CHAPTER-ONE
INTRODUCTION
1.1 General Background of the Study

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

The Nepalese financial sector is composed of banking sector and non-banking sector. Banking sector comprises Nepal Rastra Bank (NRB) and commercial banks. The non-banking sector includes development banks, micro credit development banks, finance companies, co-cooperative financial institutions, nongovernmental organizations (NGOs) performing the limited banking activities. Other financial institutions comprise of the insurance companies, employees provident fund, citizens investment trust, postal saving offices and Nepal stock exchange (NEPSE). By the year 2012, Thirty two commercial banks are established with their more than 1200 operating branches across the country. Similarly, Eighty Seven Development Banks, Seventy Nine Finance Companies, eighteen Micro Credit Development Banks are functioning in the country.

Central bank being the supervisor of the entire banking system allocated the authority to regulate & supervise the banking for the stability of the financial sector. So, for the effective and efficient functioning of the commercial banks, Nepal Rastra Bank issues directives to the commercial banks. The objective of bank supervision in Nepal has always been to promote and maintain the safety, soundness and integrity of the financial system while promoting confidence in the system through the implementation of policies and standards that are in line with the international best practices. The main aim of the directives issued by NRB is to maintain the stability & healthy development of banking & financial system of the country. According to the Bank and Financial Institution Act 2063, Nepal Rastra Bank is guiding the commercial banks through its stated eleven directives. Those are stated as follows:

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

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

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

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

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

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

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

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

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

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

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

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

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

1.1.1 Evolution of Banking System in Nepal

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

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

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

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

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

After long time, during the Rana regime, only handfuls prime minister thought about the economic development of the country. They established some offices in 1993 B.S. (1936A.D.) Tejarath Addawas established during the tenure of Prime Minister Ranoddip

Singh Rana as a first institutionized credit house. Tejarath Adda provided loans under the security of gold and silver to the government employees and public. The government established its various branches and sub-branches at different places of the country for the sake of benefits of people. In the overall development of the banking system in Nepal, the Tejarath Adda may be regarded as the father of modern banking institution and for a quite long time it rendered a good service to the government employees as well as to the general public. The government also implemented the rules against the vast interest rate taken by moneylenders. Thus, the government financial institution occupies an important role in the banking history of Nepal.To fulfills the growing need of economy in Nepal, banking activities were performed only after the establishment of Nepal Bank Limited in 1994 B.S. (1937A.D.) as the first commercial bank in Nepal. This bank was established under the Nepal Bank Act 1994 B.S.

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

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

Nepal Rastra Bank as the bank of the banks and the government bank has been granted the full authority to regulate and develop the banking sector in Nepal. Commercial banks have to strictly follow the rules and regulations issued by the NRB. The establishment of the NRB was the major step in the evolution of the financial institutions. The commercial banks are supervised by the Bank Supervision Department while the rest of these institutions are supervised by Financial Institution Supervision Department. Initiation of the NRB provided the special impetus for the development of the financial institution.

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

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

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

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

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

With the satisfactory result of joint venture banks, Nepalese promoters are highly encouraged and as a result, commercial banks are introduced with cent percent domestic investment. At present, Nepal Industrial and Commercial Bank (NIC), Lumbini Bank

Ltd., Machhapuchhre Bank Ltd., Bank of Kathmandu, Nepal Credit and Commerce Bank Ltd., Laxmi Bank Ltd., Siddhartha Bank Ltd., Kumari Bank Ltd. came into operation with cent percent domestic investment by Nepalese promoters which are the plus point of development of banking sector of Nepal. Now, there is a strong competition between commercial bank for the existence so that the growing needs of the customers can easily achieve.

1.1.2 Nepal Rastra Bank as a Central Bank

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

NRB has set up with the full ownership of the government of Nepal and an autonomous body with the main objective of stabilizing the economy and the entire financial system of the country. Unlike the other commercial banks, it neither accepts deposits nor provides loan to the public. But it accepts the credit of Government of Nepal & its offices, commercial banks and other financial institutions and provides loan to the Government of Nepal and financial institution as they need and demand. NRB is committed to strengthen and ensure the stability and soundness of the banking system. NRB issues directives to the commercial banks instructing them to fulfill its regulatory requirements of the country.

Under the existing structure of Nepal Rastra Bank, the directives applicable to the commercial banks are primarily issued from two departments viz. Bank and Financial Institutions Regulation Department and Foreign Exchange Management Department. The Foreign Exchange Management Department regulates the foreign currency transactions of the bank while the Bank and Financial Institutions Regulation Department covers the rest. At present NRB is regulating financial sector through its following legal bodies.

- Nepal Rastra Bank Act, 2012

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

1.1.3 Brief Profile of the Sample Banks

Nabil Bank Limited (NABIL)

Nabil’s inception as the first foreign joint venture bank in the year 1984 was one of the important years in the history of Nepalese banking. Founded with the technical collaboration of then Dubai Bank Ltd., along with the institutions like Nepal Industrial Development Bank, Rastriya Beema Sansthan, and Nepal Stock Exchange it soon became a great icon for customer service in the Nepalese financial industry. Even then when the modern banking was way too far for general public and technology was just budding, the then Board of Nabil and its management team contemplated about computerizing its operations from initial days. Reduced transaction time at the counter and prompt delivery of customer account statements were the main thrust for the Nabil team. Today, this noble thought has become one of the strong foundations to grow its business in manifold.

Today it has expanded its service networks to48 branches, 2 extension counters and 81ATMs, 1050 rented and owned POS machines at merchant outlets, 1237Western Union and 1263 Nabil Remit agents and various arrangements for using delivery points of other banks and financial institutions through Mechi to Mahakali to deliver services efficiently to its customers. There are number of customized products and various units designed to cater diverse needs of corporate houses and individuals. Corporate Banking, SME and Micro Financing, Project and Infrastructure Financing, Personal Lending and Cards are there for catering credit needs;

Bank assurance Division for risk as well as wealth management; Deposit Relationship Unit for deposits management through various schemes; and Remittance Unit for easy transfer of funds domestically and internationally. Besides, the businesses of Nabil have also grown multitudinously. The Bank's balance sheet size has crossed toNRs.73 billion (NRs.268 million in 1984-85) and shareholders' fund to NRs.6.6 billion (NRs.28 Million) and are ever growing steadily. Having said that the journey for Nabil had not been that too easy. There were ebbs and flows in its business during its journey of glorious 29 years; however despite adversities, it has been able to stay atop in terms of customer base, geographic outreach, business portfolio and profitability. These are all testaments of strong foundations the predecessors have laid and the legacies that have been inherited to sustain in a big way.

The culture the Bank has inculcated, the HR it has groomed, the structure it has developed and continuous oversight and guidance from the Board strongly supports the bank surging ahead on sustainable growth path. The following table shows the authorized capital, issued and paid up capital of Nabils.

Table: 1.1 Share Capital Structure

Authorized Capital	Rs. 2,500,000,000
Issued Capital	Rs. 2,436,841,400
Paid up Capital	Rs. 2,436,841,400

Source: *www.nabilbank.com*

Standard Chartered Bank Nepal Limited (SCBNL)

Standard Chartered Bank Nepal Limited has been in operation in Nepal since 1987. It was initially registered as a joint-venture operation. The Bank today is an integral part of Standard Chartered Group having an ownership of 75% with 25% shares owned by the Nepalese public. Standard Chartered Bank Nepal enjoys the status of being a subsidiary of Standard Chartered Bank, a leading international bank in the world.

Standard Chartered is a leading international banking group. It has operated for over 150 years in some of the world's most dynamic markets and earns around 90 per cent of its income and profits in Asia, Africa and the Middle East. This geographic focus and commitment to developing deep relationships with clients and customers has driven the Bank's growth in recent years. Standard Chartered PLC islisted on the London and Hong Kong stock exchanges aswell as the Bombay and National Stock Exchanges in India.

With 1,700 offices in 68 markets, the Group offers exciting and challenging international career opportunities to over 89,000staff. It is committed to building a sustainable business over the long term and upholding high standards of corporate governance, social responsibility, environmental protection and employee diversity. Standard Chartered's heritage and values are expressed in its brand promise, 'Here for good'.

With 19 points of representation, 23 ATMs across the country and more than 450 local staff, Standard Chartered Bank Nepal Ltd. has carved a position to serve its customers through an extensive domestic network. In addition, the global network of Standard Chartered Group gives the Bank a unique opportunity to provide truly international banking services in Nepal.

Standard Chartered Bank Nepal Limited offers a full range of banking products and services in Consumer, Wholesale and SME Banking by catering to a wide range of customers encompassing individuals, mid-market local corporate, multinationals, large public sector companies, government corporations, hotels as well as the Development Organization (DO) segment comprising embassies, aid agencies, NGOs and INGOs.

The Bank has been the pioneer in introducing 'customer focused' products and services and aspires to continue to be a leader in introducing new products and in delivering superior services. It is one of the first Banks in Nepal to implement the Anti-Money Laundering policy and to apply the 'Know Your Customer' procedures.

Corporate Social Responsibility is an integral part of Standard Chartered's ambition to become the world's best international bank and is the mainstay of the Bank's values. The Bank believes in delivering shareholder value in a socially, ethically and environmentally responsible manner. Standard Chartered throughout its long history has played an active role in supporting those communities in which its customers and staff live. The Bank supports its customers and clients to contribute for sustainable economic growth. The Bank also supports communities to promote local social and economic development.

Table 1.2: Share Capital Structure

Authorized Capital	Rs. 2,000,000,000
Issued Capital	Rs. 1,853,900,000
Paid up Capital	Rs. 1,853,900,000

Source: *www.standardchartered.com/np*

1.2 Statement of the Problem

Nepal is one of the least developed countries of the world with the very lower per capita income. According to the economic survey, more than 38% of the total population is below the poverty line. The major cause of this chronic problem is the lack of economic development or the slow rate of the national economic growth.

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

But, Nepalese commercial banks have not formulated their investment policy in an organized manner. The implementation of the investment policy is not effective. The credit extended by the commercial banks to agriculture and the industrial sector is not satisfactory to meet the present growing needs. Granting loan against in deposit, over valuation of goods pledge, land & building mortgaged, risk averting decision regarding loan recovery and negligence in recovery of overdue loan is some of the basic loopholes and the result of unsound investment policy sighted in the banks. Due to this fact, the Non-Performing Loan remains a very serious problem which in turn affects the efficiency of the commercial banks. Therefore, an appropriate investment policy is the basic need of all the commercial banks.

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

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

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

- What is the relationship between the Loan Loss Provision (LLP) and total loans and advances of the sample banks?
- What is the status of Non Performing Loans (NPL) of sample banks?
- What are the impact and implications of NRB guideline with respect to NPL on the financial performance of the sample banks?
- Are sample banks following NRB directives in respect to NPL?
- Is the implementation of NRB directives being monitored or not?

1.3 Objectives of the Study

Each and every study posses a certain objective. The research without any specific objectives will be worthless. This research study entitled "Impact & Implementation of Non-Performing Loan highlights to attempt the following objectives:

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

1.4 Significance of the Study

The success and prosperity of the bank heavily depends upon the successful implementation and investment is collected resources, which develops the economy of the country. Good investment policy of the bank has positive impact on economic development of the country and vice versa. Therefore success of any bank does not depend upon how much money a bank able to lend? But it depends upon the quality of loan. So success of any bank depends upon the amount of performing loan. Performing loans are those loans that repay principal and interest to the bank from the cash flow it generates. Increasing non-performance loan followed by increasing loans and loan loss provision is one of the challenges faced by commercial banks in the present context. Proper loan provision and loan loss provision helps to get financial strength of the bank. The research will be able to give the some of the present issued, latest information and data regarding non-performing loan and loan loss provision.

Nepal Rastra Bank issues directives on various aspects to regulate and promote the financial institutions. NRB as a bank of the banks issues directives to ensure that banks are investing the public deposit in right way. This study specifically focused on the directives issued by NRB on Non-Performing Loan and its implication, implementation and impact over sampled Nepalese commercial banks namely Standard Chartered Bank Nepal and Nabil Bank Limited. Moreover, this study tries to attempt the relationship between loan loss provision and total loan & advances.

1.5 Limitations of the Study

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

- This study concentrates only on the NRB directives specific to Non-Performing Loan. Also, data and information of the sampled commercial banks only are used by the researcher.
- This study based upon the data and information of a Five Years from 2008/09 to 2012/13.
- The study based upon the secondary data.
- This study based on the reliability of the data provided by the concerned banks.
- Statistical tools are used in this study wherever needed. Hence, drawbacks and weakness of those tools are also the limitation of the study.

1.6 Organization of the Study

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

Chapter - I Introduction:

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

Chapter - II Review of Literature

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

Chapter - III Research Methodology

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

Chapter - IV Data Presentation and Analysis

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

Chapter - V Summary, Conclusion & Recommendations

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

CHAPTER-TWO

REVIEW OF LITERATURE

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

2.1 Conceptual Review

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

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

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

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

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

Core Values (CREATE)

C = Credibility

R = Responsibility

E = Efficiency

A = Accountability

T = Transparency

E = Effectiveness

Strategic Objectives

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

Strategic Guidelines

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

- Develop and implement management information system.
- Automate and modernize payments and settlement system of the country.

2.1.2 Concepts of Commercial Banks

Commercial institutions are those financial institutions, which deals in acceptingthe deposits of people and institutions and giving loan against securities. Theyprovide working capital needs of trade, industry and even to agricultural sectors.Moreover commercial banks also provide technical and administrativeassistanceto trade, industries and business enterprise. Commercial banks are a corporationwhich accepts demand deposits, subject to check and make short term loans tobusiness enterprises, regardless of the scope of its other services.

Commercial banks are the heart of financial system. They hold the deposits ofmany persons, government establishment and business units. They make fundavailable through their lending and investing activities to borrowers, individual,business firms and government establishment units.

Therefore commercial banks are those banks that pool together the saving ofcommunity and arrange for their productive use. They supply the financial needsof modern business by various means. Commercial banks are restricted to investtheir funds in corporate securities. Their business is confined to financing the shortterms needs of trade and industry. They cannot finance in fixed assets. A part fromfinancing, they also lender services like collection of bills and cheque, safekeeping of valuables, financial advising etc to their customers (Vaidya, 2001: 38).

The American institute of Banking has laid down the four major function ofCommercial bank such as receiving and handing of deposits, handing payments ofits clients making loans and investments and creating money by extension of credit(Principle of Bank Operation, USA: 609).

Principally, commercial banks accept deposits and provide loans, primarily tobusiness firms, thereby facilitating the transfer of funds on the economy (Albroland Gupta, 1971:65).

In the Nepalese context, banking and financial institution act, 2063 defines “A commercial bankas one which exchange money, deposits money, accepts deposits, gratt loans andperforms commercial banking functions” (Commercial Bank Act 2063).

A commercial banks can be define as an institution which deals in money in wordsof the Crowther “ Banks collect money from those who have it to spar or who aresaving it out of their income and lend this money out against goods security tothose who requires it” (Crowther, 1985:58).

However, central bank is the main bank of the any nation that directs and controlsall the banks whose existence is in the country. In Nepal, Nepal Rastra Bank is thecentral bank of the country. All the commercial banks perform their functionsunder rules, regulations and the directives provided by Nepal Rastra Bank.

Under the free enterprise system like U.S.A. the interest of nation as well as thoseof individuals and stockholders are supposed to be best served by vigorouslyseeking profit. But the profit cannot be the sole objective of the any enterprise. Itshould not be evaluated just on the ground of profit earned. Neither the bank northe community will be best serve if the banker unreasonably scarifies the safety oftheirs fund or the liquidity of their bank in an effort to increase income (Vaidya,2001: 24)

From the above many definition, commercial banks including joint venture banks,they are mainly receiving the money from depositor and invest in different sectors.So that banks are the main source of development of a nation. In the context ofNepal, it is a poor and least developed county having low per capita income andGDP. As a result, many economic problems such as inflation, devaluation ofmoney trade, trade deficit, budget deficit etc arises. For the sake of removing theseproblems, many joint ventures are being incorporated in our country by sharingNepal's and foreign investment towards making more profit by using the funds inprofitable sectors. Therefore bank should be invested in different sector whichhelps in the growth of national economy.

2.1.3 Function of Commercial Banks

Banks can be defined according to the functions they perform. A bank is established with the prime objective of profit maximization. To achieve this, the bank carries out functional activities, principally, commercial banks accepts deposits, provide loan, primarily to business firms thereby facilitating the transfer of funds in the economy.

Although, in the yester years banks were viewed as acceptor of deposits then provider of loan, but modern commercial banks have to perform overall development of trade, commerce, industry, agriculture including supports for priority and deprived sectors. The growing bank needs and habits of people and competitive environment has made the banking sector challenging and their operation cannot be underemphasized in present context of market globalization. Hence, a bank is a commercial institution licensed as a taker of deposits, concerned mainly with the making and receiving payments on behalf of their customers, accepting deposits, creating money and making short-term loans to private individuals, companies and other organization.

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

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

- Fixed Deposit Account
- Current Deposit Account
- Saving Account

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

- Overdraft
- Cash Credit
- Direct loan with collateral
- Discounting of bills of exchange
- Loans of money at call and short notice

General Utility Functions: - Commercial banks also perform general utility functions such as:

- Issuing of letter of credit to its customers.

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

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

- Collection of customer's money from other banks
- Receipt and payment of dividend, interest.
- Security brokerage service.
- Financial advisory service.
- To underwrite the government and private securities (Commercial Bank Act 2031 B.S. (1974 A.D.).

Credit creation: - in order to earn profit, bank accepts deposit and advance by keeping small cash in reserve for day to day transactions. By granting loan bank create credit or deposit.

Other functions/services:-

- Other safeguards valuables such as securities, jewellery documents of title to goods for save custody.
- Bank assists to the traders who are engaged in foreign trade by discounting bills of exchange and others.
- Bank make venture capital loan to the start-up cost of new companies particularly in high-tech industries.
- Bank offer a wide range of financial advisory services about financial, planning, consulting and others.

2.1.4 Role of Commercial Banks

The role of commercial bank in the economy is obviously a prime prerequisite forthe formulation of the bank policy as the role shape, the nature and character of thebank. The deposit minded banker may under emphasize safety. Often commercialbank performs a number of interrelated functions. There are not only thecustodians of the community's money but the suppliers of its liquidity. For thesebanks customer who seldom borrow from the bank an impartment function may bethe acceptance and safe keeping of deposits. But those customers who often takeloans from the bank, the credit creation function may be the most important. Thecommercial bank is different from the other banks especially from central bank. Inappearance the main distinction between central bank and a commercial bank isthat now- a- days the central bank does not do much banking, but the morefundamental difference is one of aim. The main objective of the commercial bankis to make profit where as the central bank thinks of the effects of its operations onthe working of the economic system. The commercial bank has the shareholdersand is expected to do the best it can for them but the government by contrastusually owns the central bank. The commercial bank may be few or many andthey are to be found business with the general public all over the country. But,there is only one central bank in each country. Its market operations are mainlyimpersonal and are confined to what is necessary for influencing the country'sfinancial business in the directions citrated by economic policy (Sayers, 1972:17-18).

For all countries of the world and more so far the developing countries like Nepal,fast economic development is one of the most important aspects of thedevelopmental activities. However, it is obvious that unless the development ofthe most important sector like agriculture, industry, and commerce are achieved,envenomed development is impossible. For all the development, the regularsupply of financial resources is a prerequisite. Finance is thus like fuel forproviding energy to move the tempo of economic development and financialinstitution naturally, serve as reservoir for supplying and controlling the stream ofthat fuel i.e. finance. The commercial banks which are the financial institutionsdealing with activities of agriculture industry, trade and commerce play the mostimportant role for the business activities of the world. The objectives of thecommercial banks are to mobilize the idle resources in productive uses collectingthen from scattered and various sources. Its role in economic development is thusimmense in order to bring out greater mobility of resources to meet the everincreasing needs of financing or the various economic activities. (Vaidya, 2001: 87).

Presently, the contribution of commercial banks and joint venture banks inagriculture sectors has been expanding. It provides the credit facilities for thedevelopment of agriculture on cases where Agricultural Development Banks andCooperative Societies don't enter into the field. The agriculture sector needs moreand more capital for the improved methods of farming viz. the fertilizers,equipment, irrigation facilities etc. require obliviously more investment. Thus roleof commercial bank in promoting agriculture sector is increasing in many of othercountries, especially in developing countries like Nepal. The economy of ourcountry is dominated by agricultural sector. This could be exemplified from thefigures that about 73 percent of the total population is engaged on agriculture andabout 35 percent of the national income comes from the agriculture. Similarly 51percent of the export trade is in agricultural product. Also if we take into accountof the major industries of Nepal, they are mainly based on agriculture. This is veryclear that in such a country the financial help to the agriculture sector is mosturgent and indispensable for strengthening the base of national economicstructure.

The role of commercial bank is indispensable for industrial development of Nepal.Due to insufficiency of capital, industries are depending more and more upon thesupply of capital by the banks. It wouldn't be exaggeration to state that commercialbanks are mainly responsible for whatever the industrial development has beenachieved by Nepal. However many other financial institutions like ADB/N, NIDChave already been established for the development of agriculture and industrialsector of the country. The commercial banks are also continuously participating inthese activities. Being a mountainous country, many places are very remote andsometimes it requires many weeks to approach some of the places. Due to lack oftransport and communication facilities and other geographical causes, the countryhas been still facing the problem of imbalances economic growth. The scatteredcapital of the country is unable to solve the problem of imbalance of the economygrowth. Commercial banks have their appropriate role to play here by expandingtheir branches in the different Hilly and Tarai regions available loan to the localpeople. In industrial sector, commercial banks are providing the necessaryfinancial help for the industrial establishment in the country. They provide shortand medium term loan to industries to purchase machineries, tools, raw materialsetc. and to introduce new and developed techniques of production.

So the role of commercial banks is extremely important for the development ofindustries, trade commerce, agriculture, hotel, transport etc. of the country. In fact,no nation can develop itself without the development of these banks. It is not onlytrue in the capitalist countries but also true in the socialist countries and mixedeconomic countries like Nepal as well.(Vaidya, 2001: 78).

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

2.2 Definition of Loan and Advances

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

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

- The creation of debt by lenders payment of or agreement to pay money to the debtor or to a third party for the account of the debtor.
- The creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately.
- The creation of debt pursuant to a lender credit card or similar arrangement.
- The forbearance of debt arising from a loan. (Albroland Gupta, 1971:65).

Further, debt means Principal and interest provided to debtor by banks or financial institutions, with or without the pledge of immovable or moveable property of other securities of guarantees or without guarantee, and the word also mean over dues of the transactions beyond balance or fees, commission and interest incurred in that relation

The supreme court of India has defined the debt during the decision of the case of United Bank of India vs. DRT. Sudhir Gupta states that In the case in hand, there cannot be any dispute that the expression debt has to be given the widest amplitude to mean any liability which is alleged as dues from any person by a bank during the course of any business activities undertaken by the bank either in cash or otherwise, whether secured or unsecured, whether payable under a decree or other of any court or otherwise and legally recoverable on the date of the application.(Albroland Gupta, 1971:65).

2.2.1 Non-Performing Loan: An Introduction

Loan becomes non performing when it cannot be recovered within certain stipulated time that is governed by some respective laws. So, non performing loan is defined from the institutional point of view, generally from the lending institutions side. Loan may also be non performing if it is used in a different way than that for which it has been taken. This is the users point of view. But, here we will confine the definition to the institutional point of view. In this case, loan becomes non performing when it is classified as bad and loss for which Bangladesh bank requires 100% provisioning by the scheduled commercial banks (as per BRPD circular). Under Basel-II, loans past due for more than 90 days are non performing.

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

Pass Loan

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

Sub-Standard Loan

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

Doubtful Loan

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

Loss

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

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

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

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

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

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

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

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

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

2.2.2 Loan Loss Provision

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

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

Table 2.1: Provision for Loan Loss

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

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

Additional guidelines for the Loan Loss Provision

- For restructured or rescheduled loan, loan loss provision should be at least 12 percent. If priority sector or deprived sector loan which is insured or guaranteed priority sector credit has been rescheduled or restructured, provision should be only 25 percent of above point (a) such loans.
- If interest and principle of restructured or rescheduled loans have been served regularly since last two years, such loans can be converted in pass loan.

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

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

2.2.3 Causes and Measures of NPL/NPA in Different Countries

In China

Causes

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

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

- Political and social implications of restructuring bi SOEs force the government to keep them afloat.

- Banks are reluctant to lend to the private enterprises due to

- Non- standard accounting practices.

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

Measures

- Reducing risk by strengthening banks, raising disclosure standards and spearheading reforms of the SOEs by reducing their level of debt.

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

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

- Incentives like tax breaks, exemption from administration fees and clear-cut asset evaluation norms were implemented.(Robinson, 1951:89)

Thailand

Causes

- Liberalized capital and current account and external borrowings with inaccurate assessment of exchange rate risk and risk of capital flight in a crisis.

- A legal system that made credit recovery time consuming and difficult.

- Real estate speculators look massive loans projecting high growth in demand and prices of properties. When this did not materialize all the loans went bad.

- Steep interest rate rise turned a lot of loans into NPL/NPA.

- Inability to correctly assess credit risk.

Measures

- Amendments were made to the Bankruptcy Act.

- Corporate Debt Restructuring Plan (1998) focused on capital support facilities for bank recapitalization and setting up of AMCs.

- New rules governing NPL/NPA exit procedures based on international standards were introduced.

- Privatization of government entities was mooted, but faced strong political oppositions for fear of a social backlash.

- Adoption of international standards for loan classification and provisioning.

- Caps on Foreign equity ownership in financial institutions were removed.

Korea

Causes

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

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

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

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

Measures

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

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

- Creation of the Korea Asset Management Corporation (KAMCO) and a NPA fund to fund to finance the purchase of NPL/NPA.

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

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

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

Japan

Causes

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

- Legal mechanisms to dispose bad loans were time consuming and expensive and NPAs remained on the balance sheet.

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

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

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

Measures

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

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

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

2.3 Reviews of NRB Directive

Banks and Financial Institutions Regulation Department NRB (Directive No. 2/068)"*Provisions Relating to Classification of Loans/advances and Loan Losses"* having exercised the powers conferred by Section 79 of the Nepal Rastra Bank Act, 2002,the following Directives have been issued with regard to classification of credit/advancesand provisions to be made for its possible loss by the institutions obtaining licenses from thisBank to carry out financial transactions.

1. Classification of loans/advances

Entire loans and advances extended by a licensed institution have to be classified asfollows based on expiry of the deadline of repayment of the principal and interest ofsuch loans/advances:-

- Pass: Loans/advances which have not overdue and which are overdue by a period upto three months.
- Sub-standard: Loans/advances which are overdue by a period from three months to a maximum period of six moths.
- Doubtful: Loans/advances which are overdue by a period from six-months to a maximum period of one year.
- Loss: Loans/advances which are overdue by a period of more than one year.

The loans which are in pass class and which have been rescheduled/restructuredare called as "the performing loan, and the sub-standard, doubtful and losscategories are called non-performing loans.

(Note: Loans/advances also include bills purchased and discounted.)

2. Additional provisions relating to pass loans

The following loans may be included in the pass loan:-

- Loans/advances extended against the collateral of gold and silver;
- Loans/advances of fixed receipts

- Loans/advances of Government of Nepal securities and loans/advances madeagainst the collateral of Nepal Rastra Bank bonds;

Provided that the cases of the loans/advances against the fixed receipts orGovernment of Nepal securities or Nepal Rastra Bank bond as the additionalcollateral, such loans and advances shall also have to be classified inaccordance with the directive referred to into Point No. 1 above.

The working capital loan having the deadline of up to one year for repayment maybe included in the pass loan class. In case the interest to be received from theloans of working capital nature is not regular, such loans have to be classified onthe basis of the duration of interest to be due.

3. Additional Provisions Relating to Loss Loans

In case there seems any of the following discrepancies in any of the following loans,whether or not the deadline for repayment of which is expired, such loans and advanceshas to be categorized as the loss loan:

- The market price of the collateral cannot secure the loans.
- The debtor is bankrupt or has been declared to be bankrupt.
- The debtor disappears or is not identified.
- In case non-fund based facilities such as purchased or discounted bills and L/Cand guarantee which have been converted into fund-based loan, are not recoveredwithin ninety days from the date of their conversion into loan.
- Loan is misused.
- Expiry of six months of the date of auction process after the loan could not berecovered or a case is pending at a count under the recovery process.
- Providing loan to a debtor who has been enlisted in the black-list of CreditInformation Bureau Ltd.
- The Project/business is not in a condition to be operated or project or business isnot in operation.

- The credit card loan is not written off within 90 days from the date of expiry ofthe deadline.

- While converting the L/C, guarantee and other possible liabilities into a fund-based loan under the regular process, if the said loan is not recovered within 90days.

- In case of expiry of the deadline of a trust-receipt loan.

(Note: For the purpose of clause No. 3(e) of these Directives, "misuse" means non-useof the amount of the loan for the purpose for which it has is taken; the project is not inoperation; the amount accrued from the concerned project or business is not used inrepayment of the loan but in other activities; and the word also includes the loan whichis proved to have been misused by a supervisor in the course of inspection orsupervision or by an auditor in the course of auditing.)

4.Additional Provisions Relating to Term-Loan

In cases of the term loans extended in installments, if the deadline of installment of theprincipal amount expires, remaining entire loan amount has to be classified based onexpiry of the deadline of the installment amount.Provided that in cases of the installment of the term loan given by licensed institutionnot having the facility of engaging in overdraft transaction, entire loan amount has tobe categorized as loss loan only if the installment amount has crossed the deadline by aperiod of more than one year. In case the installment amount has crossed the deadlineby a period of less than one year, only such installment amount has to be classified inthe loss loan with a provision of loan loss. However, this clause shall not be deemed tohave hindered if the licensed institution wants to classify the entire loan amount as theloss loan.

(Note: For the purpose of this clause "term loan" means a credit/advances madeavailable having fixed the repayment period of more than one year.)

5. Principal and Interest not allowed to be recovered crossing the overdraft limit

Principal and interests of a loan shall not be allowed to be recovered having overdrawnthe current account of a customer so that the overdraft limit is crossed. Provided thatthis provision shall not be deemed to prohibit to recover the principal and interesthaving debited the balance in an account of the customer. In case the account is notsettled by a period of one month after overdrawn of the account while recoveringprincipal and interest by debiting the account of the customer, the amount overdrawnshall also be included in the loans not recovered and such loans have to be classified inone class lower than the class to which such loans belongs. While debiting the account,overdraft shall not be allowed by crossing the limit provided to the customer.

6. Provisions Relating to Grace Period

Licensed institution shall not normally be allowed to make available term loans withgrace period of more than one year. In case longer grace period has to be provided, thereasons for and bases on which such longer period has to be granted, such details shallhave to be disclosed and it shall have to be approved by the Board of Directors at thetime of approval of the loan.

7. Provision to be maintained for loan loss

For the loans and bills purchase classified according to these Directives, the followingloan loss provision shall be maintained based on the remaining amount of principal:loan classification Minimum Provision for loan loss

a. Pass 1 percent
b. Sub-standard 25 percent
c. Doubtful 50 percent
d. Loss loan/the loan extended to blacklisted 100 percentpersons, firms, company or corporate bodyProvided that in case of the insured loans, it would be required to make provision of only25 percent of the provision referred to in sub-clause (1).

2.4 Review of Related Studies

Basyal, M. (2008) Financial Performance of commercial bank, discussing the financial performance of government owned banks in the article, Placing RBB and NBL under Management Contracts Rational and Opposition agreed that the disappointing performance of these two banks has become serious concern to all the stakeholders. Further he mentions that they are having with huge level of NPA, which could be termed as the darkest sides of their operational inefficiency and undisciplined financial behavior.

Pradhan, R. (2009) in his article, NPA Some suggestion to tackle them expressed that unless the growth of NPA is kept in control, it has the potential to cause systematic crisis.

He has mentioned that a dream of globalization led to huge investment which unfortunately could not be utilized properly due to hesitant liberalization policies. Large corporate bodies misused the credits and delayed payments and contributed indirectly for enhancing NPA ratio. He further argues that lack of vision in appraisal of proposal while loan sanctioning, reviewing or enhancing credit limits, absence of risk management policy of financing, concentration of credit in few group of parties and sector, lack of coordination among various financiers, lack of initiatives to take timely action against willful defaulters, indecision on existing out of bad loans for fear of investigating agencies like special policy, CIAA, Public Accounts Committee of the parliament have also contributed in whatsoever measures to the worsening situation of NPA front. He further pointed out that most crucial reason for the increase in the NPA is the shabby and defaulter friendly legal system. Suggesting the remedy of NPA, he adds that administrative system should be strengthened. Legal reforms should be made and Assets Reconstruction Company should be formed.

Regmi, G. (2010) in the article titled 'Non-Performing Assets Management’ the writer stated about the management of NPAs in the commercial banks. He writes, the NPAs includes the non-performing loan, non-banking assets, remaining non-performing loan, suspend interest and unutilized assets. The increasing NPA are the emerging problem in commercial banks, which is the main factor for failure of the banks.

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

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

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

Dhugna, R. (2011) in his article "Why Assets Management Co. is considered the best to solve the non-performing loan problem “as above has tried to highlight one of the approach mainly Assets Management Company (AMC) for resolving the problem of NPL. As per him, AMC is specialize financial intermediary to manage the non-performing and distress loans of banks and financial instructions who buy the NPL from financial institution and take necessary steps to recover the maximum value from the acquired assets. As per his view, if NPLs are not resolved in time there would be inherent direct or indirect costs to the economy. As stated by him NPL may arise due to the external factors like decrease in market value of collateral deterioration borrower's repayment capacity, economic slowdown, borrower's misconduct, improper credit appraisal system, lack o frisk management practice, ineffective credit monitoring and supervision system. Hence he suggested that, NPL should be kept at minimum level and the specialized institution such as AMCs should manage the distressed loans.

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

He concludes, "As in most of the countries, Nepalese Financial System is largely dominated by the banking sector. The banking sector is severely affected by the NPL problem, it is estimated that the NPL of the Nepalese Banking system is around 16%.

Therefore there is no doubt that is has serious implication on the economic performance of the country. It will be the eclipse in the development of financial soundless in the economy, if not controlled in time. However, traditional or AMC root can be practiced to get recovery from this sickness of the financial system, the AMC root may be more effective approach to be quick recovery as it has been experience around the world."

Rawal, M. (2012) in "Measures adopted to overcome the problem of financial sector and the NPLs" addressed that financial sector reform measures can be broadly grouped under three heads: (1) restructuring of large two state-owned banks (ii) reengineering of the central banks and (iii) capacity building in the financial sector. In this connection, management of two state-owned banks has been handed over to the expert groups comprising the people within and outside of Nepal; the reengineering and restructuring process of the central bank (Nepal Rastra Bank) is in progress. Side by side, the capacity building in the financial sector is smoothly approaching ahead. Enactment of new NRB Act 2002 which, gives greater autonomy in its operation, enforcement of inspection and supervision directives based on international standard, withdrawal of government/ NRB involvement from the financial institutions, adoption of accommodative monetary measures are the efforts made to build up sound financial environment. Moreover, with a view to strengthening legal arrangement s, Debt Recovery Act has been approved and the Debt consolidate financial sector through an umbrella act Banks and Financial Institutions Act has recently been approved and for the purpose to resolve the problem of non-performing assets- Asset Management Company Act is in the process of being approved. In addition, establishment of Credit Rating Company, strengthening of Credit Bureau and Bankers' Training Center are some of the tasks progressing ahead. With the arrangement of such a legislative, regulatory, supervisory and institutional framework, the financial sector would, hopefully, take a pace for reviving which, in turn, would help NPLs to be reduced.

Sapkota, A. (2013) has written as article titled "portion of NPA in commercial Banks – High in Public, Low in Private" the researcher stated that the problem of NPL is seen less in private banks in comparison to public banks. The NPA of two big nationalized banks being about 60% if the total loans are very serious situation. He further mentioned that in order to improve this situation and to make healthy banking environment, financial reform program has been brought as its consequences, the management of two bog banks was handed to foreign company on a contract but the ratio of NPL was not reduced.

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

Adhikari, (2013) “Non-performing Loan and its Management” states in articles that one of the main function of commercial bank is to management of non-performing loan. Main function of commercial bank and financial institution is accepting deposit and provide loan. In underdeveloped country like Nepal providing Loan and interest income generating through loan is the main source of bank and financial institution. If provided loan become non-performing loan the bank and financial institution suffer from big financial scarcity. One side un-recover interest cannot make income and other side loan its self converts in NPL that make huge effect in financial condition of bank and financial institution. So management of NPL is crucial factor for any bank and financial institution. In practical, there may be default rate in aggregate banking system.

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

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

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

2.5 Review of the Unpublished Thesis

Ghimire, S. (2008) entitled with "*Non- performing Assets of commercial Banks: caused and effects*" has following facts and findings.

Objectives;

- To analyze the cause and effects of nonperforming assets in commercial bank.
- To evaluate the impacts of NPA on the profitability of commercial bank.
- To analyze the level of NPA selected commercial banks.

Research Methodology

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

Major findings;

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

Paudyal, D. (2009) entitled with "A *study of Non-performing Assets of commercial Banks of Nepal*" has following facts and findings.

Objectives;

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

Research Methodology

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

Major findings;

- In recent years NABIL Banks has shown significant decrease in Non Performing Assets, which is the result of banks effective credit management and its efforts in recovering bad debts through establishment of recovery cell.
- High degree of negative correlation exists between NPA and ROE of NABIL Bank. The bank should reduce their level of NPA to increase ROE and ROA and Profitability.
- Loan loss provision for Doubtful loan seems to be higher in case of both bank NABIL and SCBNL.

Baral, R. (2010) entitled with "*A study of Non- performing Loans of Nepalese commercial Banks"* has following facts and findings.

Main Objectives;

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

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

Research Methodology

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

Major findings;

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

Shrestha, M. (2011) entitled "*A study of Non- performing Loan and loan loss provision of commercial Banks*" A case study of NIBL, HBL and EBL".

Main objectives;

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

Research Methodology

The research, data are analyzed by using different types of tools. For this study following statistical tools Arithmetic mean, Standard Deviation, Correlation Coefficient, Probable

Error and financial tools Earnings per Share, Price Earnings Ratio, Return on Total Assets and Return on Share are also use.

Major findings;

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

Karki, S. (2012) in his thesis paper, *"Comparative Financial Performance Appraisal of Joint Venture Banks"* with references to Everest bank limited and Nepal Arab Bank Ltd.

Main Objectives

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

Research Methodology

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

Major Findings

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

Khadka,B. (2013) in his thesis paper*,"Comparative Financial Performance Appraisal of Joint Venture Banks"* has studied mainly three banks i.e. NABIL,NIBL and SCBNL.

Main Objectives

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

Research Methodologies

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

Major Findings

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

ThapaH. (2014) on his thesis entitled,*"A Study on Investment Policy of SCBNLin Comparison to Other Joint Venture Banks(NABIL and HBL).*"

Main Objectives

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

Research Methodologies

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

Share Holder's Fund or Equity, Arithmetic means, Standard Deviation and Correlation Coefficient.

Major Findings

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

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

2.6 Research Gap

Non-Performing Loan has been a very important issue for the entire banking industry in Nepal. Banking sector is backed by the hundreds of research studies but most of the research studies have conducted on the financial performance, dividend policy and in the area of risk and return. Very few studies are related to the Non-Performing Loan and Loan Loss Provisioning of the commercial banks. Going through the material related to the Non-Performing Loan, most of the research studies have found discussing the Non-Performing Loan of the two big government owned banks i.e. Rastriya Banijya Bank and Nepal Bank Limited. It is real fact that these two giant banks carry a huge amount of Non-Performing Loan but the studies done over these banks only couldn’t reflect the true picture of overall commercial banks of Nepal. Hence researcher has attempted to fill this research gap by taking reference to Nabil Bank Limited and Standard Chartered Bank Limited. Keeping this in mind, researcher of this study entitle "Impacts of Non-Performing Loan" has tried to make a comparative analysis of three Nepalese locally promoted banks (including one from government owned) and two commercial banks. Primary objective of this study is taken to find out the impacts of NRB directives on NPL comparatively among the sample bank. This study also aims to provide the present issues, information and scenario regarding NPL in the Nepalese banking industry.

CHAPTER-THREE

RESEARCH METHODOLOGY

Research in common parlance refers to a search for knowledge. Once can also define research as a scientific and systematic search for pertinent information on a specific topic. In fact, research is an art of scientific investigation. The Advanced Learner's Dictionary of Current English lays down the meaning of research as "a careful investigation or inquiry especially through search for new facts in any branch of knowledge."1 Redman and Mory define research as a "systematized effort to gain new knowledge."2 Some people consider research as a movement, a movement from the known to the unknown. It is actually a voyage of discovery. We all possess the vital instinct of inquisitiveness for, when the unknown confronts us, we wonder and our inquisitiveness makes us probe and attain full and fuller understanding of the unknown. This inquisitiveness is the mother of all knowledge and the method, which man employs for obtaining the knowledge of whatever the unknown, can be termed as research.

Research is an academic activity and as such the term should be used in a technical sense. According to Clifford Woody research comprises defining and redefining problems, formulating hypothesis or suggested solutions; collecting, organising and evaluating data; making deductions and reaching conclusions; and at last carefully testing the conclusions to determine whether they fit the formulating hypothesis. D. Slesinger and M. Stephenson in the Encyclopaedia of Social Sciences define research as "the manipulation of things, concepts or symbols for the purpose of generalising to extend, correct or verify knowledge, whether that knowledge aids in construction of theory or in the practice of an art."3 Research is, thus, an original contribution to the existing stock of knowledge making for its advancement. It is the persuit of truth with the help of study, observation, comparison and experiment. In short, the search for knowledge through objective and systematic method of finding solution to a problem is research. The systematic approach concerning generalisation and the formulation of a theory is also research. As such the term 'research' refers to the systematic method consisting of enunciating the problem, formulating a hypothesis, collecting the facts or data, analysing the facts and reaching certain conclusions either in the form of solutions(s) towards the concerned problem or in certain generalisations for some theoretical formulation.

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

3.1 Research Design

The formidable problem that follows the task of defining the research problem is the preparation of the design of the research project, popularly known as the "research design". Decisions regarding what, where, when, how much, by what means concerning an inquiry or a research study constitute a research design. "A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure."1 In fact, the research design is the conceptual structure within which research is conducted; it constitutes the blueprint for the collection, measurement and analysis of data. As such the design includes an outline of what the researcher will do from writing the hypothesis and its operational implications to the final analysis of data. More explicitly, the design decisions happen to be in respect of:

- What is the study about?
- Why is the study being made?
- Where will the study be carried out?
- What type of data is required?
- Where can the required data be found?
- What periods of time will the study include?
- What will be the sample design?
- What techniques of data collection will be used?
- How will the data be analysed?
- In what style will the report be prepared?

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

3.2 Population & Sample

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

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

- Nabil Bank Limited (NABIL)
- Standard Chartered Bank Nepal Limited. (SCBNL)

3.3 Nature & Sources of Data

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

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

3.4 Method of Data Analysis

The necessary data collected from the different sources are presented and analyzed systematically. Data are presented simply and understood able pattern through different charts, diagrams, graphs & tables. For the purpose of analysis of collected data, appropriate mathematical, financial as well as statistical tools have been used where necessary. Data are analyzed through Ratio Analysis: Credit Deposit Ratio, Non-performing loan to total loans & advances, Provision held to non-performing loan, Loan loss provision to total loan & advances. Statistical Analysis: Correlation Analysis, Probable Error, Coefficient of Determination.

3.4.1 Financial Tools

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

3.4.1.1 Credit Deposit Ratio

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

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

3.4.1.2 NPL to Total Loan & Advances

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

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

3.4.1.3 Provision Held to NPL

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

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

3.4.1.4 Loan Loss Provision to Total Loan & Advances

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

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

3.4.2 Statistical Tools

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

3.4.2.1 Arithmetic Mean ($\overline{\mathbf{x}}$)

Mean is the simplest measurement of central tendency and is a widely used measure. Its chief use consists in summarising the essential features of a series and in enabling data to be compared. It is amenable to algebraic treatment and is used in further statistical calculations. It is a relatively stable measure of central tendency. But it suffers from some limitations viz., it is unduly affected by extreme items; it may not coincide with the actual value of an item in a series, and it may lead to wrong impressions, particularly when the item values are not given with the average. However, mean is better than other averages, especially in economic and social studies where direct quantitative measurements are possible. Average is statistical constants, which enable us to comprehend in a single effort of the whole. It represents the entire data by a single value. It provides the gist and gives the bird's eye view of the huge mass of unwieldy numerical data. It is calculated as:

$$\bar{x} = \frac{\Sigma[X]}{N}$$

Where,

$\bar{x}$ = Arithmetic Mean

N = Numbers of observation

X = Sum of observation

3.4.2.2 Standard Deviation (S.D.)

Standard deviation is most widely used measure of dispersion of a series and is commonly denoted by the symbol ' σ ' (pronounced as sigma). Standard deviation is defined as the square-root of the average of squares of deviations, when such deviations for the values of individual items in a series are obtained from the arithmetic average. The standard deviation is the square root of mean squared deviations from the arithmetic mean and is denoted by S.D. or σ. It is used as absolute measure of dispersion or variability. It is calculated as:

$$\sigma = \frac{\sqrt{\Sigma(x-\bar{x})2}}{N}$$

Where,

σ= Standard Deviation

3.4.2.3 Coefficient of Variation (C.V.)

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

C.V= $\frac{\sigma}{\bar{x}}$ Where,

σ = Standard Deviation

$\bar{x}$ = Mean

3.4.2.4 Correlation Coefficient (r)

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

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

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

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

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

1. When, r = 1, then is perfect positive correlation.
2. When, r = -1, then is perfect negative correlation.
3. When, r = 0, then is no correlation.
4. When, 'r' lies between 0.7 to 0.999(-0.7to -0.999), then is high degree of positive (or negative) correlation.
5. When, 'r' lies between 0.5 to 0.6999, there is moderate degree of correlation
6. When, 'r' is lies less than 0.5, there is low degree of correlation.

3.4.2.5 Probable Error (P.E.)

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

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

Where,
r= Correlation Coefficient
N= Number of pairs of observations

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

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

3.4.3 Diagrammatic and Graphical Presentation

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

CHAPTER-FOUR

DATA PRESENTATION AND ANALYSIS

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

4.1 Financial Analysis

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

4.1.1 Credit Deposit Ratio

Credit Deposit Ratio is calculated as total loans & advances to total deposit ratio. Banks receive fund as deposits from the public so that to mobilize it in terms of loans & advances to generate the interest as income. It is the ratio that measures the banks efficiency in mobilizing deposit collected from public. In another word, CD ratio is the fundamental parameter to ascertain fund deployment efficiency of commercial banks. Greater the CD ratio implies better the mobilization of deposits and vice-versa. Hence, higher the ratio is preferred. Credit-Deposit ratio is proportion of loan created by banks from deposits it receives. In other words capacity of banks to lend, High ratio indicates banks are generating more credit from its deposits. C/D Ratio is impacted by certain factors like credit-deposit growth, cash reserves and investments (SLR) made by banks. Banks gives credit after allocating its deposits to cash reserves and SLR. Therefore increase in cash reserves or investment deposit ratio2 will reduce banks capacity to lend, thereby lowering C/D ratio.

4.1.2 Non-Performing Loan to Total Loan & Advances

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

4.1.3 Loan Loss Provision to Loan & Advances

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

4.1.4 Provision Held to Non-Performing Loan

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

Table 4.1: Total Deposit, Loans & Advances, NPL & LLP of Nabil Bank Ltd.

(Rs In Millions)

Particulars	2008/09	2009/10	2010/11	2011/12	2012/13	Mean	S.D.	C.V.
Total Deposit	**37348.25**	**46410.70**	**49696.11**	**55023.69**	**63609.80**			
Total Loans & Advances	**27589.93**	**32168.87**	**38034.09**	**41605.68**	**46369.83**			
Performing Loan	27774.19	32543.42	38215.63	41867.70	46630.35			
Non-Performing Loan	224.81	486.28	389.85	1000.05	1015.17			
Substandard Loan	113.30	59.02	170.21	162.44	204.96			
Doubtful Loan	45.75	22.73	104.65	36.78	104.42			
Loss Loan	65.75	404.53	392.83	783.62	705.79			
Loan Loss Provision	**409.07**	**762.09**	**871.39**	**1262.08**	**1275.69**			
LLP for Pass Loan	280.44	335.41	384.88	420.43	467.32			
LLP for Substandard Loan	44.07	14.75	42.55	40.61	51.28			
LLP for Doubtful Loan	23.52	11.36	52.32	18.39	52.32			
LLP for Loss Loan	59.83	400.40	388.91	778.34	704.76			
Provision Maintained (%)								
Pass Loan	291.71	280.44	335.41	384.88	420.43			
Substandard Loan	32.30	44.07	14.75	42.55	40.61			
Doubtful Loan	21.26	23.52	11.36	52.32	18.39			
Loss Loan	46.09	59.83	400.40	388.91	778.34			
Ratios								
Total L & A to Total Deposit	73.87	69.31	76.53	75.61	72.90	73.65	2.81	3.82
NPL to Total L & A	0.81	1.51	1.03	2.40	2.19	1.59	0.70	43.91
LLP to Total L & A	1.48	2.37	2.29	3.03	2.75	2.39	0.59	24.60
LLP to NPL	181.96	156.72	223.52	126.20	125.66	162.81	41.26	25.34

Source: Annex IV

The Table no 4.1 represents the status of Total Deposits, Total Loans & Advances, Performing Loan, Non-Performing Loan, Loan Loss Provision, their Ratios followed by their mean value, S.D. and C.V. of Nabil Bank Limited for the year 2008/09 to 2012/13. Nabil Bank, we see that Nabil's total loan and advances to total deposit ratio is come to 73.65% on an average. This means the bank is employing its limited fund as a loan and advances. Similarly, firm shows very negligible amount 1.59% on an average on NPL to Total Loan and Advances refers banks efficiency of making right investment on loan and advances. As well looking to the average LLP to Total Loan and Advances is 2.39%. Average LLP to NPL as 162.81%.

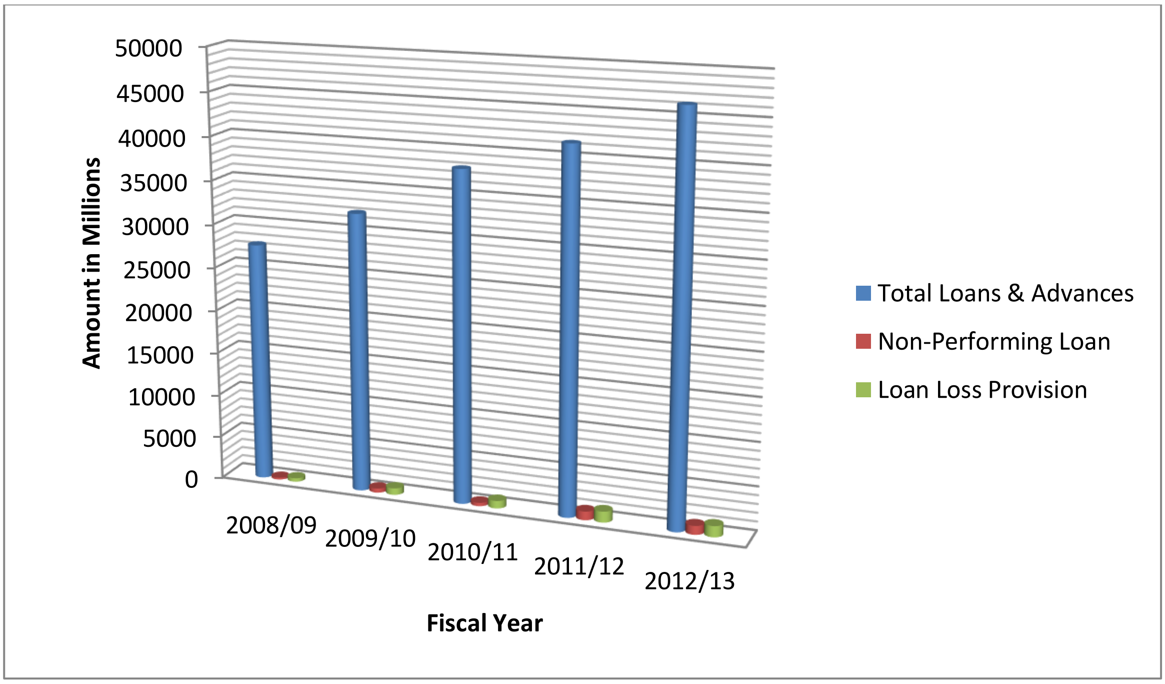

Figure 4.1: Total Loan & Advance, NPL & LLP

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

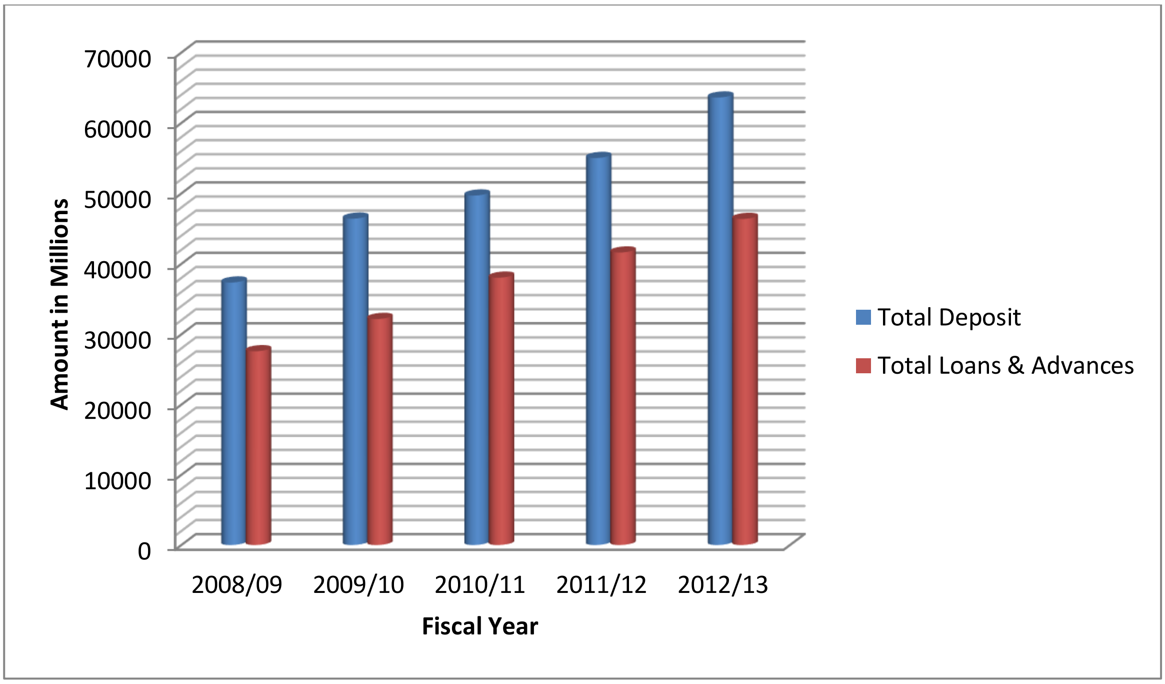

Figure 4.2: Total Deposit and Loan & Advance

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

Table 4.2: Total Deposit, Loans & Advances, NPL & LLP of Standard Chartered Bank Nepal Ltd. (Rs in Millions)

Particulars	2008/09	2009/10	2010/11	2011/12	2012/13	Mean	S.D.	C.V.
Total Deposit	**35350.82**	**35282.72**	**37999.24**	**35965.63**	**39466.45**			
Total Loans & Advances	**13679.75**	**15956.95**	**18427.27**	**19575.96**	**22828.83**			
Performing Loan	13789.66	16078.44	18546.67	19674.02	22961.10			
Non-Performing Loan	91.04	98.13	115.80	154.48	177.26			
Substandard Loan	34.42	50.94	85.72	124.44	86.07			
Doubtful Loan	11.85	2.17	3.53	10.70	68.63			
Loss Loan	44.76	45.02	26.54	19.33	22.55			
Loan Loss Provision	**200.94**	**219.62**	**235.20**	**252.54**	**309.53**			
LLP for Pass Loan	137.89	160.78	185.46	196.74	231.14			
LLP for Substandard Loan	8.60	12.73	21.43	31.11	21.51			
LLP for Doubtful Loan	9.67	1.08	1.76	5.3	34.31			
LLP for Loss Loan	44.76	45.02	26.54	19.33	22.55			
Provision Maintained (%)								
Pass Loan	138.35	137.89	160.78	185.46	196.74			
Substandard Loan	6.22	8.60	12.73	21.43	31.11			
Doubtful Loan	45.00	9.67	1.08	1.76	5.3			
Loss Loan	55.80	44.76	45.02	26.54	19.33			
Ratios								
Total L & A to Total Deposit	38.70	45.23	48.49	54.43	57.84	48.94	7.56	15.44
NPL to Total L & A	0.67	0.61	0.63	0.79	0.78	0.69	0.08	11.87
LLP to Total L & A	1.47	1.38	1.28	1.29	1.36	1.35	0.08	5.70
LLP to NPL	220.72	223.81	203.11	163.48	174.62	197.15	27.12	13.76

Source: Annex IV

As we go through the Table 4.2 and Figure 4.3 and Figure 4.4 presented financial table of SCBNL, we come to the point that SCBNL has given highest priority in complying the norms and standard given by NRB in terms of loan and advances and NPL. An exact creation of LLP, as per the guidelines prepared by NRB is resulting a higher level of efficiency in every aspect of the bank.

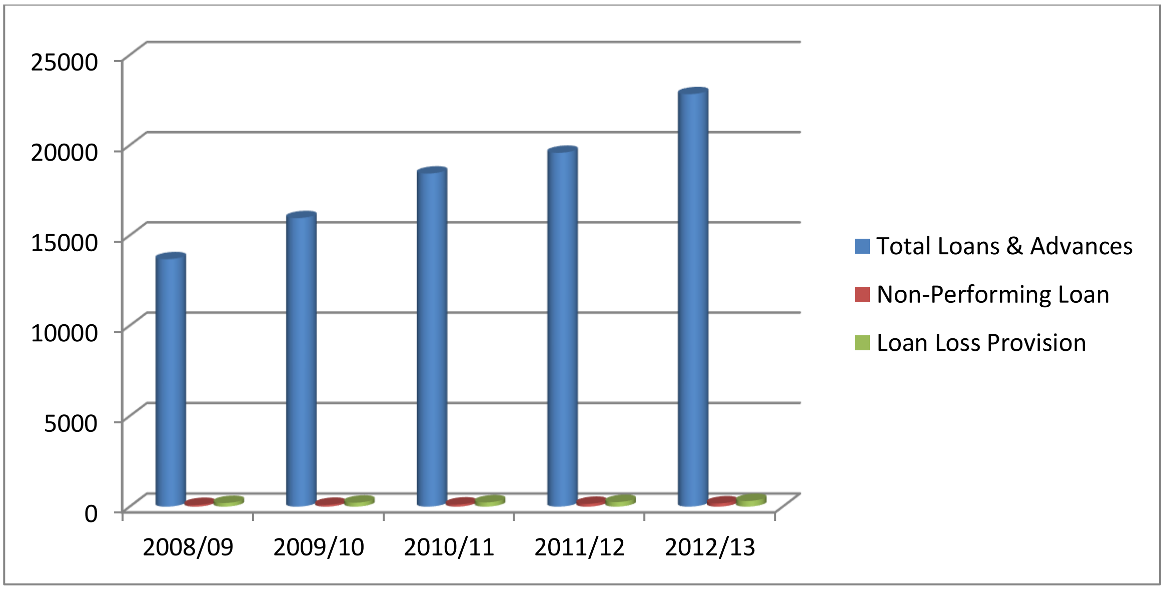

Figure 4.3: Total Loan & Advance, NPL and LLP of SCBNL

Similarly SCBNL's NPL to TLA ratio below 5% shows its efficiency in maintaining a good standard loan and advances in investment portfolio and thus eradicating the chances of happening of the bad loans. But the average ratio credit to total deposit ratio is 48.94% represents its inefficiency in employing the deposit to the interest earning fields. However, the increasing trend shown on chart is preferably marking the possibility of investment as a loan and advances. There is about 50% increment on 5 years periods and it can be a good symptom of increase in loan and advances.

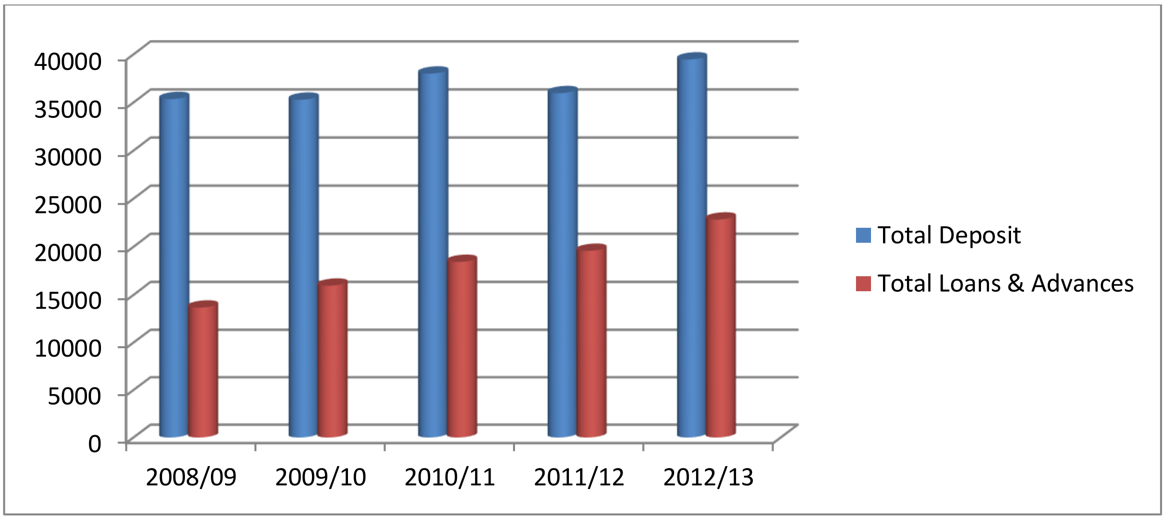

Figure 4.4: Total Deposit and Loan & Advance of SCBNL

Looking to the LLP part of SCBNL, it seems that SCBNL is most conscious in creating the loan loss provisions against possible losses from both the perspectives- NRB norms and profitability of the bank. SCBNL is separating a good level of LLP for the possible losses in loan and advances. Its mean ratio of LLP to Loan and advances as 1.35% is also marking very fewer amounts in creating the provision. As well, lesser the coefficient of variation is also showing lesser the variability in financial standards.

4.2 Statistical Tools

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

4.2.1 Correlation Coefficient

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

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

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

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

Table 4.3: Correlation Coefficient & Probable Error of NPL and Loans & Advances

Banks	Corr. Coeff	Result	P. E_r	6×P. E_r	Result
NABIL	0.8853	Highly +ve corr.	0.0651	0.3906	Significant
SCBNL	0.9536	Highly+ve corr.	0.0273	0.1637	Significant

Source: Appendix I

The Table no 4.3 presented table exhibits the correlation coefficients and the probable error and their meaning of relationship between the NPL and TLA. The table shows NABIL and SCBNL have highly positive correlation. SCBNL has the highest correlation coefficients 0.9536, amongst the Nabil banks and also its value is greater than the value of 6 times of the Probable Error. Hence the correlation coefficient is said to be significant and reliable. Similarly, NABILs correlation coefficient is 0.8853 and also the value is greater than the value of probable error and hence the correlation coefficient of the bank is significant and reliable. Principally, as NABIL has the lowest correlation coefficient, it bears the lowest portion of NPL and SCBNL holds the highest portion of NPL as it bears highest correlation coefficient. Hence both banks have the significant correlation coefficient, there is dependency of the NPL in its total loan and advances.

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

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

Table 4.4: Correlation Coefficient & Probable Error of LLP and Total Loan and Advances

Banks	Corr Coeff	Result	P. E_r	6×P. E_r	Result
NABIL	0.9604	Highly +ve corr.	0.0213	0.1276	Significant
SCBNL	0.9696	Highly +ve corr.	0.0180	0.1082	Significant

Source: Appendix II

The table no 4.4 exhibits the value of correlation coefficient and Probable Error along with their meaning of relationship of the sample banks regarding total loans and LLP. Out of the two sample banks, SCBNL has the highest correlation coefficient ie 0.9696 greater than the 6 times value of its probable error. Hence the correlation coefficient is said to be significant and reliable. NABILs correlation coefficient is 0.9604 and also the value is greater than the value of probable error and hence the correlation coefficient of the bank is significant and reliable. Hence both banks have the significant correlation coefficient, there is dependency of the LLP in its total loan and advances.

4.2.1.3 Correlation Coefficient Between Loan Loss Provision & Total NPL

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

Table 4.5 Correlation Coefficient & Probable Error of LLP and NPL

Banks	Corr coeff	Result	P. E_r	6×P. E_r	Result
NABIL	0.9536	Highly +ve corr.	0.0273	0.1638	Significant
SCBNL	0.9522	Highly +ve corr.	0.0281	0.1686	Significant

Source: Appendix III

The Table no 4.5 presented the value of correlation coefficient and probable error and the meaning of the relationship between the NPL & LLP of the sample banks. In other words it helps in determining the dependency of the LLP over NPL. As presented NABIL and SCBNL both banks has highly positive correlation coefficient ie 0.9536 & 0.9522 respectively and the value of correlation coefficient is also greater than the value of probable error. Hence the correlation coefficient is said to be significant and reliable of both banks. Both baks have positive correlation coefficient that shows there is dependency of the LLP over NPL.

4.3 Theoretical Analysis of the Implementation of NRB Directives

4.3.1 Implementation Part of the NRB Directives

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

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

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

Table 4.6 Status of the New Directive in respect to Loans & Advances.

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

Source: NRB Directives

Talking on the subject regarding the implementation of NRB directive, all the sample banks has been found satisfactorily implemented the directive as per the table presented above. Simultaneously, all the banks have been created necessary loan loss provisions for the possible losses against the loans. Looking on the financial part of the NABIL and SCBNL in all the study period total loans & advances and non performing loan is in increasing trend except NABILs non performing loan in 2010/11. The non performing loan is increasing by very few percentages among of loan and advance. During the study period which can be regarded as the best part of the directive. This could be summarized as the inefficiency of management and not implementing the NRB directives et all. Hence this can be concluded that due to the NRB regulatory efforts, not only the Non-Performing Loans of the banks has increase by low percentage, their income level has also been increased. This is because of the effect of that higher volume of NPL requires higher portion of LLP and lesser NPL requires lesser the amount of LLP and the LLP deducted in the net profit of the bank.

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

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

4.4 Major Findings of the Study

- Nabil Bank Limited as a joint venture bank, established as a first private sector bank has shown its smartest operating results from the inception. NABIL also aims to be the lowest NPL bank in Nepal whose current average NPL stood only at 1.30% which is less than the international as well NRB standard.
- Similarly, its average deposit mobilization rate 73.65% with the CV of 3.82 shows banks efficiency in mobilizing the deposit to interest earnings.
- Similarly average loan loss provision ratio 2.39% reflects presence of pass loan in its loan portfolio. Looking into the overall financial indicators of the bank, all indicate a smarter growth in every aspect of the financial parameters.
- Standard Chartered Bank Nepal, as only bank in Nepal with the global representation, shows its try in rendering a best class banking service. SCBNL's total deposit figure in 2012/13 stands at Rs. 39466.45 million where the deposit employed towards loans and advances is only 57.85%.
- Average deposit mobilization into loans and advances is only 48.94% which figure represents a very smaller amount has been deployed under the loan portfolio. But on the other hand, average Non Performing Loan ratio 0.69% shows the presence of good quality of loans in its loans portfolio which is much below than the international standards.

- Also its average Loan Loss Provision ratio 1.35% reflects the availability of the good quality of loans which in turn describes that very smaller amount has been cushioned to meet the required standards and thus profitable earning has also increased.
- The correlation coefficients of relationship between the NPL & TLA, LLP & TLA and LLP & NPL of NABIL and SCBNL have highly positive correlation. SCBNL has the highest correlation coefficients.

CHAPTER-FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Establishment of the Nepal Bank Limited in 1937 A.D, established a significant evolution in the financial sector of nation. Nepal Bank helped to set a milestone in the country's financial market. Nepalese financial sector comprises banking and Non-Banking sector. Banking sector comprises NRB and other commercial banks where Non-Banking sector comprises other finances and co-operatives and other governmental and nongovernmental financial institutions. At present, 31 commercial banks are playing their banking activities and rest 87 developments banks are operating beyond the nation. Similarly, 78 finance companies, 23 micro credit institutions and other financial intermediaries providing their services in the country. NRB being the central bank of the country and as an agent of government is authorized to supervise, control and promote the country's financial institutions of the country. In last two decades, when the Nepalese financial market is opened for the private sector and joint venture organization, financial sector made a hallmark progress in terms of quality services, quantity of the institutions and number of the services and products.

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

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

This study research entitled Impact & Implementation of NRB Directives mainly aimed to elaborate the impacts and implementers part of NRB prudential directives in respect to NPL. To meet the aimed objectives of the study, researcher has tried taken two main commercial banks out of total 31 from the different category. NABIL and SCBNL from joint venture groups having very least of NPL. For the findings of the aimed, objectives, primary as well as secondary data have been used for entire study. Statistical charts and diagrams have been presented as per the necessity. All the data used for the study have been collected from published annual reports, journals, NRB official papers and form different web based sites. Collected data have been systematically analyzed and presented along with the charts and diagrams using different mathematical, statistical and financial tools. And the findings and recommendations have been prepared on the basis of five years timed data from 2008/09 to 2012/13.

5.2 Conclusion

- As previous stated, commercial banks are the bridge between the savers and users of the money. Banks used to collect the funds form idle locations and help to mobilize them into the productive areas that push the entire economy to rise from collecting the deposit and lending them to the enterprise to meet the necessity of commercial funds and which in turn help in progressive economy of the country through employment, production and export.

- And the difference of paying interest on deposit and earning interest on lending is the income for the banks. Meaning that loans and advances are the major source of income of the bank as it generates interest earning.

- But improper lending management can create headache to the bankers in the form of non- performing loan which is the crucial matter for every financial enterprise.

- A non-performing loan not only losses the interest earning of the banks but also creation of necessary provision as per NRB standards deducts the profit of the institutions. Nepalese banking industry is also severely affected by the reason of non-performing loans due to the improper credit appraisal system, ineffective credit management, lack of proper valuation of collateral security, miss conduction of borrowers and improper credit monitoring and supervision system.

- In recent years, some other financial institutions form private and joint venture sector are also not exception. NPA in government bank is reason of poor governance and transparency in procedures, poor banking culture, limitations in auditing and accounting, lack of proper regulatory fragmentation and unnecessary political influences.

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

- At present NRB supervision and monitoring system have been tightened, regular follow up and necessary steps for any suspicious and undesirable condition have been formulated by the NRB to prevent the entire banking industry. Timely directives and guidelines have been formulated by NRB to monitor and supervise the banking industry.

5.3 Recommendations

- On the basis of the analysis of the collected data and the necessary available parameters and facts of the banks, Following recommendations have been made:

- Due to the huge sum of NPL and the LLP, banks operating profit has been badly hampered. Also as a largest deposit holder bank in Nepal, Nabil should try to maximize its credit to deposit ratio to maximize the profit form current level.

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

- Nabil Bank as a joint venture private sector bank in Nepal is showing its tuff level operating status. But in respect to other parameters of the bank, credit to deposit ratio is not well and hence it should try to maximize the level of this ratio to maximize the operating return.

- Standard Chartered Bank, as an only bank in Nepal with the global representation, it is showing quality in its overall services and financially the same. But looking in the part of credit to deposit ratio, its deposit utilization rate seems very lower comparing to the other financial enterprise.

- Purely Nepalese invested bank shows its extra level efficiency in its operation. It's all the financial parameters, loan loss provisioning level, non-performing loan status, credit to deposit ratio are looking in perfect level.

- However, it holds very smaller level of deposit in overall in comparing to the other successful financial institutions. So, it should try to grow in its total deposit level.

- Whether a huge sum of money has been employed in loans and advances, presence of higher level bad loans are resulting the failure of banks operating.

- Also, its operating profit has been reduced due to the reason of higher amount of provisioning in the loan loss category, hence minimizing the level of loan loss; it should try to maximize the overall return of the bank.

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APPENDICES

Appendix I

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

Year	Loan & Adv (X_1)	NPL (X_2)	$x_1=X_1-\bar{x}_1$	$x_2=X_2-\bar{x}_2$	$x_1 . x_2$	x_1^2	x_2^2
2008/09	27589.93	224.81	-9563.75	-398.42	3810408	91465314	158740.1
2009/10	32168.87	486.28	-4984.81	-136.95	682679.7	24848331	18755.85
2010/11	38034.09	389.85	880.41	-233.38	-205472	775121.77	54467.16
2011/12	41605.68	1000.05	4452	376.82	1677594	19820304	141991.8
2012/13	46369.83	1015.17	9216.15	391.94	3612159	84937421	153615.4
$N_1 = 5$ $N_2 = 5$	**$\sum X_1=$ 185768.4**	**$\sum X_2 =$ 3116.16**			**$\sum x_1.x_2 =$ 9577369**	**$\sum x_1^2=$ 221846491**	**$\sum x_2^2$ 527570.3**

For Loan & Advance,

$$\text{Mean } (\bar{X}_1) = \frac{\sum X_1}{N_1} = \frac{185768.4}{5} = 37153.68$$

For NPL,

$$\text{Mean } (\bar{X}_2) = \frac{\sum X_2}{N_2} = \frac{3116.16}{5} = 623.23$$

Correlation between Loan & Advance & NPL,

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

$$= \frac{9577369}{\sqrt{221846491 \times 527570.3}} \quad = 0.8853$$

$$r^2 = 0.8853^2 = 0.7838$$

For Probable Error,

$$PE = 0.6745 \times \frac{1 - r^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.7838}{\sqrt{5}} = 0.06 \text{ or, } 6\%$$

$$6\ PE = 6 \times 0.06 = 0.36$$

Appendix II

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

Year	Loan & Adv (X_1)	NPL (X_2)	$x_1=X_1-\bar{x}_1$	$x_2=X_2-\bar{x}_2$	$x_1 . x_2$	x_1^2	x_2^2
2008/09	13679.75	91.04	-4414.002	-36.30	160237.1	19483414	1317.835
2009/10	15956.95	98.13	-2136.802	-29.21	62420.26	4565922.8	853.3409
2010/11	18427.27	115.8	333.518	-11.54	-3849.46	111234.26	133.2178
2011/12	19575.96	154.48	1482.208	27.14	40224.16	2196940.6	736.471
2012/13	22828.83	177.26	4735.078	49.92	236365.6	22420964	2491.807
$N_1 = 5$ $N_2 = 5$	$\sum X_1 =$ 90468.76	$\sum X_2 =$ 636.71			$\sum x_1.x_2 =$ 495397.7	$\sum x_1^2 =$ 48778475	$\sum x_2^2$ 5532.67

For Loan & Adv,

$$\text{Mean } (\overline{X}_1) = \frac{\sum X_1}{N_1} = \frac{90468.76}{5} = 18093.75$$

For NPL,

$$\text{Mean } (\overline{X}_2) = \frac{\sum X_2}{N_2} = \frac{636.71}{5} = 127.34$$

Correlation between NPL & Loan & Advance,

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

$$= \frac{495397.7}{\sqrt{48778475 \times 5532.67}} = 0.9536$$

$r^2 = 0.9536^2 = 0.9094$

For Probable Error,

$$PE = 0.6745 \times \frac{1 - r^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.9094}{\sqrt{5}} = 0.025 \text{ 0r, } 2.5\%$$

$6PE = 6 \times 0.025 = 0.1529$

Appendix III

Calculation for Average value of Sample Banks

Year	NABIL		SCBNL	
	Total La to Total Deposit	**NPL to Total LA**	**Total La to Total Deposit**	**NPL to Total LA**
2008/09	73.87	0.81	38.70	0.67
2009/10	69.31	1.51	45.23	0.61
2010/11	76.53	1.03	48.49	0.63
2011/12	75.61	2.40	54.43	0.79
2012/13	72.90	2.19	57.84	0.78
Total	368.22	7.94	244.69	3.48

Mean of Nabil Total Loan and advance to TD Ratio $(\overline{X}) = \frac{\sum X}{N} = \frac{368.22}{5} = 73.65$

Mean of Nabil NPL to Total LA $(\overline{X}) = \frac{\sum X}{N} = \frac{7.94}{5} = 1.59$

Mean of Total Loan and advance to TD Ratio of SCBNL $(\overline{X}) = \frac{\sum X}{N} = \frac{244.69}{5} = 48.94$