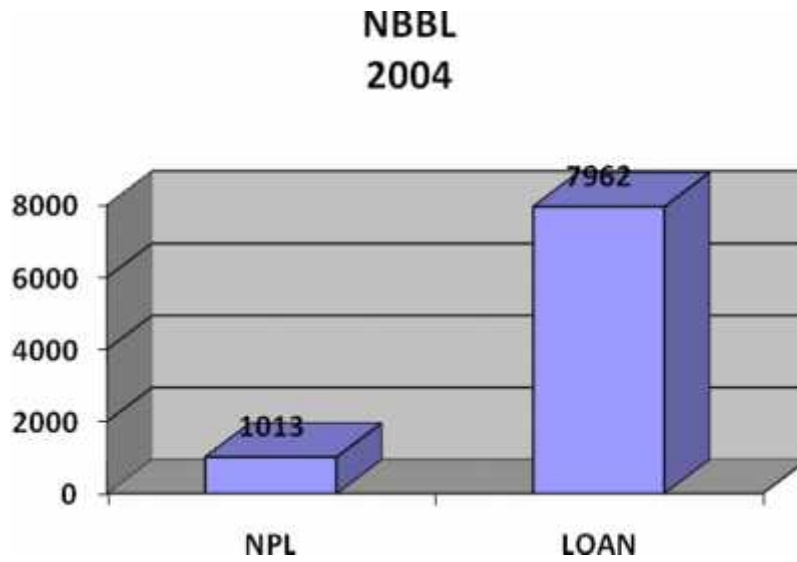
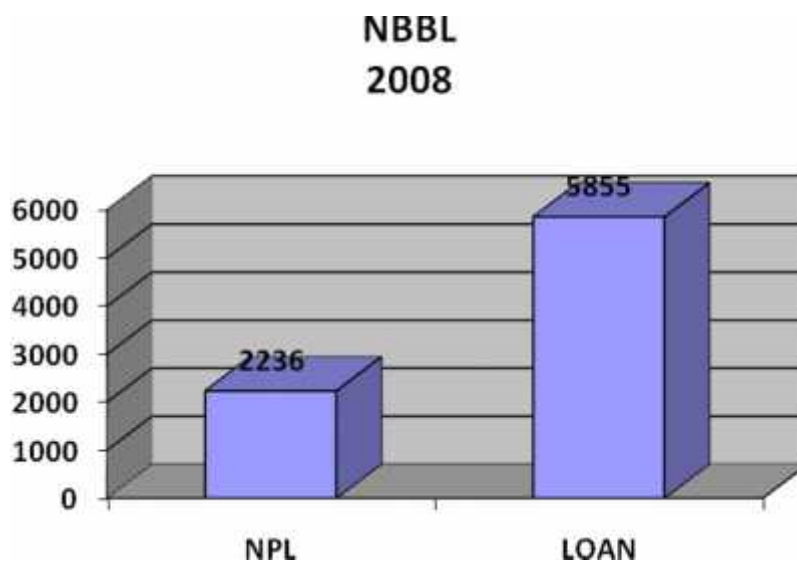


Figure no. 10

Comparison of credit quality of NBBL JULY 2004 (Volumes in millions)



July 2008 (Volume in Millions)



4.5 Major findings of the study

From the analysis of data , following major findings have been obtained.

- J The average loans and advances to total asset ratio of NIBL, NABIL &NBBL during the study period is found to be 62.46%, 56.40% respectively the relatively low ratio of NABIL is the indication of risk averse attitude of the management or they have the policy of investing low in the risky asset risk i.e. loan and advances, they have higher proportion of their investment in risk free or nominally risky asset like treasury bills national saving bonds its. Here this ratio is the highest of NBBL but issued loan and advances are not generating the desired income. NBBL shows the highest degree of deviation and variable while NIBL and NABIL have the most consistent ratio throughout the study.

- J The core banking function is to mobilize the funds obtained from the depositors and how successfully this function have been sis charged by the banks is measured by the ratio of loans and advances to total deposit ratio or simple CD ratio the average CD ratio of NIVL NABIL and NBBL during the study period is found to be 70.78%, 66.63% & 73.14% respectably. The average ratio of NIBL and NABIL is nearly same but that NBBL is relatively lower. Even though this ratio is the least of NBBL it has the most consistent and least deviated ratio during the study period whereas NIBL has higher deviation and variability in this ratio NBL is moderate among the three banks in terms of deviation and veniality of ratio.

- J The analysis of nonperforming loan to total loan reveled that average NPA of NIBL, NABIL & NBBL is 2.31%. 2.55% & 22.12% of total loan respectively. That means 97.69%, 97.45% & 77.88% of total loan of NIBL, NABIL & NBBL is performing loan. Amongst three banks NBBL

has significantly higher proportion of the non performing loan in the total loans portfolio and this ratio also shows an increasing trend which exhibits the precarious condition of the bank.

) NIBL and NABIL have controlled the NPA level and strive to maintain below 5% which is within prescribed international banking standard. During the study period this ratio is found moderate in NIBL but NPA is on an increasing trend. However, NABIL has shown significant decrement and control over NPA which is the result of the bank's effective credit management and its efforts of recovering bad debts through establishment of a recovery cell. Due to a high level of NPA, NBBL has been declared a bank run and has been given serious attention to come over from high NPA. The central bank (Nepal Rastra Bank) has taken over its management from last years.

) Loan loss provision ratio of NBBL is found to be significantly higher which is around 20.96% in average, followed by NIBL of 2.85% and NABIL of 3.37%. Since a higher ratio is an indication of higher non performing loan in the total loans and advances, NBBL's relatively higher ratio is the result of a higher proportion of NPA in total loan even though higher than that of NIBL. NIBL and NABIL show a decreasing trend in this ratio which means both banks' asset quality is improving. NBBL has the higher deviation and variability of the ratio followed by NABIL and then NIBL.

) The average ratio of provision held to non performing loan of NIBL, NABIL & NBBL was found to be 124.35%, 169.74% & 92.44% respectively. Hence NABIL has a significantly higher ratio in comparison to other two banks which exposes that the bank has adequate provision against non performing loan but this ratio of NBBL is comparatively lower. Even though NBBL has provided required provision on each category of NPA as per NRB, defectively it has not enough provision

against NPA if all the NPA goes in default still there is minimal risk of 7.56% which is not secured a little bit. However this ratio shows increasing trend NIBL is moderate in this ratio and has the least variability and NABIL show the higher variability in this ratio.

-) The main objective of commercial Banks is to earn profit through mobilization of fund. The ratio of returns on loans and advances ratio revealed that NBBL seem to be failure to earn return on loans and advance. Even though NBBL has higher investment in the most income generating asset i.e. Loans and advances it is in loss since last five year. The average return on loans and advances is -2.80% NABIL with an average of 4.84% return on loans and advances has the higher ratio as it is ahead in generating net profit NIBL is moderate with an average of 2.35% return on loans and advances. NBBL has the higher variability followed by NIBL and then NABIL.
-) The correlation coefficient between LLP and advances of NIBL, NABIL & NBB is 0.9836, 0.4931 and -0.0298. here correlation coefficient of NIBL is less than the value of 6 times PE and even less than PE it is insignificant and there is performing loan the high negative correlation of NBBL is the result of high non performing loans in the total loans portfolio. Hence the increase in provision of NBBL is not due to increment in loans and advance but due to increment in its non performing loans NABIL has positive correlation between LLP and loans and advance but it is not significant. This is also due to higher proportion of NPL in the total loan portfolio. However LLP of NIBL is highly correlated with loans and advance and its correlation coefficient is significant and reliable.
-) The correlation between LLP and NPL reveals that there is positive correlation between LLP and NPL in all the three Banks. As earlier mentioned higher provision needs to be provided for NPL higher the

NPL higher would be the LLP correlation coefficient between these two variable in NIBL, NABIL& NBBL is 0.9592 and 0.9929. The correlation coefficient of NIBL and NBBL is significant but that of NABIL is insignificant the reason behind this is relatively lower proportion of NPL in the total loan portfolio of NABIL.

-) While analyzing correlation between loans and advances and deposit it has been found that NIBL NABIL& NBBL have high degree of positive correlation between these two variables. the respective correlation coefficient of NIBL, NABIL&NBBL is 0.9940,0.9170 and 0.9681, which is significant and reliable. That means increase in volume of deposit leads to increment in loans and advances of above three Banks.
-) Trend analysis was done based on the data of past five year and forecast was made for next five years. The trend of loans and advance showed decreasing trend in NBBL and increasing trend in regards to NIBL &NABIL but rate of increment of NIBL is higher that than that or NABIL the loans and advance of NBL is decreasing at the rate of Rs406.30 million every year and that of NIBL & NBBL is increasing at the rate of Rs2953.60million and 2030.80million every year respectively.
-) From the trend analysis of NPL it is found that NPL is increasing in case of NIBL&NBBL and in case of NABIL it is decreasing. The NPL of NABIL Its decreasing at the rate of Rs64.80million every year and that of NIBL &NBBL is increasing at the rate of Rs70.10million and 433.10million every year respectively. The decreasing trend of NABIL is due to its efforts towards good management of existing and new loan and recovering bad debts.
-) From the trend analysis of LLP it is found that LLP is expected to increase in coming years in case of NIBL &NBBL and in case of NABIL it is expected to remain in the same level in coming years. The LLP of

NABIL is decreasing at the rate of Rs0.50%million every year and that of NIBL&NBBL is increasing at the rate of Rs86million and 477.20million every year respectably. The decreasing trend of LLP in NABIL is due to its recovery efforts towards reducing NPL .

) From the trend analysis of net profit it is found that NP is expected to increase in coming year in two banks I.e. NIBL and NABIL. NBBL shows decrement of net profit at the rate of Rs81.50million each year. Similarly net profit of NIBL&NBBL is increasing every year by Rs96.70million and Rs69.60 million respectively. As NIBL has higher rate of increment if this trend is to continue NBL would SOON surpass NABIL NBBL has to give proper attention in recovery of bad debts (NPA)to recover the profit.

) Increasing non performing loan is one of the burning problem of Nepalese banking sector improper credit appraisal system ineffective credit monitoring &supervision system economic slowdown borrower misconduct political pressure to lend to un credit worthy parties etc are the major factors leading to non performing assets setting up recovery cell hiring asset management company etc are some to the measures to resolve the problem of NPA loan classification and loan loss provision. Also helps to confront the problems the created due to non performing loans since loan loss provision is deducted from the profit of bank. Increase in provision decrease the profit of the banks by the same amount but this type of negative effect is only for short period once the banks have adequate provision and sound credit management the profitability will again gear up.

After the completion of analysis of data., The next chapter or the final chapter incorporates the summary conclusion and recommendation regarding the subject matter.

CHAPTER –V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

Finally this chapter includes the summary, conclusions and recommendation based on the result of the analysis of the data.

5.1 Summary

National development of any country depends upon the economic development of the country and economic development is supported by financial infrastructure of the country. Banks constitute an important segment of financial infrastructure of any country. Thus Banks play an important role in the economic development of the country as the issue of development always rest upon the mobilization of resources.

Banks deals in the process of canalizing the available resources to the needy sector causing overall economic development this research is aimed at studying the non performing loan and loan loss provisioning of commercial Banks for this purpose descriptive cum analytical research design was adopted. out of the total population of 23 commercial banks, taken as sample using judgmental sampling Method Nepal investment banks kitized was selected from private sector banks and two joint venture bank NABIL banks limited and nepal Bangladesh Bank ltd both primary and secondary data have been used in the study primary data has been collected through questionnaire direct interviews & telephone interviews and annual report and other publication forms the basis of secondary data the data collected from various sources are recorded systematically and presented in appropriate forms of tables and charts and appropriate mathematical statistical financial graphical tools have been applied

to analyze the data the data the data of five consecutive years of the three selected banks have been analyzed to meet the objective of study.

NABIL and NIBL have the highest proportion of the loans and advances in the total asset structure but NABIL has relatively lower loans and advances in the total asset structure the credit deposit ratio also shows increasing trend of two banks (NIBL &NABIL) and decreasing trend of NBBL it indicates the risk diversification and minimization attitude of the management of NABIL. There is higher proportion of non performing assets loan in the total loans and advances of NIBL which comes around 22.12% on average which is very much higher than the acceptable standard of minimum 10% since higher provision has to be apportioned for NPA its loan loss provision is also significantly higher than the other two Banks. Regarding NPA and LLP NIBL is moderate among the three and NABIL has the least NPL and according the least LLP than NBBL and nearer to NIBL. The modern credit analysis approach applied by NABIL towards lending has made this Banks successful to have low ratio of provisioning and lower ratio of nonperforming loans.

Even though NBBL has the highest proportion of their investment in the most income generating asset the Bank is in loss. Most of the loans of NBBL have at risk zone and become non performing and hence it is not generating any income instead demanded high provision for probable loss there is negative return on loans and advance in NBB. Even NIBL has higher proportion of investment in loans and advances in comparison to NABIL its return on loans and advances is comparatively lower. However the high return of NABIL is not due to its proper lending function but due to low deposit cost high fee based income high yield on lending high forging currency deposit foreign exchange earnings and high foreign trade income (LC) etc.

There is positive correlation between LLP and loans and advances in NIBL &NABIL but these two variable shows negative correlation in case of NBBL. This is due to increment of nonperforming assets (loan) of NBBL. Among to be provisioned depends upon the non performing assets (loan) and its quality.

Higher provision has to be provided for NPA. Hence even though loans and advances do not increase if in the same loan portfolio NPA increases, LLP will increase. This has also been shown by the positive correlation between LLP and NPL in two Banks, however, NABIL has negative correlation between LLP and NPA the negative correlation of NABIL clearly indicates that the Banks has been reducing NPA provision. Similarly all three Banks NIBL, NABIL and NBBL have shown positive correlation between loans and advances and deposit.

The trend analysis of loans and advances shows increasing trend in case of NIBL and NABIL but decreasing trend in NBBL. This is because NBBL has no further investment plans in loans and advances in recent years instead they are concentrating core on recovering bad debts the trend analysis of non performing loan and loan loss provision shows increasing trend in NBBL and even in NIBL whereas NABIL shows decreasing trend in coming year. This is due to NABIL recovery efforts towards reducing NPL through establishment of recovery cell. The past trend of net profit of the entire three banks except NBBL exhibits increasing trend in coming years since NBI is in loss if this trend is to continue to loss goes drastically.

Today Banking industry is severely affected by the problem of NPA improper credit appraisal system ineffective credit monitoring & supervision system economic slowdown borrower misconduct and overvaluation of collateral political pressures to lend to un creditworthy parties etc are the major factors leading to non performing assets. Setting up recovery cell hiring Asset management company etc some of the measures to resolve the problem of NPA loan classification and loan provision also help to confront the problem thus created due to non performing assets (loans) the directive regarding loan classification and loan loss provisioning is very important for maintaining sound financial health of the Banks leading to decrement in profitability of the Banks but this is only for a short run.

5.2 Conclusions

Liberalization of financial sector started in 1980s with the aim to streamline it after that the financial sector widened with more banks and financial institution. Even the financial sector developed rapidly but in terms of quality it is far behind the developed countries. Banks came into existence mainly with the objectives of collecting idle fund mobilizing then into productive sector and causing an overall economic development the Banker have the responsibility of safeguarding the interest of the depositors the shareholders and the soviet they are serving. lending is the major function of any commercial Bank and it s the most income generating asset of any commercial Bank but there is risk inherent in bank lending portfolio in order to cover the risk inherent in the lending portfolio Banks have to make loan loss provision by categorizing the loans into different category as per the NRB directives. Increasing nonperforming assets (loan)is the serious problem of the Banking sector in Nepal. Non-performing asset debar the income flow of the Bank while claiming additional resources in the form of provisioning and hinder further gainful investments.

It has been found that NBBL has very high portion of nonperforming loan resulting to higher provision. Hence even the Bank has the highest investment in the most income generating asset i.e. loans and advance it is in loss.The private sector Banks like NIBL and NABIL does not have higher non performing loan and accordingly don't have higher provision. However in recent last year NIBL non performing loan has shown significant increment and according provision has also increased among the three banks .NABIL has low average of NPA & LLP in comparison of last five years data. NABIL has been improving on NPA &LLP from last four years. NIBL is also a head in generating income from these indicators .It can be said that NABIL is the best among the three banks however NABIL seems less oriented towards lending.Hence the lower percentage of NPA and provision of NABIL is not only due to proper lending management function but also due to relatively lower investment in loans and advances.

In the conclusion it can be said that ineffective credit policy, political & board executive's pressure to lend to un-creditworthy borrowers, overvaluation of collateral are the major causes of mounting nonperforming assets in the joint venture banks like NBBL other factors leading to accumulation of NP as are weak loan sanctioning process ineffective credit monitoring & supervision system economic slowdown borrower miscount etc continual review and classification of loans enables banks to monitor quality of their loan portfolios and to take remedial action to counter Management company are also measures to resolve the problem of NPL the present loan classification and provisioning directive seems more stringent than the previous one as a result more provision has to be apportioned leading to lesser profitability but this kind of negative impact is only for short period adequate provisioning strengthens the financial health of the banks and makes them able to face any kind of future contingencies.

5.3 Recommendations

- The high portion of nonperforming loan accompanied by higher provision of NBBL indicates that the banks credit portfolio needs serious attention. Hence NBBL is recommended to take immediate remedial actions for recovering bad debts hiring asset Management company (AMC) is recommended for NBBL to resolve the problem of mounting non performing loan.
- Though NBBL loan portfolio seems low in comparison to other banks their loan and advances are considered here to be lower as NBBL has stopped extending of loan and advance rather they are involved in recovery of bad debts and mounted NPA. NBBL credit contribution to loan and advance is also relatively low. Entire economy is largely dependent upon the proper execution of lending function by commercial banks low level of lending means low-level of investment resulting to low level of productivity which may ultimately affect negatively on the national. Loans and advance on one hand is the highest income

generating asset and on the other hand it also helps to upgrade the economic health of the country. Hence NABIL is recommended to increase its investments in productive sector in the form of loan and advances.

- It has been observed that the loan and advance of NBBL are decreasing and there were no further investment of deposit in recent in recent years. Hence it is recommended for NBBL for exploring new areas of investment.
- The main factors which lead to non performing assets are improper credit appraisal system ineffective credit monitoring and supervision system etc .Besides that negligence in taking information from credit information Bureau may also lead to bed debts. Hence all the three banks are recommended to be more cautious and realistic while granting loans and advance. After advancing loans there should be regular supervision and follow up proper utilization of loan.
- It is recommended for the Banks to initiate training and development program for the employees to make them efficient and professional in credit appraisal monitoring and proper risk management.
- Following the directives of NRB and acting upon it also reduce many of the credit risk. Besides there are penalty implication on non compliance of the directives. Hence all the three Banks are recommended to adhere the directives and they are also suggested to come up with a stronger internal audit department to ensure that the directives are properly implemented.
- The regulation regarding loan classification and provisioning is stringed and tighter than the previous. Hence NRB should not only impose directives but also create supportive environment for the commercial Banks NRB is recommended to strengthen credit information bureaus

(CIB)so that Banks can get required credit information about the borrowers on time. This would help in reducing NPA.

- The ratio of provision held to non performing loan of NABIL is relatively lower in comparison other two Banks. Even though NABIL has made provision for each category of loan as per NRB directives the total provision amount is not enough in case all the non performing goes on default of the loan has to be written off. Hence NABIL is recommended to increase this ratio by reducing non performing loan.
- It is often sad that prevention is better than cure. Hence it is recommended for all the three Banks to take preventive measures before the loan goes to default .All the Banks are recommended to have an information system to gather all the possible information and activities about its borrowers so that necessary precautions can be taken in time.

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APPENDIX 1

Figures from Balance Sheet & Profit & Loss Account

Total Assets

Banks	2003	2004	2005	2006	2007
NIBL	9014	13255	16064	21330	27591
NABIL	16563	16745	17064	22330	27253
NBBL	11919	14258	13283	12959	10118

Total Deposit

Banks	2003	2004	2005	2006	2007
NIBL	7923	11525	14255	18927	24488
NABIL	13348	14119	14587	19347	23342
NBBL	10591	12807	12125	13015	9464

Loans & Advance

Banks	2003	2004	2005	2006	2007
NIBL	5921	7338	10453	13178	17769
NABIL	8114	8549	10947	13279	15903
NBBL	7962	9645	9627	9796	5855

Non Performing Loan

Banks	2003	2004	2005	2006	2007
NIBL	117	181	281	272	422
NABIL	450	287	145	183	178
NBBL	1013	1042	1832	2927	2236

Performing Loan

Banks	2003	2004	2005	2006	2007
NIBL	5804	7157	10172	12906	17347
NABIL	7664	8262	10802	13096	15725
NBBL	6949	8603	7795	6869	3619

Loan Loss Provision

Banks	2003	2004	2005	2006	2007
NIBL	150	208	327	402	483
NABIL	358	359	361	356	357
NBBL	713	995	1839	2971	2112

Net Profit

Banks	2003	2004	2005	2006	2007
NIBL	117	152	232	351	501
NABIL	416	455	520	635	674
NBBL	71	3	(650)	(1456)	(393)

Note :

- The entire figures presented above are rounded off to the nearest million Rs.
- The data presented herein are pertained to mid July of each year .
- The data presented herein are based on the amount mentioned in the annual reports of respective years in case of NABIL & SCBNL, The data of NBL is based on data in websites of www.nepalstock.com and the annual reports to shareholders of NBL published in Gorkhapatra.
- Loans and Advance also include Bill Purchased & Discounted.

APPENDIX 2

Calculation of Mean, S.D. & C.V. of Loans & Advances to Total Assets

Ratio of Nabil (Sample Calculation)

(Rs. In Million)

Years (Mid July)	Ratio (X) %	(X-X)	(X-X)²
2003	47.51	0.51	0.26
2004	48.82	1.82	3.30
2005	45.32	-1.68	2.84
2006	44.26	-2.74	7.53
2007	49.11	2.11	4.44
N=5	X X235.02		(X Z X)² X18.37

We have,

$$\text{Mean } (\bar{X}) = \frac{\sum X}{N} = \frac{235.02}{5} = 47\%$$

$$\text{Standard Deviation } (\dagger) = \sqrt{\frac{\sum (X - \bar{X})^2}{N}} = \sqrt{\frac{18.37}{5}} = 2.14$$

$$\text{Coefficient of variation (C.V)} = \frac{\dagger}{\bar{X}} \times 100 = \frac{2.14}{47} \times 100 = 4.55\%$$

Similarly the Mean , S.D. & C.V of other ratios of the three banks have been calculated.

APPENDIX 3
Calculation of Correlation Coefficient, P.E. & 6 P.E.
of Nabil (Sample Calculation)

(Rs. In Million)

Years (Mid July)	Loans & Advance (X)	LLP (Y)	x=(X-X)	y= (X-X)	x ²	y ²	xy
2003	5789	360	(1684)	(63)	2835182	3994	106416
2004	7335	434	(138)	11	18989	117	(1488)
2005	8324	600	851	176	724541	31258	150492
2006	7802	364	330	(59)	108373	3505	(19489)
2007	8114	358	641	(65)	411138	4251	(41806)
N = 5	X X 37,364	Y X 2116	Y X 1226	y ² X 0	x ² X 4,098,223	y ² X 43,125	xy X 194,125

We, have , Karl Pearson Correlation coefficient,

$$\text{Correlation, (r)} = \frac{xy}{\sqrt{x^2 \cdot y^2}} \times \frac{194,125}{\sqrt{4,098,223 \cdot 43,125}} \times 0.4618$$

$$\text{Probable Error (P.E.)} = \frac{0.6745(1 - Zr^2)}{\sqrt{N}} \times \frac{0.6745(1 - Z0.4618^2)}{\sqrt{5}} \times 0.2373$$

$$6 \text{ P.E.} = 6 \times 0.2373 = 1.4240$$

Similarly the Correlation coefficients, P.E. & 6 P.E. between different variables of three banks have been calculated.

APPENDIX 4
Calculation of Trend Values of Loans & Advances
of NIBL (Sample Calculation)

(Rs. In Million)

Years (Mid July)	Loans & Advance (Y)	Deviation from Mid July, 2001	X ²	XY	Y _c =a+bX Y _c = 20021.20+ (785.90) X
2003	21,074	(2)	4	(42,148)	21,593
2004	21,228	(1)	1	(21,228)	20,807
2005	2,019	0	-	-	20,021
2006	19,253	1	1	19,253	19,235
2007	18,132	2	4	36,264	18,449
N = 5	Y X100,106	X X0	X ² X10	XY X(7,859)	

Here,

When = 0, from the two normal equations,

$$a = \frac{X}{N} \times \frac{100,106}{5} \times 20,021.20$$

$$b = \frac{XY}{X^2} \times \frac{(7,859)}{10} \times (785.90)$$

Thus,

Average Loans & Advances (a) =Rs. 20,021.20

Rate of change of Loans and Advances (b) = Rs (785.90)

Hence, the equation of straight-line trend is Y_c=a+bX

$$Y_c = 20,021.20 + (785.90) \times X$$

Expected Trend Values of Loans & Advances (2004-2008)

Expected Trend Values of Loans & Advances (2004-2008)

Years (Mid July)	Deviation from Mid July 2005 (X)	Y _c =a+bX Y _c =20,021.20+(785.90)x X
2008	3	17,664
2009	4	16,878
2010	5	16,092
2011	6	15,306
2012	7	14,520

Similarly the trend values for other variable of the three banks have been calculated

Appendix 6

Table No. 1

List of Licensed Commercial Banks in Nepal

Mid-April, 2008

S.No	Names	Operation Date (A.D.)	Head Office	Paid up Capital (Rs. In Million)
1.	Nepal Bank Limited	15-Nov-37	Kathmandu	380.4
2	Rastriya Banijya Bank	23-Jan-66	Kathmandu	1,172.3
3	Agriculture Development Bank Ltd.	2-Jan-68	Kathmandu	9,278.0
4	NABIL Bank Limited	16-July-84	Kathmandu	689.2
5	Nepal Investment Bank Limited	27-Feb-86	Kathmandu	1002.6
6	Standard Chartered Bank Nepal Limited	30-Jan-87	Kathmandu	620.8
7	Himalayan Bank Limited	18-Jan-93	Kathmandu	810.8
8	Nepal SBI Bank Limited	7-July-93	Kathmandu	647.8
9	Nepal Bangladesh Bank Ltd	5-Jun-93	Kathmandu	744.1
10	Everest Bank Limited	18-Oct-94	Kathmandu	831.4
11	Bank of Kathmandu Limited	12-Mar-95	Kathmandu	603.1
12	Nepal Credit and Commerce Bank Limited	14-Oct-96	Siddharthanagar, Rupendehi	1195.7
13	Lumbinui Bank Limited	17-July-98	Narayanghat, Chitwan	750.0
14	Nepal Industrial & Commercial Bank Limited	21-July-98	Biratnagar, Moragn	792.0
15	Machhapuchhre Bank Limited	3-Oct-00	Pokhara, Kaski	821.7
16	Kumari Bank Limited	3-Apr-01	Kathmandu	900.0
17	Laxmi Bank Limited	3-Apr-02	Birgunj, Parsa	732.0
18	Siddhartha Bank Limited	24-Dec-02	Kathmandu	690.0
19	Global Bank Limited	2-Jan-07	Birgunj, Parsa	700.0
20	Citizens Bank Ltd.	21-Jan-07	Kathmandu	560.0
21	Prime Bank Ltd.	24-Sep-07	Katmandu	700.0
22	Sunrise Bank Ltd.	12-Oct-07	Katmandu	700.0
23	Bank of Asia Nepal Ltd.	12-Cot-07	Kathmandu	700.0

Source : www.nrb.org.np

Appendix 7

Table No. 2

Bank wise NPA Level of Mid July 2007

Bank Wise NPL	Mid July 2007		
	Total Loans (Rs.000s)	NPL	
		%	Amount
Nepal Bank Limited	13,756,620	13.49	1856049
Rastriya Banijya Bank	25,394,627	29.16	7405073
Agriculture Development Bank Ltd.	27,153,148	14.97	4064826
NABIL Bank Limited	15,903,024	1.12	178294
Nepal Investment Bank Limited	17,769,100	2.37	421972
Standard Chartered Bank Nepal Limited	10,790,148	1.83	197017
Himalayan Bank Limited	17,793,724	3.61	641615
Nepal SBI Bank Limited	10,065,052	4.56	458756
Nepal Bangladesh Bank Ltd	5,854,583	38.19	2235865
Everest Bank Limited	14,082,686	0.80	113179
Bank of Kathmandu Limited	9,694,102	2.51	243296
Nepal Credit and Commerce Bank Limited	5,122,222	30.63	1568937
Lumbinui Bank Limited	4,944,501	2.37	1007036
Nepal Industrial & Commercial Bank Limited	9,128,649	1.11	101140
Machhapuchhre Bank Limited	7,319,939	1.16	85161
Kumari Bank Limited	9,062,433	0.73	66119
Laxmi Bank Limited	6,529,239	0.35	23021
Siddhartha Bank Limited	6,319,727	0.34	21542
Global Bank Limited	2,602,564	-	-
Citizens Bank Ltd.	2,026,260	-	-
Prime Bank Ltd.	N.A.	-	N.A.
Sunrise Bank Ltd.	N.A.	-	N.A.
Bank of Asia Nepal Ltd.	N.A.	-	N.A.

(Based on Provisional data of id April 2008)

Appendix 8

Table No. 3

Bank wise NPA Level on Mid April 2008

Bank Wise NPL	Mid July 2007		
	Total Loans (Rs.000s)	NPL	
		%	Amount
Nepal Bank Limited	15603598	11.00	1716396
Rastriya Banijya Bank	25598327	25.85	6617167
Agriculture Development Bank Ltd.	29188865	15.28	4460059
NABIL Bank Limited	20817386	1.30	270626
Nepal Investment Bank Limited	26437653	1.36	359552
Standard Chartered Bank Nepal Limited	12695035	1.02	129489
Himalayan Bank Limited	20092426	3.46	695198
Nepal SBI Bank Limited	11852093	4.07	482380
Nepal Bangladesh Bank Ltd	6379397	37.60	2398653
Everest Bank Limited	17281501	0.63	108873
Bank of Kathmandu Limited	12166668	2.28	277856
Nepal Credit and Commerce Bank Limited	5199244	26.83	1394957
Lumbinui Bank Limited	5284497	15.42	814869
Nepal Industrial & Commercial Bank Limited	10558391	0.80	84467
Machhapuchhre Bank Limited	8343138	4.62	385453
Kumari Bank Limited	9238987	1.39	128482
Laxmi Bank Limited	8569717	0.29	24852
Siddhartha Bank Limited	8374699	0.31	25962
Global Bank Limited	4744883	-	-
Citizens Bank Ltd.	4504534	-	-
Prime Bank Ltd.	3954316	-	-
Sunrise Bank Ltd.	2290404	-	-

Bank of Asia Nepal Ltd.	2020109	-	-
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(Based on Provisional data of id April 2008)

Appendix 9

Table No. 6

Loans & Advances to Total Asset Ratio (%) in Million Rs.

Year (Mid July)	NIBL			NABIL			NBBL		
	Loans & Advances	Total Asset	Ratio (%)	Loans & Advances	Total Asset	Ratio (%)	Loans & Advances	Total Asset	Ratio (%)
2004	5921	9014	65.69	8114	16563	48.99	7962	11919	66.80
2005	7338	3255	55.36	8549	16745	51.05	9645	14258	67.65
2006	10543	16064	65.07	10947	17064	64.15	9627	13283	72.48
2007	13178	21330	61.78	13279	22330	59.47	9796	12959	75.59
2008	17769	27591	64.40	15903	27253	58.35	5855	10118	57.87
Mean			62.46			56.40			68.08
S.D.			4.24			6.26			6.74
C.V			6.79			11.10			9.90

(Source : Annual Reports & Websites of Concerned Banks)

Appendix 10

Table No. 8

Loans & Advances to Total Asset Ratio (%)

Rs. in Million

Year (Mid July)	NIBL			NABIL			NBBL			
	NPL	Loan & Advances	Ratio (%)	NPL	Loans & Advances	Ratio (%)	NPL	Loan & Advances	Ratio (%)	
2004	117	5921	1.98	450	8114	5.55	1013	7962	12.72	
2005	181	7338	2.47	287	8549	3.36	1042	9645	10.80	
2006	281	10543	2.69	145	10947	1.32	1832	9627	19.03	
2007	272	13178	2.06	183	13279	1.38	2927	9796	29.88	
2008	422	17769	2.37	178	15903	1.12	2236	5855	38.19	
Mean			2.31	Mean			2.55	Mean		22.12
S.D.			0.29	S.D			1.91	S.D		11.67
C.V			12.69	C.V			74.99	C.V		52.74

(Source : Annual Reports & Websites of Concerned Banks)