Analysis of Financial Performance Focusing on Non Performing Assets: Evidence from Nepal Investment Bank Limited and Machhapuchhre Bank Limited

A MASTER'S DEGREE THESIS

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CHAPTER 1

Introduction

1.1 Background of the Study

Financial sector is regarded as the backbone for the growth of any economy whether developed or developing or in transaction or emerging. It plays a vital role in the development of all sectors of economy and actually works as a lubricator by providing financial resources. It operates as an intermediary between Financial surplus units and financial deficit units i.e. lenders/savers and borrowers/spondees. It provides different avenges to savers to invest their saving in financial product and services as per their needs and makes funds available to borrower/investors in most competitive price. Financial markets provide a playing field to financial institutions and customers with all type of financial instruments such as deposits, loans and advances, securities, insurance policies, corporate bonds and shares etc. A modern financial sector provides electronic banking services. ATM services, credit cards, debit cards, innovative insurance products and services, attractive pension schemes derivatives, hedging and financial future. It can provide a wide range of financial service at lower costs while minimizing financial risk to a large number of customers.

Non-Performing Assets (NPA) or Non-Performing Loan (NPL) is a burning problem of Nepalese financial sector. In the present banking scenario, NPA is being more headaches for the banking sector. In the general context, non-performing assets are nothing but those advances that do not generate income. In other words it refers to those unproductive assets of any firm that cannot be converted into cash within specified time limit. If the credit allowed by banks and financial institutions turns bad, it creates NPA. NPA percentage in assets portfolio shows health of a bank. The performance of any financial institution is greatly measured with the coverage of NPA in that particular institution. Since the prime sources of income for the bank are generated through income from loan and advances, increase in non-performing assets may lead bank in the verge of collapse (Nepal Rastra Bank, 2010).

As per the rules laid down by Nepal Rastra Bank, the loan and advances which is overdue for 3 months or more should be treated as NPA. Therefore, the significance of the study is for banking sector. Major impacts of NPA lie in the fact that it does not generate income. The credit remains idle. Also, it hits in the profit of a bank by requiring a large sum from its income as a provision. As overdue ageing more than 3 month, 6 months and one year requires 25%, 50% and 100% provisions respectively as per the NRB directives. A large sum of money goes as a provision from income, which is virtually sure to reduce the profit. Furthermore, borrowing cost of resources locked in NPA and opportunity loss due in none recycling of funds are other impacts. It also increases the administrative and recovery cost and legal cost as well. Effect on employee morale and decision making, lower image and rating of bank and reduce investor and foreign aid agencies confidence are some of the prominent impacts (Nepal Rastra Bank, 2010).

The primary objective of a bank like any other commercial organization would be to enhance profitability from their operation, generate surpluses adequate for ensuring growth and increase shareholder's value. In today's competitive scenario, profits and the index of the efficiency and banks rating are decided on the basis of the return on assets, return on equity and the profits generated. These indicate the functional, operating and allocate efficiency of the banks and investors compare these indices to evaluate the banks. "The capital adequacy norms ensure that banks cannot increase their assets without increasing their capita" (Athmanthan and Venkatakrishnan, 2001). Only profitable banks or those that are perceived to name clear edge over the others to generate future profits are likely to be rewarded by the investors with their funds. In the era where capital markets decide allocation of funds among competitive investments, profitability is the key factor for such allocation.

1.2 Statements of the Problems

Despite the better performance and quality services, there are still problems within commercial banks, which need to be resolved. In the recent year, number of development banks, finance companies, joint-venture banks, rural banks and co-operative societies came into existence bringing high competition in the market. They have been facing neck to neck competition against one another. Government policy of economic liberation has further intensified the competition, which has ultimately affected the profitability of the banks. It was observed that commercial banks are concentrating their activities in urban areas. In Nepal, 90 percents of population live in the rural areas and 81 percent of population depends on agriculture. It is difficult to solve the credit problems of the country because commercial banks are reluctant to enter rural, and agriculture areas.

Besides other problems, the country is facing the major challenge of high non-performing loan (NPL) of banking sector, which comes around 30 percent of the total loan. This basically happened by the weak management of two large public sector banks whose NPL is around 60% of the total loan. The supervision and regularity system of the central bank along with slowdown in economic activities has attributed to this situation. Poor governance was resulted from political and insider lending, lack of independency at the top management, weak information system, and weak legal framework and accounting system etc. are the main causes of increasing NPL in government owned two banks. Such malpractices further deteriorated the conditions of the banks. Moreover, the board of directors, the apex body in both banks was not able to withstand pressures from outside and virtually failed to chalk out the clear future strategy (Poudel, 2061).

A dream of globalization led to huge investment, which unfortunately could not be utilized properly due to hesitant liberalization policies. Large corporate miss-utilized the credits and delayed payments have contributed indirectly for enhancing NPA ratio. The use of the existing banks in Nepal as instrument of public-policy has been another reason. Lending under pupils schemes like directed lending to certain sectors, like priority sector lending, expert financing at reduced return rates are some of the examples. Lack of vision in appraisal of proposal while loan sanctioning, reviewing and enhancing credit limits, absence of risk management policy of financing, concentration of credit in few groups of parties and sectors, lack of coordination among various financiers, lack of initiative to take timely action against willful defaulters, labor oriented small sized old technology operations, non-transparent accounting policies and poor auditing practices are some factors behind the increment of NPA (Pradhan, 2058).

Lack of adequate and effective analysis and evaluation in connection with the purposed project or customer, weak legal regulatory framework, lack of effective monitoring and supervision, misuse of loan provided for the particular purpose, unsecured collateral and willful defaulter are the main causes which may deteriorate the quality of the investment. In this regard, study deals with following issues:

- What is condition of NPA in Nepal Investment Bank Limited and Machhapuchhre Bank Ltd.?
- What is the trend of NPA?
- What are the main factors behind the increment of NPA?
- What measures should be adopted to overcome the problem of NPA?

1.3 Objectives of the Study

The main objective of this study is to compare and analyze the financial performance of Nepal Investment Bank Limited and Machhapuchhre Bank Limited with special focus on NPA. The specific objectives are as follows:

- To examine NPA of sampled banks;
- To analyze the relationship of NPA with return on assets, return on equity, return on loan and advances, loan loss provision, total assets, total loan and advances,
- To analyze the impact of NPA on net profit of selected banks;

1.4 Significance of the Study

The significance of this study will also be for development banking sector, finance companies, co-operative, researcher/students who want to study in this topic, other interested parties and of course, the selected two banks.

The management can identify the comparative status between NIBL and MBL and they can understand their weak area, which should be corrected. The analysis may also help to identify effective use of resources for efficient and profitable operation having the efficient service to the people. The study will be helpful to the policy makers while formulating the policy and people can understand how much benefits are being taken by them from commercial banks.

1.5 Organization of the Study

The study has been divided into five chapter chapters. The first chapter deals with the subject matter of the study consisting of background of the study, statement of the problem, objectives of the study, significance of the study and organization of the study.

Chapter two consists of review of literature. This chapter deals with conceptual review, and review of previous studies.

Chapter three deals with research methodology employed in the study which includes the research design and sample, nature and sources of data and analysis method, processes that are planned for conducting this study.

Chapter four includes presentation and analysis of data according to research methodology.

The last chapter five consists of summary, conclusion and recommendation. This chapter provides summary of the study, its conclusion and some suggestions and recommendation has been provided to the sample banks to overall banking system also.

CHAPTER II

Review of Literatures

Review of literature means viewing research studies or other relevant propositions in the related area of the study so that all the past studies their conclusion and deficiencies may be known and further research can be conducted it is an integral and mandatory process in research works. The main reason for a full review of research in the past is to know the outcomes of those investigations in areas where similar concepts and methodologies had been used successfully, further, an extensive or even exhaustive process of such review may offer vital lings with the various familiarizing with the characteristic precepts, concepts and interpretation, with the special terminology, with the rationale for understanding one's proposed investigation. In this connection a review of previous related research projects will help the researcher to formulate a satisfactory structure for the project.

A pitfall to be avoided in a related literature section is the presentation of a series of abstracts, one per paragraph. By doing this, the author presents his/her audience with tedious reading and misses the opportunity for laying meaningful ground word for the study. It is much better to organize by topic and to point out how the studies presented relate to one's question. It is not necessary to discuss about the past studies in detail i.e. only important results are to be described. Enthusiastic beginning researchers often imagine their proposed study is unique and that there is no related research available. A thorough search will almost always turn up several research papers related to at least some aspect of one's study. Even if there should chance to be no research in the field, there is usually literature of a theoretical or speculative nature that should be included as part of the background of a study.

Thus the related literature section should conclude with a discussion of the findings and their implications. Here, the author shares the insights he/she has gained from the review of the literature and points out the gaps presently existing in what is known about his/her topic, and thus leads directly to the question he/she proposes to investigate (Joshi, 2003)

2.1 Conceptual Review

2.1.1 Development of Nepalese Financial System

The history of modern financial system of Nepal was begun in 1937 with the establishment of the Nepal Bank Ltd. (NBL) as the first commercial bank of Nepal with the joint ownership of government and general public. Nepal Rastra Bank (NRB), as the central bank of Nepal, was established in 1956, after 19 years since the establishment of the first commercial bank (i.e., NBL). After the establishment of NRB, Nepal witnessed a systematic development of the financial system. The second commercial bank is Rastriya Banijaya Bank, which was established 29 years later (in 1966) than NBL, and thereafter no commercial banks were established during the period of 18 years. But in the span of that period two development banks, NIDC (in 1959) and ADB (in 1967) were established, and there were no finance companies before 1985. But during the period of 1990, financial institutions had been increasing very fast. Nepal Arab Bank Ltd was the first joint venture bank established in Nepal in l984. Then the policy towards financial liberalization was undertaken in the financial year 1987/88 with the objective of expediting the process of economic development under the structural adjustments program. After the restoration of democracy in 1991, Nepal has clearly been following a liberalized economic policy and witnessing diversification in financial system. As a result, various banking and non-banking financial institutions have come into existence. (Nepal Rastra Bank)

Nepalese financial system can be divided into two pairs namely the banking system and non-banking financial institutions. Now the banking system comprises the central bank and 30 commercial banks. Non-banking financial institution comprise 58 development banks, 5 ruler development Banks, 82 finance companies, 21 cooperative societies (Licensed by NRB), 44 micro finance companies.

So far, development of financial services in the country is uneven. In some regions of the country, fast and advanced banking services are available while other regions are fully deprived of banking services. These measures included the de-regulation of interest rate, free entry for banks and financial institutions, removal of Statutory Liquidity Ratio (SLR), enactment of new commercial banks, finance companies and development bank acts, so as to encourage private sector, including foreign banks and financial institutions, divestment of government shares in financial intuitions, allowing the cooperatives and Non-Government Organizations (NGO) for limited banking activities and freedom of portfolio management except in the priority sector loan etc. As consequences of these measures, Nepalese financial sector has been widened with the establishment of more banks and financial institutions. (Nepal Rastra Bank)

Thus the environment led to the establishment of other two joint venture banks, Nepal Indosuez Bank Ltd (later converted in Nepal Investment Bank Ltd.) in 1986 where as Machhapuchhre Bank Limited (MBL) was established in late nineties.

2.1.2 Non-Performing Assets/Loan

Non-performing Loan/Assets is that part of loan that is not current yielding on return. NPAs are defined as debt instruments whose obligors are unable to discharge their liabilities as time became due. The term 'debt instruments' refer to both loans and bonds (David, 2000).

The notion of non-performing loan or assets is often used as proxy for assets quality of a particular bank of banking system. Although there is no uniform definition of NPA in many countries, including most Group of Ten (G-10) countries, assets are considered to be non performing when principle or interest is due and unpaid for 90 days or more; or interest payment equal to 90 days interest or more has been capitalized, re-financed or rolled over (Cortavaria, Dziobek, Kanaya and Sony, 2000).

If the date of the loan becomes past dues, the loan become non-performing assets of the institution. The definition of NPA differs with countries. In some developing countries of Asia-Pacific Economic Corporation (APEC) forum, a loan is clarified as non-performing only after if it has been in arrear for at least six month from the date of deemed commercial production to realize interest income, any date out to reschedule was considered as NPA on the book of account. Loans, thus defaulted, are classified into various categories having their different implication on the assets management of financial institution (Kshetry, 2057).

The determination of NPL depends upon the judgment or central bank of the country on the basis of the situation, need and international accounting norms of banking sector. Limited countries have adopted some flexible loan classification and loan loss provisioning and other many countries have followed rigid and internationally adopted practice. Therefore, the adopted process for loan classification affects the definition of loan. On-Performing assets means an asset or account of borrower, which has been classified by a bank or financial in accordance with the direction or guidelines relating to assets classification issued by RBI (Athmanathan and Venkatakrishnan, 2001)

An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement systems, recovery climate, upgradation of technology in the banking system, etc., it was decided to dispense with 'past due' concept with effect from March 31, 2001. Accordingly as from that date, a non performing asset shall be an advance where:

- Interest and/or installment of principal overdue for a period of more than 180 days in respect a term loan,
- The account remaining 'out of order' for a period of more than 180 days in respect of an overdraft/cash credit,
- The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,
- Interest and/or installment of principal remaining overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
- Any amount to be received remains over due for a period of more than 180 days in respect of other accounts.

"With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days overdue' norm for identification of NPAs from the year ending March 31, 2004" (www.helplinelaw.com). Accordingly, with effect from March 31, 2004, a non performing asset shall be a loan or an advance where:

- Interest and/or installment of principal remain overdue for a period of more than 90 days in respect a term loan,

- The account remaining 'out of order' for a period of more than 90 days in respect of an overdraft/cash credit,
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest and/or installment of principal remaining overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
- Any amount to be received remains over due for a period of more than 90 days in respect of other accounts.

For getting the real meaning of Non-Performing Assets, first of all the meaning of assets should be clearly understood. Assets mean "the property of a person or company" (Dictionary of Finance, the Penguin International, 1994). This indicates that the assets are the property of a company accumulated with the help of sources. Non-Performing Assets means "An outstanding loans and advances that is not being repaid, i.e. neither payment on neither interest nor principal being made" (Athmanathan and Venkatakrishanan, 2001). In case of the banks, the loans and advances are the assets of the bank. As the banks flow loans from the fund generated through shareholders equity, money deposited by the people and fund having through the borrowings, it expect the repayment of funds with some additional amount that is interest. So that it could meet its all kinds of expenses. When any loans couldn't be repaid in time it directly effects to the performance of the banks. Hence, non-performing assets means that loans and advance, which are not performing well or those loans and advances which, are irregular. In this regard, it would be very useful to present cross country definition with regards to non-performing assets which is presented below:

Table 2.1
Cross Country Definition of NPA

Country	Definition
India	Loans and Advances which are due for six months
Indonesia	Loans and Advances classified as sub standard, doubtful and bad (over 3 months overdue)
Korea	Loans overdue over 3 months plus non accrual loans
Malaysia	loans classified as substandard, doubtful and bad as per banks discretion (principal or interest overdue by 3 or 6 months at banks discretion)
Philippines	Substandard, doubtful and loss loan or loans payable in monthly installment more than 3 months overdue and loans repayable on other term if one month overdue
Singapore	loans classified as substandard and all loans and advances which are overdue more than three months
Thailand	substandard, doubtful and bad loans (overdue more than three months)

Source: Cotvaria L., Dziobek C., Kanaya A., and Songs I., WP/00/195 December 2001

2.1.3 Impacts of NPA

Under the circumstances assets that do not earn any income or these assets that are categorized as NPAs affects to the bank in many ways which are described below:

A) Impacts on Profits

- The resources locked up in NPA are borrowed at cost and have to earn a minimum return to service this cost but NPA earn any interest and other income. Thus NPas directly affect to the profitability of the banks
- NPAs on the hand do not earn any income but on the other hand drain the income earned by performing assets through the claim of provisioning them, NPAs reduce the net profit of the bank.
- Since they do not earn the interest, they bring down the yield on advances and the net interest margin or the spread.
- NPAs have direct impact on return on assets and return on equity, the two main parameters for measuring the profitability of the Bank
- Return on Assets will be affected because while the total assets included the NPAs, they do not contribute to profits, which is the numerator in the ratio
- Return on Equity is also as provisioning eats more and more from operating profits earned.

B) Impacts on Capital Adequacy

- The risk weighted on Non-Performing Assets is hundred percent and capital has to be blocked these assets do not produce income to sustain the capital blocked by them, which again drain the profits earned on the other performing assets.
- If the bank is required to provide for the entire outstanding NPAs (not provided so far) it could wipe out half of our net worth and reduce the capital adequacy.

C) Increase Other Costs

As the income on performing assets subsidies NPAs, the ability of the banks to offer their spreads to good customers comes down. This in turn makes the best customers choose other cheaper financing option and banks assets portfolio quality deteriorates this result in future NPAs.

The cost of monitoring non-performing assets includes administrative costs, legal costs and cost of procuring the resources locked.

D) Impact on Capital Market Perception

- NPAs bring down the profits, affect the shareholder’s value and thus adversely affect the investors confidence.
- In extreme cases, it brings customers confidence also and increase borrowing costs
- It also affects the ability of the banks to start other business ventures.

Apart from the major impacts mentioned above, non-performing assets have other adverse impacts on banks activities. They are:

- Regulators view increasing NPA seriously and they might prescribed harsher measure.
- Increasing level of NPA means no or less bonus and other benefits which ultimately lowers employee morale and reduces their affiliation with organization and decision making capacity.

2.2 Capital Adequacy Norms for Commercial Banks

Meaning of Capital

While talking about capital, the authorized capital is the maximum amount that a bank may issue during the course of its operation which is mentioned in the Memorandum of Association of the banks. The issued capital is that portion of the capital, which is issued by the bank to the public for subscription. The subscribed capital is the amount of capital subscribed by the general public. It can be either whole or just a part of the issued capital. Called up capital is the amount of capital that the shareholders need to pay. The paid up capital is the capital already paid by the shareholders. This is the only cash that have been realized by the bank. The difference between called up and paid up capital is the uncalled capital.

Maintenance of Minimum Capital Fund

With the objective to develop a healthy, capital and served banking system for promoting economic growth of the country as well as to protest the interest of depositors, as provided under Section 2.3 (1) of Nepal Rastra Bank Act 2058 relating to development and regulation of banking system, this directives in respect of Maintenance of minimum capital fund by the commercial bank has been issued.

All commercial banks need to maintain the prescribed proportion of minimum capital fund in the risk-weighted assets. As per directive issued by the central Bank, the banks need to follow the following time table.

Table 2.2

Required Capital Fund on the basis of weighted risk assets (in percentage)

Time Table	Core Capital	Total Capital Fund
For F/Y (2062/63)	7.97	11.97
For F/Y (2063/64)	7.9	12.17
For F/Y (2064/65)	7.71	11.28
For F/Y (2065/66)	8.56	11.24

Source: NRB Directives 2010 Edition.

Classification of Capital

For the purpose of calculation of capital fund, the capital of the bank is divided into the following two components.

1. Core Capital

Core capital of the commercial banks includes the following:

a) Paid up capital

b) Share premium

c) Non-redeemable Preference share

d) General reserve

e) Accumulated profit and loss account

2. Supplementary Capital

Supplementary capital of the commercial banks includes the following:

a) General loan loss provision: Under this heading, provision made only against the pass loan shall be included. Previously, the total amount of loan loss provision made for all six category of loan used to be included in the supplementary capital but now with the new directives, the amount of general loan loss provision shall be included in the supplementary as per the following time table.

Table 2.3

Provision available for inclusion in the supplementary capital

Time Table	**Provision available for inclusion in the supplementary capital**
For F/Y (2063/64)	Pass, substandard and Doubtful loans
For F/Y (2064/65)	Pass and substandard loans
For F/Y (2065/66)	Pass loan

Source: NRB Directives 2010 Edition, chap viii. p.2

The amount of general loan loss provision shall not exceed 1.25 percentages of the total risk weighted assets.

b) Exchange equalization reserve

c) Assets Revaluation reserve: For the purpose of calculating supplementary capital, the amount of Assets Revaluation Reserve shall limited up to percent of the total supplementary capital, inclusive of the amount of this reserve.

d) Hybrid Capital Instruments

e) Unsecured subordinated term debt:

f) Other free reserve not allocated for a specific purpose:

Total Capital Fund

Total capital fund is defined as the sum of core capital and supplementary capital. Value of goodwill shall not be included for the purpose of calculation of capital fund.

Total Weighted Risk Assets

For the purpose of calculation of capital fund, the risk weighted assets has been classified in the following two components:

a) On-Balance sheet Risk-weighted Assets

b) Off-Balance sheet Risk-Weighted items

a.) On-Balance Sheet Risk-weighted Assets

On-Balance sheet of the bank are grouped into three categories and assignment of separate risk-weighted. To determine the risk-weighted credit balance sheet assets, the notional value of the various balance sheet assets are multiplied by their respective risk weights and then added together.

b.) Off-Balance Sheet Risk-Weighted Items

In order to determine the value of risk-weighted of off-balance sneer items of a bank, the items are grouped into three categories and according to risk-weighted of 20 percent, 50 percent and 100 percent have been assigned. In determining the total risk-weighted amount of off-balance sheet items the values of the off-balance sheet items shall be multiplied by their respective risk-weights and then added together.

Capital Fund Adequacy Ratio:

This ratio would measures the total capital fund adequacy on the basic of total risk weighted assets. The capital fund adequacy ratio shall be determined as follows:

$$\text{Capital Fund Ratio} = \frac{\text{Core Capital + Supplementary Capital}}{\text{Sum of total Risk Weighted Assets}} \times 100$$

Sum of risk weighted Assets = Total on-balance sheet risk weighted assess -Total off-balance sheet risk weighted assets

2.3 Loan Classification and Provisioning

NRB issues various directives for banking regulation and prudential norms. Directives issued in 2001 have total 12 directives. Out of 12 directives, directive no. 2 is relating to loan classification and provisioning. According to these directives banks classify loan and advances on the basis of aging of principal amount into the following category:

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

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

Doubtful: All loans and advances which are past due for a period of 6 moths to one year shall be included in this category.

Loss Loan: All loans and advances which are past due for a period of more than one year as well as advances which have least possibility of recovery of considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category. Loans and Advances falling in the category of Sub-standard, Doubtful and Loss are classified and defined as Non-performing Loan.

Table 2.4
Loan Classification as per NRB Directives

Loan Classification	**For 2062/63**	**For 2065/66**	**For 2064/65**	**For 2065/66**
Pass	Loans not past due and past due up to 3 months	Loans not past due and past due up to 3 months	Loans not past due and past due up to 3 months	Loans not past due and past due up to 3 months
Sub-standard	Loans and advances past due for a period of over 3 months to 1 year	Loans and advances past due for a period of over 3 months to 1 year	Loans and advances past due for a period of over 3 months to 9 months	Loans and advances past due for a period of over 3 months to 6 months
Doubtful	Loans and advances past due for a period of over 1 year to 3 years	Loans and advances past due for a period of over 1 year to 3 years	Loans and advances past due for a period of over 9 months to 2 years	Loans and advances past due for a period of over 6 months to 1 year
Loss	Loans and advances past due for a period of over 3 years	Loans and advances past due for a period of over 3 years	Loans and advances past due for a period of over 2 years	Loans and advances past due for a period of over 1 years

Source: NRB Directives, 2010

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

Additional Arrangement in Respect of "Pass" Loan

Loans and advances fully secured by gold, silver, fixed deposit receipts, credit cards and HMG securities shall be included under "pass" category. However, where collateral of fixed deposit receipt or HMG securities or NRB Bones is placed as security against loan for other purposes, such loan has to be classified on the basis of ageing. Loans against FDRs of other banks shall also qualify for inclusion under pass loan (Nepal Rastra Bank, 2010)

Additional Arrangement in Respect of "Loss" Loan

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

Note: Bills purchased/Discounted are to be classified into Loss Loan where they are not realized within 90 days from due date. This is departure from the normal classification Viz. pass and Loss.

Additional Arrangement with Respect to Term Loan: In respect of term loans, the classification shall be made against the entire outstanding loan on the basis of the past due period of overdue installment.

Loan Loss Provisioning: The loan loss provisioning, on the basis of the outstanding loans and advances and bills purchases classified as per this directives, shall be provided as fallows:

Classification of Loan Loss provision:

Pass loan	1 percent
Substandard loan	25 percent
Doubtful loan	50 percent
Loss loan	100 percent

Loan Loss provision set aside for performing loan is defined as "General Loan Loss provision" and Loan loss provision set aside for Non performing loan is defined as "Specific loan Loss provision".

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

Additional provisioning in case of personal Guarantee Loans : Where the loan is extended only against personal guarantee, a statement of the assets, 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. Substandard and doubtful, in addition to the normal loan loss provision applicable for the category, an additional provision by 20-percentage point shall be provided. Classification of such loans and advances shall be prepared separately. Hence the loan loss provision required against the personal guarantee loan will be 21%, 45% and 70% for pass, substandard and doubtful category respectively.

2.4 Review of Related Terms

Under this heading, meaning of some terms used in this study has been reviewed.

Loan and Advances: Granting loans and advances are important function of the commercial bank. Commercial bank grants loan to needy individuals and institutions against the security of valuable assets. This is the most important item on the assets side of the balance sheet of the bank. Loan and advances generate incomes for the bank. Therefore, the profitability of the bank depends upon the extent to which it grants loan and advances (Dahal & Dahal, 1999).

Performing Loan and Non-performing Loan: Performing assets are those loans that repay principal and interest to the banks form the cash flow it generates. Loans are risky assets, though a bank interest most of its resources in granting loan and advances. If an individual bank has around 10 percentage non-performing assets/loan, it sounds the death knell of that bank ceteries paribus call other thing remaining constant. The objective of bound loan policy is to maintain the financial health of the banks which result in safety of depositor's-money and increase in returns to the shareholder. Since the loan is a risky asset, there is inherent risk in every loan. However, the bank should not take risk above the certain degree irrespective of returns prospects (Dahal and Dahal, 1999).

Loan Loss Provisioning: Loan loss provisioning is the vehicle for adjusting the value of loans, so as to reflect loan review and classification. For example, when a review shows that a loan value has become "doubtful", a provision needs to be established to reflect the loss of value. In some respects, provisioning is similar to the concept of depreciation of the property and equipment for non-banks (Dziobek, 1996). The cost of provision constitutes a normal business expenses and reduces bank profit. For a prudential perspective, an important distinction is made between specific and general provisioning. (Cited form IMF book: "Building strong Banks Through surveillance and Resolution, 2001).

Loan Classification System: To access loan quality, credit analyst's segregate the bank's loan portfolio into risk categories according to certain specification the U. S. guidelines are the good example of a relatively simple and transparent grid. The system includes five categories standard, special mention, substandard, doubtful, and loss.

Standard Assets: loans in this category are performing and have sound fundamentals. (Fundamentals include the borrower's overall financial condition, resources and cash flow. credit history, and character. They also include the purpose of the loan, and types of secondary sources of repayment).

Specially mentioned loans: loans in this category are performing bur have potential weaknesses which, if not corrected, may weaken the loan and the bank asset quality. Examples are: credit that the lending officer is unable to properly supervise; an inadequate loan agreement: uncertainty of the condition of collateral, or other deviations from prudent lending practices.

Substandard loans: loans in this category have well-defined weaknesses, where the current sound worth and paying capacity of the borrower is not assured. Orderly repayment of debt is in jeopardy.

Doubtful loans: doubtful loan exhibits all the characteristics of substandard loan with the added characteristics, that collection in full is highly questionable and improvable. Classification of loss is defatted because of specific pending factors which may strengthen the asset. Such factors include merger, acquisition, liquidation, procedure, capital injection, perfecting liens on additional collateral, and re-financing plans.

Loss loans: Loss loans are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the assets has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer full provision or writing off this basically worthless loan. Partial recovery may be affected in the future (Cited from IMF: "Building strong Banks' through surveillance and Resolution", 2001).

Assets Management Company: This is a company to which the bad loans and assets are transferred from the problem banks. The AMC could be owned and funded by the state or by private owners. An assets management company is a special purpose limited liability company (holding or subsidiary), agency or undertaking which facilitates the:

Transfer of problem assets from financial institutions in exchange for a consideration

- Financing and resolution of problem loan and assets
- Expert management of problem loans through reconstruction and rehabilitation
- Specialist management of loan of loan security (real estate, share. etc.)
- Expert and focused management of the process of maximizing net returns (i.e. after costs) over a reasonable time frame

2.5 Review of Previous Study

Shrestha and Bhandari (2004) in their article entitled "Financial Market and Institutions” have written about "loan losses". As per their view, customers do not pay the loans either intentionally or due to some genuine causes and the factors beyond the control. "Banks face loan loss due to the borrower's defaults of loan obligation. It is not possible for the bank to 100 percents success in selecting the good clients since in practice. There are many other factors like change in economic environment, keen competition in the economy, managerial weakness and other outright frauds that bring the loan losses to the banks. This affects the earnings and the reserve building capability of the banks. In such situation, the regulatory body like central bank compels the commercial banks to maintain loan loss provisions according to classification of loans into various categories like pass loan, substandard loan, doubtful loan, and loss loan. Loan loss provisioning is the part of bank capital.

Commercial banks have to be very selective and careful in providing loan, so that loan will be minimized and the loan loss provision will automatically become less for the commercial banks. Among the commercial banks developed in the country, local commercial banks have to face much more loan loss.

Pradhan (2004) has studied on "Financial Distress, Financial Ratios, Stockholder losses in Corporate Restructuring: A Case of Nepal" published in the book "Research in Nepalese Finance". In this study attempt is made at determining the extend of financial distress in Nepalese enterprises, indicating how financial ratios deteriorate as the firms move in financial distress, pointing out concessions to be made by various stockholders in the restructuring process, and analyzing legal framework concerning financial distress in Nepal. The study used both primary and secondary data.

In this study, attempt is made to form portfolio on net profit ratio, "indicated how profitability ratio deteriorate in financial distressed firms. As net profit ratio increased from 33 percent in portfolio 1 to 30.3 percent in portfolio 4, return on capital employed and return on equity also improved significantly. Similarly, it may also be seen how improvement in net profit also improved operating ratio as on movers from portfolios 1 to 4. Increase in net profit ratio led to increase in liquidity ratio, and turnover ratios. Similarly, was the case with labor productivity and debt coverage. As the enterprises moved into financial distress, labor productivity and debt coverage ratios also deteriorated. The regression result showed that net profit ratios are negatively related to operating expenses and are positively related to liquidity, turnover, labor productivity, and interest coverage."

In this study, it is concluded that despite of significant number of financially distress firm, legal frame work has not received much attention in Nepal. The Company Act, the industrial policy, and Ninth Five year plan, are all silent on financial depress in Nepal. The industrial enterprises act 1997 came up with the delimitation of sick industry on in 1997 through the first amendment. Some facilities were specified for the sick industries while importing machineries and equipment. There are many actions, which the government might take concerning the financial distressed firms. These actions included soft loan schemes for financially distressed firms, policy of merging financial distressed firms, establishing an industrial reconstruction bank and so on.

Rodman (2005) has written a chapter entitled "Progress towards the Resolution of Non-Performing Loans" in a book, "Corporate Restructuring: Lesson from Experiences" published by World Bank.In this chapter, the writer has recommended that multiple strategies should be used to resolve non-performing loans, depending in part, on the effectiveness of legal and regulatory institution. The seller of nonperforming loan need to view the problem realistically, accept that non-performing loan sell for substantially less than face value and close transaction at market clearing prices. Seller should welcome foreign investment and financial advices to guide transaction, ensure transparency and carry out due diligence.

Similarly, he recommended "Government needs to create resolution friendly non-performing loan regulation, including market-clearing principal for the disposition of non performing loan and to enforce them through strong political leadership. Capital and bailout monies are required to make the process work along with efforts to promote transparency and support the development of capital market.

Neyens (2005) has written a chapter entitled "The Successful Assets Management Companies" in a book, "Corporate Restructuring: Lesson form Experiences" published by World Bank. In this chapter, the writer has dealt with experiences faced by four assets management companies, the challenge they faced the solution they adopted and the result they achieved. The review of the experiences of assets management companies reveals common principles that were central to their success. After reviewing experiences some conclusions have been made.

- First, assets management companies need effective policies and procedure for the disposal of non-performing assets. These processes must be transparent and designed within the framework of appropriate governance structures. Ensuring that they are short-lived agencies helped to establish the right incentives for rapid disposal of assets and form corporate reorganizations that addressed underling problems.

- Second, assets management companies are rarely in a position to manage the ongoing business operation of distressed corporations. Without effective management, assets will deteriorate due to lack of maintenance, lack of employees, supplier, and customer, commitment; and inability to respond to change in the business environment.

- Third, assets management companies must acquire asserts at a realistic price and be prepared to dispose of assets at market prices, without regard to historical cost. If asset management companies purchase distressed assets at book value then their managers must not be held accountable for losses relative to this purchase price.

- Fourth, asset management companies should engage the private sector in the process of asset disposition. The papers presented in this chapter describe innovative measures by Korean and Chinese asset management companies to use private expertise, for example, through joint venture with investment banks.

- Finally, assets management companies need to be flexible. No single financial technique is appropriate for each situation, and menu of instrument is necessary to deal with distressed corporation.

David Woo (2001) in the chapter written by him, entitled 'Two Approaches to Resolving Nonperforming Assets during Financial Crises" published by IMF in the book "Building Strong Banks through Surveillance and Resolution".

According to him NPAs are generally a manifestation of weakness in corporate sector and immediate source of problem in financial sector (holder of the assets). Effective assets management policies need to be recognize these linkages and interdependence between two sectors. In this sense, asset management policies cannot be independently formulated and must be conceived in the context of a comprehensive framework for restructuring of financial and corporate sectors".

In this chapter, he has explained two asset management approaches that have been used extensively during the recent Asian crises to help faceplate the restructuring of the financial and the corporate sectors: assets management companies serving primarily as a vehicle for financial restructuring and out of court centralized corporate debt workout framework for corporate restructuring.

Finally, he concluded that these approaches have inherent weakness and their dependence on government involvement is likely to lead to outcomes that are neither the most efficient nor the optimal in normal in normal times.

2.6 Review of Journals, Reports and Articles

Kshetry (2057) in his article entitled "Non-performing Assets: A need for Rationalization", has attempt to deal with practice of NPA classification, factors generating NPA, implication o f NPA and measures regarding problems of NPA.

According to him, "the degree of NPA depends sole on the length of time the assets has been in the form of non-obligated by the lone. The more time it has elapsed the-worse condition of assets is being perceived and such assets are treated accordingly."

In his opinion, the main factors generating NPA are failures of business for which loan was used. Defect in appraising projects, lack of monitoring project in time to time, the definition of the NPA and accounting norms adopted by concerned agencies also amount to higher or lower magnitude of such assets, slowdown in economy etc.

He said that there is serious implication of NPAs, on financial institutions. The liability of credit institution does not limit to the amount declared as NPA but extend to extra amount that requires by regulation of supervisory authority in the form of provisioning as the amount required for provisioning depends upon the level of NPL and their quality. As per his view, rising level of NPL create a psyche of worse environment especially in the financial sector. He mention that by reviewing the activity of the financial institution like waving interest, rescheduling the loan, writing off the loan appointing private recovery agent, taking help of tribunals and law of land etc. can reduce the level of NPL.

Finally he concluded that credit agency may be encouraged to reduce the level of NPL by waiving the interest to be paid notionally; the debtor may be invited to enter into compromise settlement. The management aspect of banks and financial institutions has no less responsibility then entrepreneurs themselves. Diversion of funds and under capitalization of projects might have contributed to amass the level of NPL. Concern efforts to lesson the burden of NPL do not include 'ever greening' process but adequate provisioning and administrative measures like debt recovery tribunals should be prepared to solve the cases speedily. Raising level of NPL can not be taken as stimulus but the vigilance demanded to solve the cases speedily.

Pradhan (2058) in his article "NPA: Some suggestion to tackle them" found saying that unless the growth in 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 couldn't be utilized properly due to hesitant liberalization policies. Large corporate 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 police, CIAA, public account committee of the parliament have also the 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.

A SEACEN Seminar paper (2001) had prepared in Taipei on "The NPL Resolution Mechanism and its Impact on Financial System”. As per this paper, Thailand also took legal and regulatory initiatives as taken by its counterparts to stem the impacts of crisis, further to of measures have been implemented. Among them, Financial Sector Restructuring Authority (FRA) and Corporate Department Restructuring Advisory Committee (CDRAC) were formed initially aiming to rehabilitate and liquidate the assets of financial companies and to promote voluntary out-of-court corporate debt workout. Later on, with the view to enhance the stability of the financial sector and promote efficient management of NPLs "Thai Assets Management Corporation (TAMC)" came into effect in June 2001. Nonetheless, Thailand has also encouraged establishing bank based asset management company. Following the above reforms, Thailand became able to lower down the non-performing loans from 45.0 percent in 1998 to 13.0 percent in July 2001. (Cited from Prashikshhan, NRB Training Center, 2004.)

Rahan et.al. (2003) had prepared a country paper for SEACEN Seminar on "Who and Liberalization of the Financial Services". As per this paper, Malaysia executed the National Economic Recovery plan in July 1998 aiming to stabilize the Ringgit (RM). Restore market confidence and maintain financial stability. With regard to financial sector, institutional arrangement made in 1998 to deal with the NPLs by setting up Danaharta (an asset management company), Danamodal (bank recapitalization agency) and Corporate Debt Restructuring Committee (platform for voluntary debt workout). The basic objectives of Danamodal were to remove NPLs and to realize maximum value of NPLs through restructuring, settlement, foreclosure and schemes of arrangement. In this regard, Danaharta has been successful to restructure RM 52.3 billion loans as at 31 March 2003. Similarly, Danamodal was established to raise funds to recapitulates the ailing banking sector, which injected RM 7.1 billion into 10 institutions since its inception. However, Danamodal has made no capital injections into financial institutions since 1999. Corporate Debt Restructuring Committee (CDRC) was formed to provide platform for both borrowers and creditors to workout feasible debt restructuring schemes without having to resort to legal proceedings. During its operation rill August 2002, it resolved 48 cases involving debts of RM 52.6 billion. In addition, a merger program for domestic banking industry w^as undertaken in 1995 to rationalize and consolidate fragmented banking industry. As a consequence, institutional arrangements have yielded net NPL ratio 7.0 percent in May 2003 from 9.0 percent in 1998.

Santos et al (2003) had prepared a country paper on "Financial Reform on in Philippines-Experiences and Implication". As per this paper, the Philippines responded to the crisis focusing on legislative and regulatory reforms of the banking sector. Increasing the minimum required capitalization of banks, granting of incentives for mergers and consolidation, upgrading prudential regulation and supervision, strengthening corporate governance disclosure were regulatory measures taken to resolve the banking crisis, with regard to legislative reform, the New General Banking Act 2000, the Securities and Regulation Code, the Anti Money Laundering Law 2001, Special Purpose Vehicle Act 2002 had been enforced.

The Philippines unlike its counterparts in the region did not form an Asset Management Company (AMC). Instead, the central Bank endorsed the passage of law that would encourage the private sector to setup an AMC. However, the total NPLs as of end June 2003 accounted 15.0 percent of the system's total loans compared to 5.4 percent in 1997. The rise in NPLs was basically, due to the weakening of the peso and increased interest rates.

Dahal (2004) had written an articled entitled "The Non-performing Loan: An Analytical Overview”. In this article, he had emphasized that inferior mortgages against the loans, lack of ample financial information of loanees, extension of bank branches in the least feasible geographical areas, over staffing in the bank are the reason behind the increment of NPL in Nepal.

In this article the writer had concluded that a weak financial system and the rising inferior assets, to' some extent, could be considered simultaneously. The poor financial system degrades the assets quality, which is evidenced by the East Asian crises and by the Nepalese financial sector has been hard-hit by the domestic factors. Robust economic fundamentals and inadequate regulatory and legislative framework were the factors attracting to the foreign capital which further led to the East Asian economies towards vicious circle of crisis. In order to resolve the problem of financial hardship and impaired assets. Several of measures adopted by the East Asian countries have been effective. In the Nepalese context, weak legislative, supervisory and regulatory arrangements along with laxity in debtors' financial behaviors are the factors responsible for worsening financial system and thereby assets quality. In the meantime, it has been observed that the total credit requirement of the country is not adequately supplied by the banking sector. At the same time, there is a problem of deteriorating credit quality in the system. In this scenario, conductive monetary policy adopted by Nepal Rastra Bank, on the one hand, would help extension of more credit into the economy and on the other hand, strengthening of legal and institutional arrangements along with updated regulatory and supervisory framework would help to improve the financial health as well as the problem of NPLs. Moreover, the aforementioned suggestions would also be worthy enough to overcome the quality.

Poudel (2004) in his article entitled "Final System. Impaired Assets and Their Resolution in Nepal" has written "Heavily concentrated lending in a few group beyond normal prudent risk acceptability, larger consortium loans, higher credit risk exposures with a serious collateral shortfalls adversely affects both banks' liquidity, profitability, assets quality and capital base."

In his article, he concluded that NRB's role in insuring financial stability can hardly be exaggerated. The NRB surveillance of banks and financial institutions on the basis of micro-prudential indicators is important from the standpoint of preventing distress in the financial system. Efficient market can prevent financial crises by channeling financial resources from relatively lower productive secretor to higher ones, and it also implicitly helps on controlling impaired assets of the banking sector. For this, the publication of biannual financial stability reports by NRB can be useful to stakeholder in order to make them aware of the information and able to take decisions. Financial reporting of public and private banks and other financial institutions are to be made public timely. Reports of special studies related to financial sector reforms and bank restructuring also required to be publish so that investors and deposits can give pressures to authorities for prompt implementation^ of suggestions incorporated in the reports. NRB’s decisions are expected to support the market. NRB's supports to banks and financial institutions and recently proposed AMC are expected to be useful in the resolution of the impaired assets of the banking system. A separate and independent financial sector reform department in NRB can accelerate the pace of reform.

National Planning Commission (2005) had published progress report of implementation of Tenth Five-Year Plan. As per this report about financial sector reform, Nepal's financial sector is very weak and lacks competitiveness. In the past, the government made attempts to inject fresh capital in publicly-owned companies and to introduce expertise by opening up the sector to foreign joint ventures. However, the sector remains dominated by two-government owned and semi owned-commercial banks that account for almost one-half of the total transaction volume. Both of these banks are in serious trouble, as their non-performing Assets exceed the acceptable limit.

The government has been implementing a financial sector reform program since July 2002 to address-the-weaknesses of the sector, which even though not directly pro-poor has a direct bearing on the larger economic environment that in turn influences economic growth and poverty reduction. The reform objectives include making the two problematic banks financially sound through improved accounting and auditing standards and loan recovery, strengthen the monitoring, and regularity capacity of the central bank and the ' legislative and institutional framework, and to eventually restructure and privatize the banks. The reforms also include restructuring the state-owned Nepal Industrial Development Corporation, an industrial financing institution, and the Agriculture Development Banks, both of which face serious financial problems.

International consultants were hired to manage the two banks and implement the reforms during the transition. The new managements have undertaken a series of measures to improve performance. The two banks, Nepal Bank Limited and the Rastriya Banijya Bank had operating losses of over Rs.2 billion and Rs. 7 billion respectively when the reforms were started. Both the banks have reported operating profits. In summary, the reform has helped to check the speed at which the two banks were failing but they still have large stocks of non-performing assets. The reforms have also resulted in progress in terms of rationalizing the workforce, financial disclosure, credit appraisal mechanism, improved revenue and cost control.

The banking sector also has a new legislative framework that grants greater independence to the central bank and empowers it to better perform its regulatory functions. The central bank has also introduced new accounting standard in the financial sector.

Measures taken to resolve the crisis and NPLs in some Asian countries Legislative and institutional arrangements were the prominent measures adopted to overcome the problems of non-performing loans largely caused by the weak financial programs, policies and practices.

Karki (2006), in her article entitled "Challenges of Non Performing Loan Management in Nepal" she has mentioned the causes of increasing trend of non-performing loan. She identifies the major causes such as poor loan analysis, guarantee oriented loan system, depreciation of valued assets, misuse of loan, lack of regular supervision of loan.

Default risk is one kind of investment risk of non payment of loan at the fixed future date. In Nepalese context, when interest rate is increased, it causes the decrease in economic activities as well as capacity of borrower. Sometimes, debtors knowingly do not pay bank the loan, and invest the loan in unproductive sector. Such kind of activities occurs continuously, if there is lack of sound credit policy, improper credit analysis, lack of information about loan holders and lack of regular supervision. So bank should formulate and implement sound credit policy. Loan approval and disbursement process should be conducted in better way. Proper credit analysis and regular supervision can control the credit risk.

Bhattarai (2006), in his article entitled "Restructuring Process of Commercial Banks and Responsibility of Restructuring Team" indicated the problems of bank bad debt and non-performing assets. According to him, if a bank cannot recover its loan lending, banks cash flow will be badly affected. Similarly it can affect the close relationship between depositors.

"Why does loan become defaulter?" This study finds out the causes that makes loan default. When the due date is over the loans become default. But why do the due dates be over? Generally, increase in interest rates decreases in economic activities cause decrease in the capacity of debtor and sometimes the debtor knowingly do not pay bank the loan. Other than these reasons in the context of Nepal lack of credit policy, lack of information about the loan holder (three Cs: Capacity, Character, and Capital), unhealthy competition and small market area cause loan defaults. Default loan increases the resource mobilization cost and reduces the profit earning capacity of a bank. Therefore increase in default loans are the indicator of problematic situation to the bank.

2.7 Review of Thesis

Bhattarai (2003) has conducted a study on "Impact and implementation of Nepal Rastra Bank Directives on Commercial Banks: A Case Study of Nabil Bank Ltd. and Nepal SBI Bank Ltd." The main objective of this study is to find out the impact of NRB Directives on commercial banks. She has also made effort to find out whether the directive are actually implemented and are being monitored or not.

She concluded after study that the change in NRB Directive made both positive and negative impacts on the commercial banks. Even though this study is limited to only two samples among entire population, it clears the new directives issued by NRB make good impact more than bad impact on the various aspects of the banks. It can be seen that the provision has been changed and the increased provisioning amount has decreased the profitability of commercial banks. Apart from, loan exposure has been cut down to customers due to the borrowers limits have been brought down by NRB. Therefore, reduction in loan amount results to decrease the interest income from loans, which will decrease the profits of the banks in coming years. Decreasing profitability pushes toward lesser dividends to shareholder and lesser bonus to employees. Recently the problems of bans are increasing operating cost and decreasing loan amounts resulting decreasing in profits of the banks. But it shows that only for short term because the directives are more effective to protect the banks from bad loans, which protect the bank from bankruptcy as well as protection of deposits of depositors. Increase n capital adequacy ratio strength the bank's financial position, loan related provision will made safety of loans except the risk reducing provision will protect the bank from liquidation.

Finally, she concluded that newly issued directives are more effective than previous although it has bout some problems towards banks. To decrease the decreasing profit of the bank, they should research the alternative such like more investment in other business; bank should adopt new technology according to the demand of time and most not depend on only interest income for profits.

Shrestha (2004) conducted a study entitled "A Study on Non-performing Loan and Loan Loss provisioning of Commercial Banks" with the special reference to Nepal Bank Ltd. NBL Bank Ltd. and Standard chartered Bank Lid. He set some objectives which are given below:

- To find out the proportion of non-performing loan in the selected commercial banks.
- To find out the factors leading to accumulation of non-performing loan in commercial banks.
- To study and analyzed the guidelines and provision pertaining to the loan classification and provisioning.
- To find out the relationship between loan and loan loss provisioning in the selected commercial banks.
- To study the impact of loan loss provisioning on the profitability of the commercial banks

After study, she concluded that ineffective credit policy, political pressure to lend to un-creditworthy borrowers, overvaluation of collateral are the major causes of mounting non-performing loan in government owned banks like NBL. Other factors leading to accumulation of NPL are weak loan sanctioning process, ineffective credit monitoring and supervision system, economic slowdown, borrower's misconducts etc.

She also concluded that continual review and classification of loans enables banks to monitor quality of their portfolio and to make the remedial action to counter deterioration in credit quality. The present loan classification and provisioning directive seems more stringent than the previous one. As a result more provision has to be apportioned leading to lesser profitability but this kind of negative impact is only for short period.

Finally, she recommended that adequate provisioning strengthens the financial health of the banks and makes them able to face any kind of future contingencies. . In addition to this establishing recovery cell, hiring assets Management Company are also measure to resolve the problem of NPL. She also concluded that all banks to take preventive measures before the loan go to default. All the banks ate recommended to have an information system to gather all the possible information and activities about its borrowers so that necessary precautions can be taken in time.

Bhattarai (2004) has conducted a research work on the topic of " Implementation of Directives issued by Nepal Rastra Bank: A comparative study of Nepal SBI Bank Limited and Nepal Bangladesh Bank Limited". The study is mainly concerted to Capital Adequacy and Loan Classification and Provisioning.

After the study she concluded that continual review and classification of loan and advances enables banks to monitor the quality to their loan portfolio and to take remedial action to counter deterioration in the credit quality of their portfolios.

She also concluded that the banks will be able to withstand tough economic situations in the future with adequate capital and provisioning for losses. The tough time, through which the bank is under going at present, will prevail only for a short period but in the long run, it will be strong enough to attract more deposits and expose itself to more risks with capital cushion behind it.

Finally, she recommended that commercial banks have to come up with a stringer internal audit department to make sure that the directive is properly implemented. NRB should not only issue directives for the sake of issuing them but a proper homework need to done to combat the problems associated with the directiv3s. The directives should be applicable in the context of Nepal.

2.8 Research Gap

From the review of previous research study, it has been found that increasing non-performing loan is one of the challenges faced by commercial banks in the present scenario. Some researchers were studied on implementation aspects of NRB directives by commercial banks while some other were studies researchers have made non-performing loan and loan loss provisioning of commercial banks. No research has been found on the impact of non-performing loan and loan loss provision on the performance of commercial banks, and capital adequacy of commercial banks as per NRB directives. Therefore, this attempt is made to fulfill the research gap by taking comparative study of the two commercial banks in Nepal. This research will be able to deliver some of the present issues, latest information, and survey on NPL and NRB directives.

CHAPTER III

Research Methodology

Research methodology describes the methods and process applied in the entire study. In other words, research methodology is a systematic process to approach any research problem and explore it objectively. Research is a systematic and organized effort to investigate a specific problem that needs a solution (Sekaran, 1992).

3.1 Research Design

Research design of the study is descriptive as well as analytical research design. Financial and statistical tools have been used for analytical purpose. This process of investigation involves a series of well through out activities of gathering, recording, analyzing, and interpreting the data with the purpose of finding answers to the problem. This chapter includes research design, population and samples, sample selection procedure, nature and sources of data and method of data analysis, etc.s

3.2 Population and Sample

The total number commercial banks represent as the total population for the purpose of this study. Hence, the population consists of thirty commercial banks. Out of total population, two private sectors' commercial banks are used as samples. They are Nepal Investment Bank Limited, and Machhapuchhre Bank Limited.

3.3 Nature and Sources of Data

Data has been collected form both primary and secondary sources. The research is mainly based on the secondary data and some primary data will also be used. Secondary source of data is presented as under:

- From the following sources data will be collected:
- Annual reports of NIBL and MBL banks
- Financial statistics of Nepal Rastra Bank
- Unpublished official records
- Other published journal of NIBL, MBL and NRM materials
- Newspapers and magazines and other relevant data regarding non-performing assess of commercial banks.

- Various published and unpublished Nepalese thesis
- Text books of P.R. Joshi
- Various related websites
- Laws, guidelines and directives regarding the subject manors etc.

Data are collected using both primary and secondary data. Primary data has been obtained through questionnaire, direct interview, field visit, and telephone inquiries. While secondary data were collected through the annual reports of Nepal Investment Bank Limited and Machhapuchhre Bank Ltd. which were collected from concerned banks and other reports were downloaded from websites. Various publications of NRB were collected from concerned department of NRB. Similarly reports of Credit Information Bureau have been collected from office of CIB, Thapathali. The reference of NRB directives and textbooks, journals and dissertation has been obtained by visiting concern libraries.

3.4 Method of Data Analysis

The collected data from various sources will be presented and tabulated in systematic way, and data will be analyzed by using different financial and statistical analysis tools as necessary.

3.4.1 Standard Deviation

The standard deviation is the absolute measure of dispersion in which the drawbacks present in other measure of dispersion are removed. It is said to the best measure of dispersion as it satisfies most of the requisites of a good measure of dispersion. Standard deviation is defined as the positive square root of the mean of the square of the deviation taken from the arithmetic mean. Standard deviation is calculated as follows:

$$\sigma = \sqrt{\frac{fd^2}{N} - \left(\frac{fd}{N}\right)^2}$$

where; σ = standard deviation

$d = x - \bar{x}$

N = No. of observation

3.4.2 Coefficient of Variation

Standard deviation is the absolute measure of dispersion. The relative measure of dispersion based on the standard deviation is known as the coefficient of variation

Coefficient of Variation $X \frac{s.d.}{Mean} X \frac{\text{¢}}{\bar{x}}$

The coefficient of dispersion based on standard deviation multiplied by 100 is known as the coefficient of variation (C.V.). If $\bar{x}$ be the arithmetic mean and. the standard deviation of the distribution, then the C.V. is defined by:

C.V. $X \frac{\text{¢}}{\bar{x}} | 100$

It is independent of unit. So, two distributions cab bitterly be compared with the help of C.V. for their variability. Less the C.V., more will be the uniformity; consistency etc. and more the C.V. less will be the uniformity, consistency, etc.

3.4.3 Analysis of Time Series

Time series analysis also called trend analysis. It is one of the statistical tools which are used to determine the improvement or deterioration of financial situation.

A time series is a sequence of observations of a variables made at regular points or intervals of time and arranged in a chronological order. Time series analysis is one quantitative technique to determine the patterns in data collected over time.

A time series depict the relationship between two variables, one of them being time mathematically. A time series is defined by the functional relationship.

Y=f(t)

Where, y is the value to the variables under the consideration at a time.

The least square method has been adopted to measure the trend behavior of the selected banks. This method is widely used in practice. The formula for least square method for the straight line trend is represented by the following formula.

Y_c = a + bx ……………………………………..(i)

Where,

Y_c = Trend values

a = Y intercept or the computed figures of the Y variables, when x = 0

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

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

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

$\sum y = Na + b\sum X$ ………………………………….(ii)

$\sum xy = a\sum X + b \sum X$ ……………………………….(iii)

Where, N = number of years.

For the simplification, if the time variables are measured as a deviation from its mean i. e. mid point taken as the origin. The negative value in the first half of the series balances out the positive values in^ the second half so that ($\sum X=0$) the values of constant a, and b can be easily determine by using following formula.

$a = Y/N$

$b = XY/X^2$

3.4.4 Ratio Analysis

Ratio analysis is analysis of quantitative and numerical relationship between two variables. It is widely used tool of financial analysis. Ratio analysis indicates the strength and weakness of any organization and reflects the operating and financial growth of the organization.

Various ratios used in this study are as follows:

a) Performing loan to total loan and advances
b) Non-performing loan to total loan and advances
c) Substandard loan to total NPL
d) Doubtful loan to total NPL
e) Loss loan to total NPL
f) Performing loan to total assets
g) Performing loan to total deposit
h) Performing loan to total loan and advances
i) Non-performing loan to total assets

j) Non-performing loan to total deposit

k) Non-performing loan to total loan and advances

l) Loan loss provision to total loan and advances

m) Return on assets

n) Return on Equity

3.4.5 Correlation Analysis

Correlation analysis enables us in determining the degree and direction of relationship between two variables. Two variables are said to be correlated if change in the value of one variable appears to be related or linked with the change in other variables.

Correlation is an analysis of the covariance between two variables and correlation analysis deals to determine the degree of relationship between variables, the measures of correlation, called correlation coefficient in one figure, the degree and direction of correlation. The correlation analysis refers the closeness of the relationship between the variables. There are different techniques of calculating correlation coefficient. Among various techniques it is used Karl Pearson Coefficient of correlation. It is calculated as follows:

Correlation Coefficient $r_{xy} = \dfrac{n \quad xy\,Z \quad x. \quad y}{\sqrt{n \quad x^2\,Z(\quad x)^2}\sqrt{n \quad y^2\,Z(\quad (y)^2}}$

3.4.6 Diagrammatic and Graphical Representation

Data presentation in the form of chart and graph can provide a quick and concise insight in the subject under investigation. Diagrammatic representation of information has now become a popular way to communicate finding to readers. Diagrams and graphs are visual aids that give a bird eye view of a given set of numerical data. Hence various bar diagrams, pie charts and graphs have been used for the peregrination and analysis of data.

3.5 Hypothesis

"The test of hypothesis is a process of testing of significance regarding the parameters of the population on the basis of the sample drawn from the population" (Shrestha and Manandhar 1994). Setting up and testing hypothesis is an essential part of statistical inference. In order to formulate such a test, usually some theory has been put forward, either because it is believed to be true of because it is to be used as a basis for argument, but has not been proved. Generally, following steps are followed for the test of hypothesis:

A) Formulating Hypothesis

Nepal Investment Bank Ltd. Is one of the joint venture bank in Nepal and Machhapuchhre Bank is the first commercial bank in Nepal established by the Nepalese investors. The years of operation are different of these two banks. Correlation coefficients (r) of Non-Performing Loan with different parameters such as Return on Assets (ROA), Return on Equity (ROE), Total Loans and Advances and Net Profit of both banks have been calculated. By the help of hypothesis, the significance of observed correlation with the parameter will be tested.

Null Hypothesis H_0 : There is no correlation between NPL and another parameter
Alternate Hypothesis H_1 : There is correlation between NPL and another parameter
B) Computing of Test Statistics (t-Test)

When sample size is less than 30, t-Test is generally carried out. t-Test can be used to test significance of observed correlation in the population.

Formula of t-Test:

$$t = \frac{r\sqrt{n-2}}{\sqrt{1-r^2}}$$

where, t is the t-Test

r = observed correlation of NPL with another parameter

n = no. of observations

Level of significance α = 5%

Degree of freedom (d.f.) = n -2 = 7 – 2 = 5

The tabulated value of t at 5% level of significance and 5 d.f. is 2.57

There is tabulated value of the t-Test. The tabulated value is compared with the calculated value of t. The procedure of making decision is:

If $t_{cal} > t_{tab}$, then Null Hypothesis is rejected and Alternate Hypothesis is accepted

If $t_{cal} > t_{tab}$, then Null Hypothesis is accepted and Alternate Hypothesis is rejected

3.6 Limitations of the Study

The scope of the study is limited only commercial banks because of time and resources constraints. Most of the analyses are descriptive in present study. This study is very basic attempt to address the researches issues; therefore, it might not be able to show casual linkage or effect. The following are the limitations of the study:

- This research study largely depends on published documents such as Balance Sheet, Profit and Loss Account Statements, which are circulated at the close of the financial year.
- The study is associated only to the financial performance of Nepal Investment Bank Limited and Machhapuchhre Bank Limited.
- The other limitation is the lack of sufficient time and resource because the purpose of this thesis is only to fulfill the partial requirement for the Master of Business Studies (MBS) of the management faculty, Tribhuvan University.
- The study deals mainly with secondary data.

CHAPTER - IV

Presentation and Analysis of Data

This chapter is related to presentation and analysis of data. The chapter has been divided into two sections. The first section implies the analysis of data collected from various sources and second section implies the major findings of the study. For this purpose efforts are made to present and analysis of collected data. Data are collected from various sources and classified and tabulated as requirement of the study and in accordance to nature of the collected data. Collected data are analyzed by using various arithmetical and statistical tools such as ratio, percentage, tabulation, graphs, correlation, regression etc.

4.1 Capital Adequacy Ratios of Commercial Banks

As per NRB Directives, all commercial banks need to maintain the prescribed proportion of minimum capital fund on the risk weighted assets. Total capital fund of commercial banks include core capital and supplementary capital.

4.1.1 Capital Adequacy Ratio for Core capital to Total Risk Weighted Assets

As per NRB Directives, commercial banks should maintain its core capital 7.97%, 7.9%, 7.71% in FY 2062/63, 2063/64, 2064/65 respectively and 8.56% in FY 2065/66 onwards of total risk weighted assets. Table no. 4.1 presents the Capital Adequacy Ratios of the two commercial banks for core capital.

Table: 4.1

Capital Adequacy Ratio for Core capital to Total Risk weighted Assets

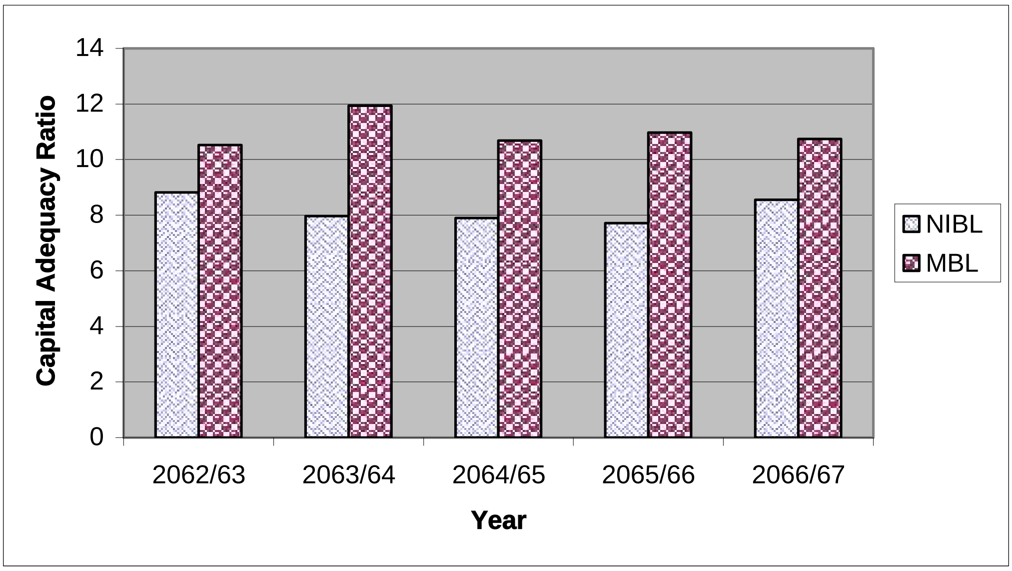
(in percentage)

FY	NIBL (%)	Change	MBL	Change
2062/63	8.82	-	10.52	-
2063/64	7.97	(9.60)	11.94	13.49
2064/65	7.9	(9.00)	10.68	(10.49)
2065/66	7.71	(2.40)	10.97	2.71
2066/67	8.56	11.00	10.74	(2.09)

Source: Annual Reports of NIBL and MBL

Figure: 4.1

Capital Adequacy Ratio for Core Capital to Total Risk Weighted Assets



From the Table 4.1, it can be concluded that both banks have maintained more than 4.5% core capital of total risk weighted assets. In FY 2062/63 Nepal Investment Bank has maintained 8.82% core capital of total risk weighted which is the lesser than Machhapuchhre Bank (10.52%). In FY 2066/67 also, Nepal Investment Bank Ltd has maintained core capital 8.56% on total risk weighted and Machhapuchhre Bank has maintained 10.74% on total risk weighted. FY 2063/64 onwards, maintaining the core capital on total risk weighted of Machhapuchhre Bank is higher than Nepal Investment Bank. But Nepal investment Bank has also maintained enough core capital on total risk weighted according to the NRB Directives. MBL and NINL maintained enough core capital in study period which is more than enough as per NRB Directives. Among the Sample period, NIBL has maintained highest core capital to total risk weighted in the FY 2062/63 which is 8.82% and MBL has maintained highest core capital to total risk weighted in the FY 2063/64 which is 11.94%.

Issue of share capital, increase in general reserve fund, increase in the volume of capital adjustment fund, increase in the volume of redemption reserve fund, increase in the volume of net profit are the reasons which increased core capital to total risk weighted assets ratios of the banks.

4.1.2 Capital Adequacy for Total Capital Fund to Total Risk Weighted Assets

As per NRB directives, all commercial banks should maintain its total capital fund 9%, 10%, and 11% in FY 2060/61, 2061/62, and 2062/63 respectively and 12% in FY 2063/64 on wards of total risk weighted. Table 4.2 shows the capital adequacy ratios on total capital fund of the NIBL and MBL

Table: 4.2

Capital Adequacy Ratio for Total Capital Funds to Total Risk Weighted Assets

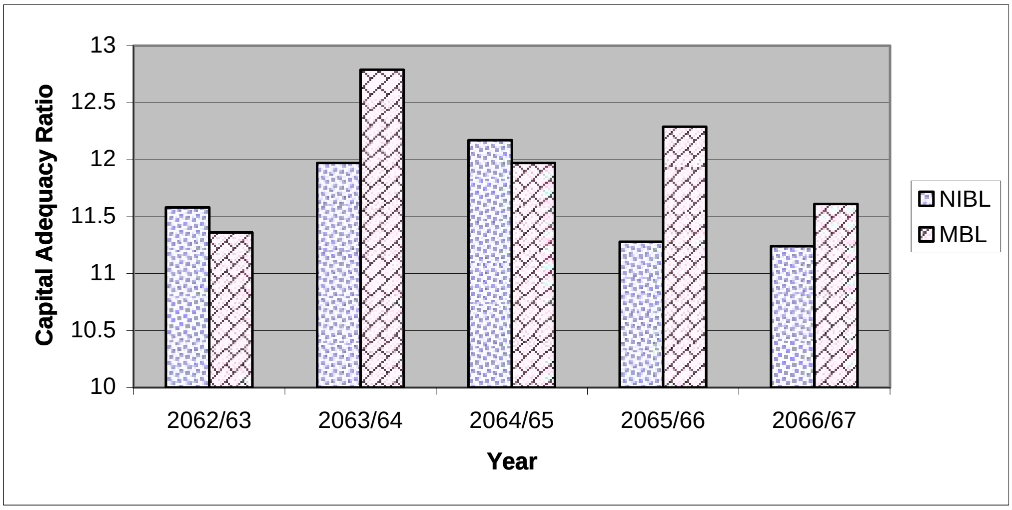
(in percentage)

FY	NIBL (%)	Change	MBL (%)	Change
2062/63	11.58	-	11.36	-
2063/64	11.97	3.36	12.79	12.58
2064/65	12.17	1.67	11.97	(6.41
2065/66	11.28	(7.31)	12.29	2.67
2066/67	11.24	(0.35)	11.61	(5.53)

(Source: Annual Reports of NIBL and MBL)

Figure: 4.2

Capital Adequacy Ratio for Total Funds to Total Risk Weighted Assets



From the Table 4.2, it can be concluded that NIBL had maintained enough total capital funds which is 11.58% in FY 2062/63 and MBL has maintained the minimum total capital fund which is only 11.36%. But in the next FY, both the banks have maintained less total capital funds i.e. 11.97% and 12.79% of NIBL and MBL respectively. In FY 2066/67, NIBL and MBL have failed to maintain its minimum total fund i.e. 11.24% and 11.61%. In FY 2066/67 all commercial banks need to maintain 12% of minimum total capital fund to total risk weighted and both of the banks have fail to maintained enough total capital fund i.e. 12%. From FY 2063/64 onwards, all commercial banks need to maintain 12% of total capital fund to total risk weighted but there are fluctuations in maintaining the total capital fund to total risk weighted. In FY 2063/64 both the banks failed to maintain the minimum total capital fund.

Issue of share capital, increase in general reserve fund, increase in the volume of capital adjustment fund, increase in the volume of redemption reserve fund, increase in the volume of net profit, loan loss provision maintained for pass loan exchange equalization reserve, issue of subordinate term debt are the reasons which increased the total capital fund to total risk weighted assets ratios of the banks.

4.2 Loan Loss Provisioning and Total Capital Fund

Total capital funds of commercial banks include core capital and supplementary capital. Supplementary capital includes general loan loss provisioning as per NRB Directives. Therefore, general loan loss provisioning affects the capital funds and capital adequacy ratio of the banks.

General loan loss provision is loan loss provisions made only against the pass loan.

Table: 4.3

Loan Loss Provision to Total Capital Fund Ratio

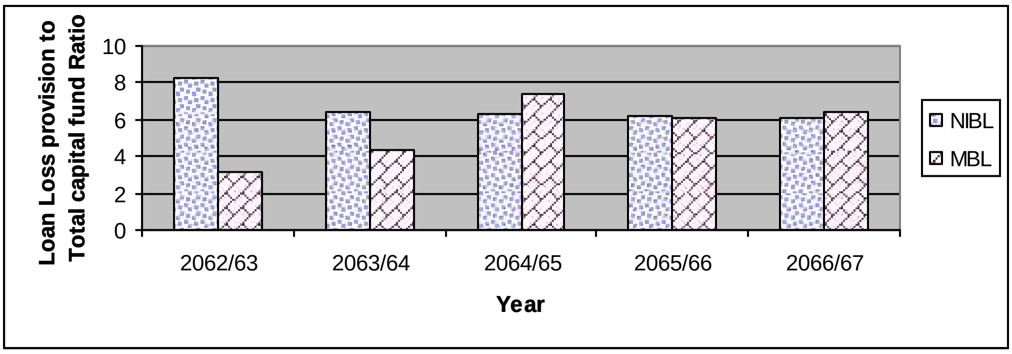
(in percentage)

F/Y	NIBL (%)	Change	MBL (%)	Change
2062/63	8.23	-	3.12	-
2063/64	6.44	(21.75)	4.34	39.10
2064/65	6.27	(2.64)	7.42	70.97
2065/66	6.15	(1.91)	6.13	(17.39)
2066/67	6.08	(1.14)	6.38	4.08
Average	**6.26**		**7.06**	

(Source: Annual Reports of the Concern Banks)

Figure: 4.3

Loan Loss Provision to Total Capital Fund Ratio



From the Table 4.3, it can be concluded that the LLP to Total Capital Fund Ratio of NIBL in FY 2062/63, 2063/64, 2064/65, 2065/66 and 2066/67 were 8.23, 6.44, 6.27, 6.15, and 6.08 respectively. Similarly, Total Capital Fund Ratio of MBL in FY 2062/63, 2063/64, 2064/65, 2065/66 and 2066/67 were 3.12, 4.34, 7.42, 6.13, and 6.38 respectively.

4.3 Comparative Analysis of the Banks' level of Total Assets, Total Deposit, and Total Loan and advances, Total performing loan and Total Non-performing loan of the selected bank

Following tables and figures present comparative status of assets, deposits, loan and advances, performing and non-performing loans of NIBL and MBL.

4.3.1 Analysis of Level of Total Assets

Table 4.4
Comparison of Total Assets of NIBL and MBL

(Amount in Rs.)

FY	Total Assets			
	NIBL		MBL	
	Amount	% Change	Amount	% Change
2062/63	16390652	-	6456460	-
2063/64	21732081	32.58	9046270	40.11
2064/65	28073517	29.18	10897281	20.46
2065/66	39405959	40.36	12608246	15.70
2066/67	53739438	36.37	17447570	38.38
S.D.	53.71		18.79	
C.V.	168.59%		166.54%	

(Source: Annual Reports of NIBL and MBL)

Figure: 4.4

Comparison of Total Assets of NIBL and MBL

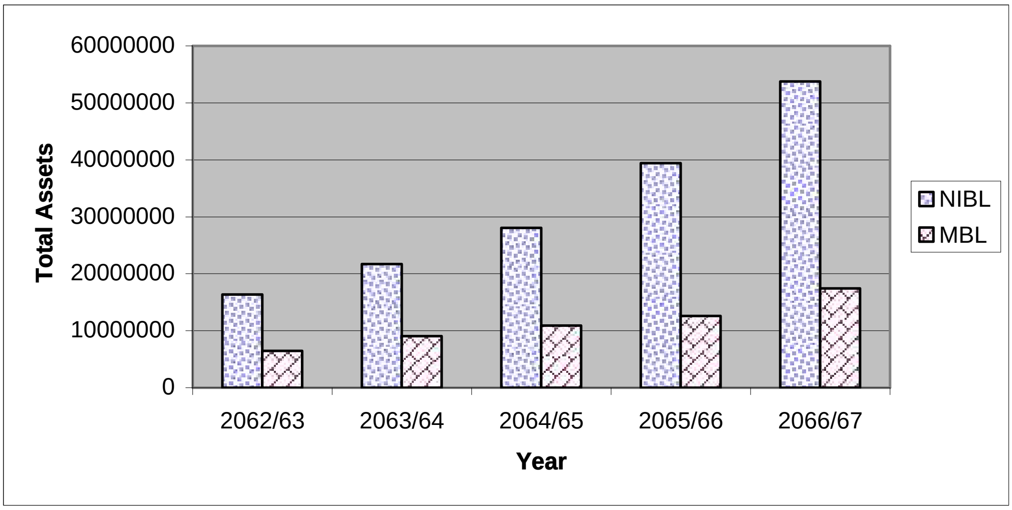


Table 4.4 and Figure 4.4 show that the total assets of NIBL were Rs. 16390652 in FY 2062/63. They were slightly increased by 32.58% and reached to Rs. 21732081 in FY 2063/64. In the next following fiscal years, Total Assets were highly increasing. The increment in percentage in fiscal years 2064/65, 2065/66 and 2066/67 were 29.18%, 40.36%, and 36.37% respectively. There is a high growth in total assets from FY 2064/65 to 2065/66.

Table 4.4 and Figure 4.4 show that the total assets of MBL were Rs. 6456460 in FY 2062/63. They were highly increased in FY 2063/64 by 40.11% and reached to Rs. 9046270. In the next following fiscal years, Total Assets were gradually increasing. The percentage increment in total assets in FY 2064/65, 2065/66 and 2066/67 were 20.46%, 15.70% and 39.39% respectively. There is tremendous growth in total assets from FY 2065/66 to 2066/67.

4.3.2 Analysis of Level of Total Deposits

Table: 4.5

Comparison of Total Deposits of NIBL and MBL

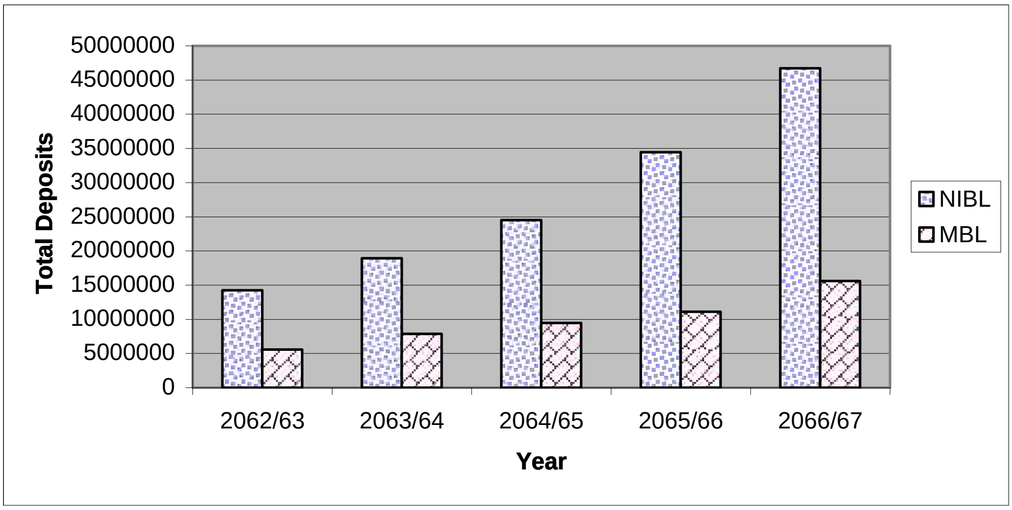
(Amount in Rs.)

FY	Total Deposits			
	NIBL		MBL	
	Amount	% Change	Amount	% Change
2062/63	14254574	-	5586802	-
2063/64	18927306	32.78	7893297	41.28
2064/65	24488856	29.38	9474968	20.03
2065/66	34451726	40.68	11101180	17.16
2066/67	46697983	35.54	15596249	40.49
S.D.	46.79		16.55	
C.V.	168.57%		166.78%	

(Source: Annual Reports of NIBL and MBL)

Figure: 4.5

Comparison of Total Deposit of NIBL and MBL



There is high increment in total deposit from FY 2064/65 to 2065/66 which is 40.68% which is tremendously high.

Table 4.5 and Figure 4.5 show that the total deposits of MBL were Rs. 5586802 in FY 2062/63. They were slightly increased in FY 2063/64 by 41.28% and reached to Rs.

7893297. In the next following fiscal years, Total Deposits were gradually increasing. The increment percentage in Total deposits in the fiscal years 2063/64, 2064/65, 2065/66 and 2066/67 were 41.28%, 20.03%, 17.16% and 40.49%. There is high increment in total deposit also from FY 2062/63 to 2063/64 by 41.28% which is high.

4.3.3 Analysis of Level of Total Loans and Advances

Table: 4.6

Comparison of Total Loans and Advances of NIBL and MBL

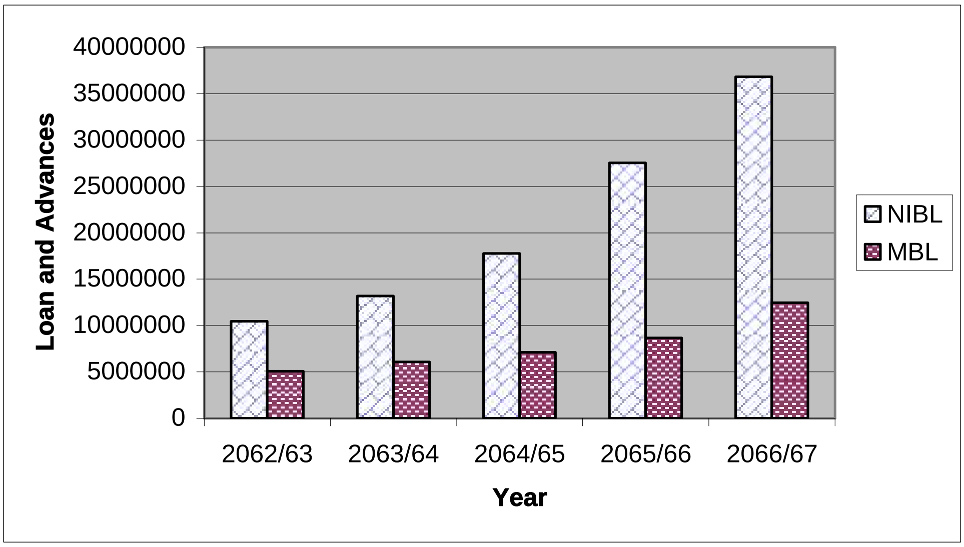
(Amount in Rs.)

FY	Total Loans and Advances			
	NIBL		MBL	
	Amount	% Change	Amount	% Change
2062/63	10453164	-	5061433	-
2063/64	13178152	26.06	6068913	19.90
2064/65	17769100	34.83	7096898	16.93
2065/66	27529305	54.92	8674976	22.23
2066/67	36827157	33.77	12467188	43.71
S.D.	35.87		13.10	
C.V.	169.69%		166.57%	

(Source: Annual Reports of NIBL and MBL)

Figure 4.6

Comparison of Total Loans and Advances of NIBL and MBL



Total loan and advances of NIBL in FY 2062/63 was Rs. 10453164 and it was slightly increased in the next FY 2063/64 by 26.06% and reached to Rs. 13178752. The amount of total loan and advances was dramatically increased in the next following years. Percentage increment in total Loans and Advances in FY 2063/64, 2064/65, 2065/66 and 2066/67 were 26.06%, 34.83%, 54.92%, and 33.77% respectively. The growth in total loan and advances from FY 2064/65 to FY 2065/66 is 54.92%, which high.

Total loan and advances of MBL in FY 2062/63 was Rs. 5061433 and it was slightly increased in the next FY 2063/64 by 19.90% and reached to Rs. 6068913. The amount of total loan and advances was dramatically increased in the next following years. Percentage increment in Total Loans and Advances in FY 2061/62, 2062/63, 2063/64, 2064/65 and 2065/66 were 19.90%, 16.93%, 22.23%, and 43.71% respectively. The growth in total loan and advances from FY 2065/66 to FY 2066/67 is 43.71%, which is high.

4.3.4 Analysis of Level of Total Performing Loan

Table 4.7

Comparison of Total Performing Loans of NIBL and MBL

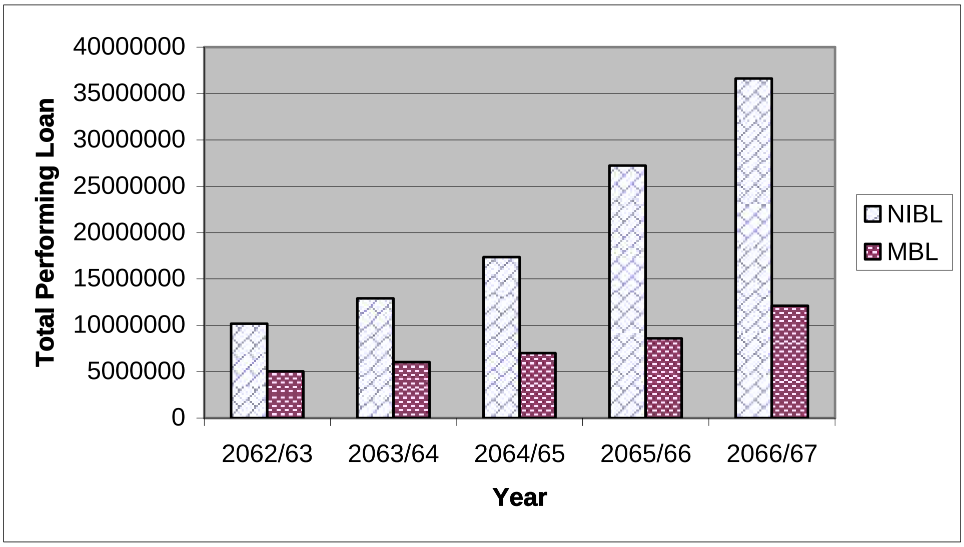
(Amount in Rs.)

FY	Total Performing Loan			
	NIBL		MBL	
	Amount	% Change	Amount	% Change
2062/63	10171974	-	5041693	-
2063/64	12905664	26.87	6051920	20.03
2064/65	17347172	36.42	7001090	15.68
2065/66	27220977	56.90	8584756	22.62
2066/67	36613559	34.50	12124340	41.23
S.D.	3542.82		1291.24	
C.V.	169.90%		166.38%	

(Source: Annual Reports of NIBL and MBL)

Figure: 4.7

Comparison of Total Performing Loans of NIBL and MBL



Total Performing Loan shown by the table and figure is gradually increasing in sample periods of NIBL. Total performing loan in FY 2062/63 was Rs. 10171974 and increased by 26.87% and reached to Rs. 12905364 in FY 2063/64. Increment percentage of total Performing Loans of NIBL in FY 2063/64, 2064/65, 2065/66 and

2066/67 were 26.87, 36.42%, 56.90% and 34.50% respectively.

Total Performing Loan shown by the table is gradually increasing in sample periods of MBL. Total performing loan in FY 2062/63 was Rs. 5041693 and increased by 20.03% and reached to Rs. 6051920 in FY 2063/64. Percentage increment of Total Performing Loan in FY 2063/64, 2064/65, 2065/66 and 2066/67 were 20.03%, 15.68%, 22.62% and 41.23% respectively.

From the Table 4.7 and Figure 4.7, it can be concluded that both banks are successful to convert their loan and advances into performing loan in the beginning period and increased thereafter.

4.3.5 Analysis of Level of Total Non-Performing Loan

Table: 4.8

Comparison of Total Non-Performing Loans of NIBL and MBL

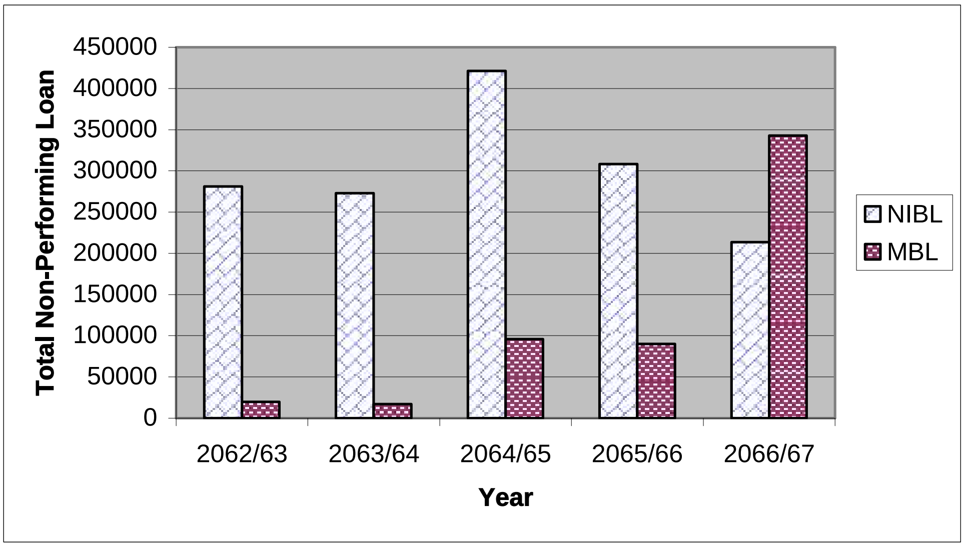
(Amount in Rs.)

FY	Total Non-Performing Loan			
	NIBL		MBL	
	Amount	% Change	Amount	% Change
2062/63	281190	-	19740	-
2063/64	272788	(2.98)	16993	(16.91)
2064/65	421128	54.37	95808	463
2065/66	308328	(26.78)	90220	(5.83)
2066/67	213598	(30.72)	342848	280
S.D.	49.37		9.07	
C.V.	164.90%		176.61%	

(Source: Annual Reports of NIBL and MBL)

Figure 4.8

Comparison of Total Non-Performing Loans of NIBL and MBL



Total Non-Performing Loan (NPL) of NIBL in FY 2062/63 was Rs. 281190 and was successfully decreased by 2.98% to Rs. 272788 in FY 2063/64 which was good symbol for the bank's financial health. The amount of total NPL further decreased in the next year 2065/66 by 26.78% and reached to Rs. 308328 which means the bank was successfully converting its credit to assets. But in the next following years the amount of the NP was increased by 54.37% reached to Rs. 421128 in FY 2064/65. Level of NPL in FY 2066/67 of the bank was slightly decreased by 30.72% and reached to Rs. 213598.

Total non-performing loan (NPL) of MBL in FY 2062/63 was Rs. 19740 and tremendously decreased by 16.91% and reached to Rs. 16993 in FY 2063/64 which was good symbol for the bank's financial health. There is highly fluctuation in NPL of the bank. The level of total NPL decreased by 5.83% in next year 2065/66 and reached to Rs. 90220 from Rs. 95808 which means the bank was successfully converting its credit to assets in that year. In next FY 2066/67 the level of NPL was further increased by 280% and reached to Rs. 342848. But the level of NPL highly increased in FY 2064/65 by 463% and reached to Rs. 95808 which means the bank is not properly converting its loan and advances to the total assets.

4.3.6 Analysis of Level of Net Profit

Table 4.9

Comparison of Net Profits of NIBL and MBL

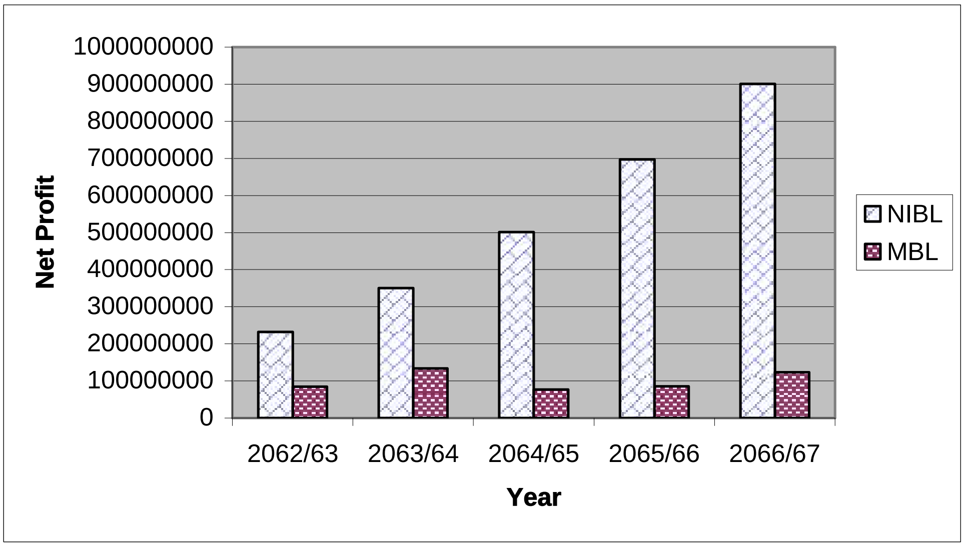
(Amount in Rs.)

FY	Net Profit			
	NIBL		MBL	
	Amount	% Change	Amount	% Change
2062/63	232147000	-	84870027	-
2063/64	350536000	51.00	133996709	57.88
2064/65	501399000	43.03	76799259	(42.68)
2065/66	696732000	38.95	85016002	10.69
2066/67	900619000	29.26	123251098	44.97
S.D.	90.78		16.54	
C.V.	169.29%		165.0%	

(Source: Annual Reports of NIBL and MBL)

Figure 4.9

Comparison of Net Profit of NIBL and MBL



Total Net Profit of NIBL in FY 2062/63 was Rs. 232147000 and was slightly increased by 51.0% and reached to Rs. 350536000 in FY 2063/64. The amount of net profit tremendously increased in the next year 2063/64 by 43.03% and reached to Rs. 501399000 which means the bank was successfully converting its credit to assets. The level of net profit further increased in FY 2065/66, and 2066/67 by 38.95% and 29.26% and reached to Rs. 696732000 and Rs. 900619000 respectively.

MBL had net loss in FY 2062/63 amounting Rs. 84870027. In the next year 2063/64 the profit increased by 57.88% and reached to Rs. 133996709. The further decreased in profit was Rs. 76799259 by 42.68%. In FY 2060/61 the level of Net Profit increased by 10.69% and reached to Rs. 85016002. The level of net profit increased in FY 2061/62, 44.97% and reached to Rs. 123251098.

Weak regulation and supervision of banks, global economic recession after July 2008 incident, improper credit appraisal, ineffective credit monitoring and supervision, economic slowdown, borrowers' misconducts, overvaluation of collateral, political pressure in lending, lack of responsibility and accountability of employees, domestic insurgency problems, financial distress in manufacturing and service sector's industries, insider lending, weak financial and management information, weak legal and accounting practice affected the repayment rate and NPL of the Nepalese commercial bank rose considerably in the previous years which ultimately decreased the overall performance of banks.

Similarly, reforming the financial sector laws and regulation, strengthen of NRB's regulatory and supervisory functions, setting up of recovery cell, regular, tactful follow up of borrowers, effective credit analysis of projects, issue of new directives by NRB, accurate valuation of securities and insurance coverage, rebate and concession in repayment of principal and interest, periodic supervision by NRB, establishment of bankers training institute, restructuring of Credit Information Bureau reduced the NPL level of banks in subsequent years which ultimately improving the overall performance of banks.

4.4 Financial Analysis

4.4.1 Ratios Related to Classified Loans

These ratios show the percentage of different classified loans to total loan and advances. Under MBL are analyzed. These ratios measure the proportion of performing loans and non-performing loans is total loan portfolio. As pr NRB Directives, the loans falling under category of pass loan is regarded as performing loan and loan falling under the category of substandard, doubtful and loss loan are regarded as non-performing loans. Higher the pass loan to total loan and advances ratio implies the better quality of banks assets is the form of total loans and advances. Lower the performing loan to total loans and advances ratio implies the poor quality of assets of the banks which is not desirable.

Ratios of the Nepal Investment Bank and Machhapuchhre Bank for the sample period are presented under:

Nepal Investment Bank Ltd.

Table 4.10

Different ratios related to classified loan of Nepal Investment Bank Ltd for the sample period.

Ratios (Percentage)	**2062/63**	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Performing Loan to Total Loan	97.31	97.93	97.63	98.88	99.42
Non-Performing loan to Total Loan	2.69	2.07	2.37	1.12	0.58
Substandard Loan to total NPL	10.59	35.07	19.34	7.37	5.03
Doubtful loan to total NPL	89.41	11.34	9.78	7.59	5.37
Loss loan to total NPL	0	53.59	70.88	85.04	89.6

Source: Nepal Rastra Bank, 2010

From the Table 4.10 it can be concluded that performing loan to total loan ratio of NIBL was 97.31% which indicates that performing loan occupied 97.31% in total loan and advances in FY 2062/63. This ratio increased to 97.93% in FY 2063/64 and further increased to 98.88% in FY 2065/66 which indicates that the bank is able to recover its bad loans as a result bank's performing loan is gradually increasing. IN the next following years the ratio is remain almost same.

Similarly NPL to total loan and advances ratio is gradually decreasing from FY 2062/63 to FY 2066/67. It was 2.69%, 2.07%, and 2.37%,1.12% and 0.58.

By the end of FY 2066/67, total NPL comprises 22.96% substandard loan, 20.39% doubtful loan and 56.65% loss loan which means there is large amount of NPL occupied by loss loan.

Machhapuchhre Bank Ltd.

Table: 4.11

Different ratios related to classified loan of Machhapuchhre Bank Ltd for the ample period

Ratios (Percentage)	2062/63	2063/64	2064/65	2065/66	2066/67
Performing Loan to Total Loan	97.92	99.02	99.61	99.72	98.84
Non-Performing loan to Total Loan	2.08	0.98	0.39	0.28	1.16
Substandard Loan to total NPL	19.46	3.38	10.46	0.39	22.65
Doubtful loan to total NPL	61.14	14.64	5.95	7.17	31.24
Loss loan to total NPL	19.40	81.98	83.42	92.44	46.11

Source: Nepal Rastra Bank, 2010

From the Table 4.11 It is found that performing loan to total loan ratio of MBL was 99.09% which indicates that performing loan occupied 99.09% in total loan and advances in FY 2063/64. This ratio increased to 99.61% in FY 2064/65 and increased to 99.72% in FY 2065/66 which indicates that the bank is able to recover its bad loans as a result bank's performing loan is gradually increasing. In the next following years the ratio is gradually increasing to 98.84% in FY 2066/67.

NPL to total loan and advances ratio in FY 2063/64 was 0.98% but it is highly increased in FY 2062/63 to 2.08% which means the bank has large amount of total loan and advances as NPL. In the next 4 years the ratio was decreasing to 0.39%, 0.28%, and 1.16% in FY 2064/65, 2065/66 and 2066/67.

By the end of FY 2066/67, total NPL comprises 22.65% substandard loan, 31.24% doubtful loan and 46.11% loss loan which means there is large amount of NPL occupied by loss loan.

4.5 Comparative Analysis of different Ratios between NIBL and MBL

This analysis compares the ratios of NIBL and MBL for the sample period. These ratios are performing loan as percentage of total assets, performing loans as percentage of total deposit, performing loans as percentage to total loans and advances, non-performing loans as percentage to total assets, non-performing loans as percentage to total deposits, non-performing loans as percentage to total loans and advances.

4.5.1 Performing Loan to Total Assets Ratio

Performing loan to total Assets Ratio presents the percentage of performing loan is total assets for the sample period. In this analysis, comparison of the ratio between NIBL and MBL is presented. Performing loan to total assets ratio is calculated dividing performing loan by total assets.

The ratio of performing loan to total assets ratio measures the volume of total performing loan in the structure of total assets. The high degree of ratio indicates that the good performance of the bank in mobilizing its fund in productive sector by the way of lending functions. As per NRB Directives, the loan falling under category of pass loan is considered as performing loan. Higher the ratio implies that better the quality of bank assets in the form of total assets. Lower the performing loan to total assets ration implies poor the quality of assets of the bank which is not desirable.

Table: 4.12

Performing Loan to Total Assets Ratio

FY	NIBL	MBL
2062/63	62.06	78.09
2063/64	59.38	66.09
2064/65	61.79	64.25
2065/66	69.08	68.09
2066/67	68.13	69.49
Average	**57.22**	**66.51**

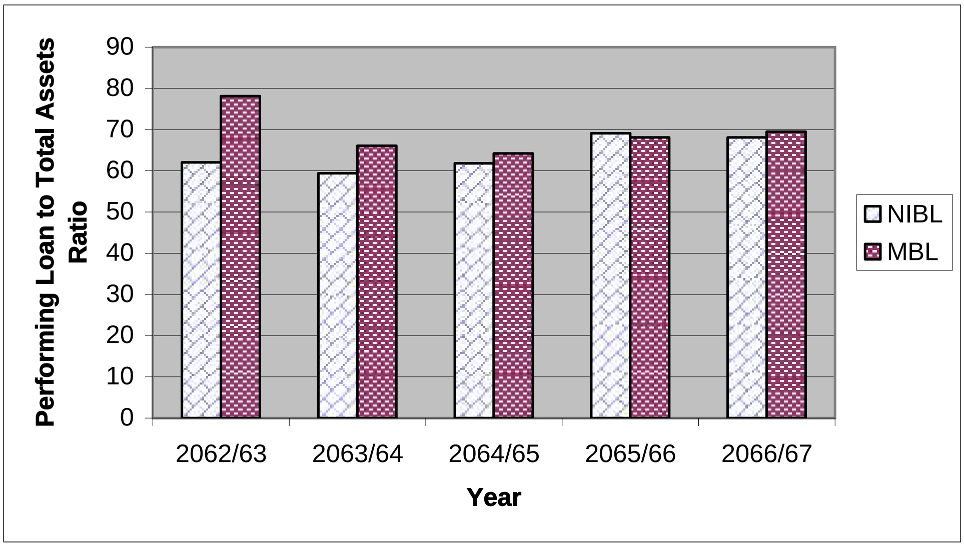
(Source: Annual Reports of NIBL and MBL)

Table 4.12 clearly presents that performing loan to total assets ratio of NIBL and MBL were 62.06%and 78.09% respectively in FY 2062/63. In FY 2062/63 performing loan to total asset ratio of MBL was higher than NIBL. Similarly in FY 2063/64 the ratio of NIBL and MBL was 59.38% and 66.09% respectively. The ratio of NIBL was increased but the ratio of MBL was decreased which means MBL was failed to convert its NPL to asset in comparison to NIBL in that particular FY.

In the next FY 2065/66 the ratio of both banks had been increased to 69.08% and 68.09.15% respectively but comparatively the performance of NIBL was better than MBL. But in comparison, the ratio of MBL was higher than NIBL. In the recent year 2066/67 the ratio of NIBL has been decreased to 68.13% and the ratio of MBL has slightly increased to 69.49% but still MBL has the highest ratio in comparison to the ratio of NIBL. The figure below clearly indicates the above described data.

Figure: 4.10

Performing Loan to Total Assets Ratio



4.5.2 Performing Loan to Total Deposit Ratio

This ratio implies that to what extent banks was success in mobilizing their deposits on productive sector.

This ratio measures the proportion of performing loans in the total deposits portfolio. As per NRB Directives, the loan falling under category of pass loan is considered as performing loan. Higher the ratio implies that better quality of banks assets in the form of total deposits. Lower the performing loan to total deposits ratio implies poor quality of assets of the banks which is not desirable.

Table: 4.13

Performing Loan to Total Deposit Ratio

FY	NIBL	MBL
2062/63	71.36	90.24
2063/64	68.18	76.67
2064/65	70.84	73.89
2065/66	79.01	77.33
2066/67	78.04	77.74
Average	**65.71**	**78.71**

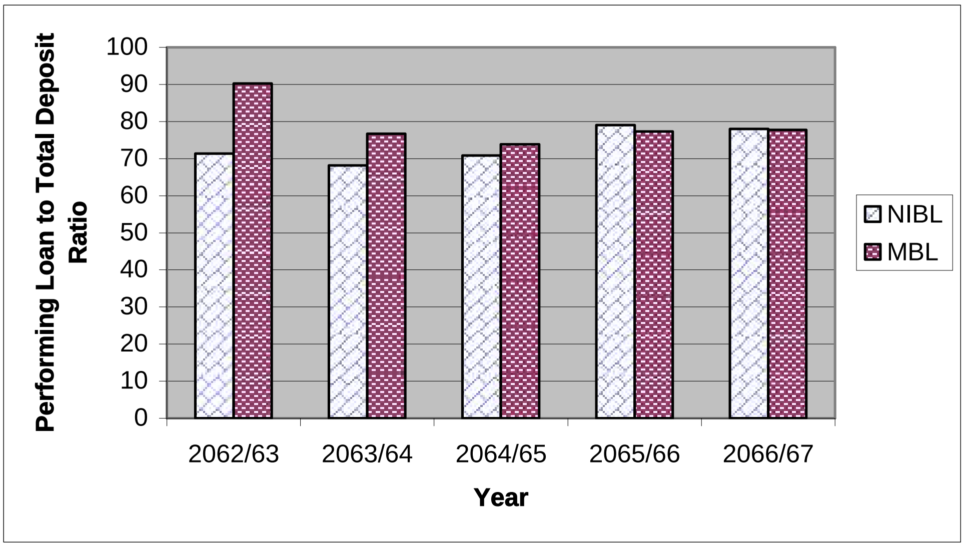
(Source: Annual Reports of NIBL and MBL)

In the Table 4.13, the comparative ratio of Performing Loan to Total Deposit of NIBL and MBL has been presented. Performing loan to total deposit ratio of NIBL and MBL were 71.36% and 90.24% respectively in FY 2062/63. In this FY the ratio of MBL was higher than NIBL. Similarly in FY 2063/64 the ratio of NIBL and MBL was 68.18% and 76.67%respectively. The ratio of NIBL and MBL was decreased which means MBL and NIBL was failed to convert the ratio of performing loans to total deposits portfolio in comparison to NIBL in that particular FY.

In FY 2062/63 the ratio of performing loan to total deposits ratio of both banks had tremendously increased to 71.36% and 90.24% respectively. Comparatively, MBL was highly successful to convert its total performing loans to total deposits portfolio than NIBL. Similarly, the ratio of NIBL and MBL in FY 2066/67 is 78.4% and 77.74% respectively. In this year the ratio of NIBL had decreased but the ratio of MBL had highly decreased which means that MBL had been successful in that year to convert its loans to total deposits portfolio in comparison to NIBL.. The figure below clearly indicates the above described data.

Figure: 4.11

Performing Loan to Total Deposit Ratio



4.5.3 Performing Loans to Total Loans and Advances Ratio

This ratio measures the proportion of performing loans in the total loan portfolio. As per NRB Directives, the loan falling under category of pass loan is considered as performing loan. Higher the ratio implies that better the quality of banks assets in the form of total loans and advances. Lower the performing loans to total loan and advances ratio implies poor quality of assets of the banks which is not desirable.

Table: 4.14

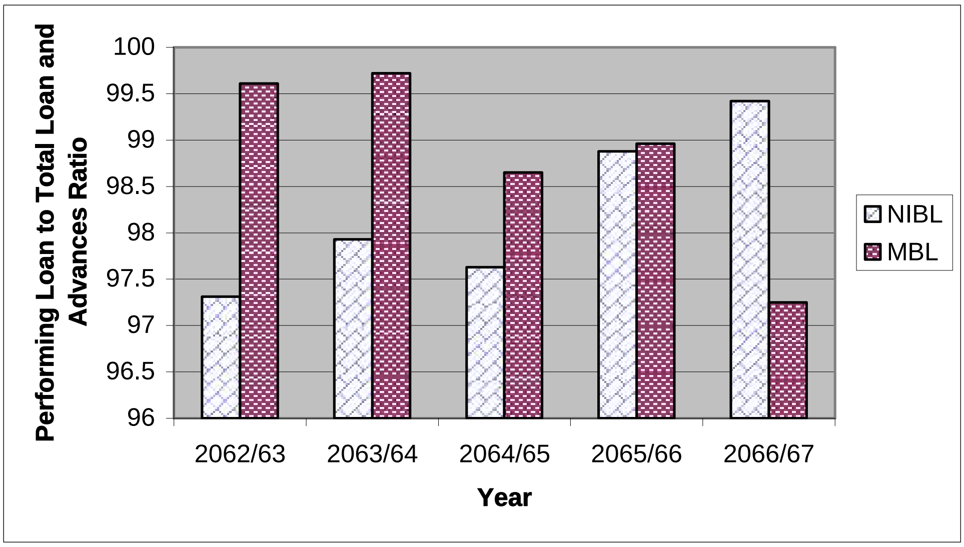
Performing Loan to Total Loan and Advances Ratio

FY	**NIBL**	**MBL**
2062/63	97.31	99.61
2063/64	97.93	99.72
2064/65	97.63	98.65
2065/66	98.88	98.96
2066/67	99.42	97.25
Average	**96.48**	**97.68**

(Source: Annual Reports of NIBL and MBL)

Figure: 4.12

Performing Loan to Total Loan and Advances Ratio



From Table 4.14 and Figure 4.12, it can concluded that the difference between performing loan to total loans and advances ratios in sample periods of both banks. Performing loan to total loans and advances ratio of NIBL and MBL were 97.31% and 99.61% respectively in FY 2062/63 which means that MBL has higher ratio than NIBL and indicates that MBL has lower non-performing loans comparatively of NIBL. Similarly, in FY 2063/64 the ratio of NIBL and MBL was 97.93% and 99.72% respectively. Ratio of NIBL was decreased but ratio of MBL was increased which means non-performing loan of MBL has been increased in that particular fiscal year.

In the next FY 2064/65 the ratio of NIBL had been slightly decreased to 97.63% and the ratio of MBL decreased to 98.65%. But in the next FY 2065/66, the ratio of both banks had been increased to 98.88% and 98.96% respectively. Comparatively, the ratio of MBL was higher than NIBL. In recent year 2066/67 the ratio of NIBL and MBL had been slightly increased to 99.42% and decreased to 97.25% but still MBL has the highest average ratio in comparison with the ratio of NIBL.

4.5.4 Non-Performing Loan to Total Assets Ratio

This ratio measures the proportion of non-performing loans in the total assets portfolio. As per NRB Directives, the loan falling under category of substandard, doubtful and loss loan is considered as non-performing loan. Higher the ratio implies that poor quality of banks loans in the form of total assets. Hence lower the NPL to total assets implies best quality of assets of the banks which is desirable.

Table: 4.15

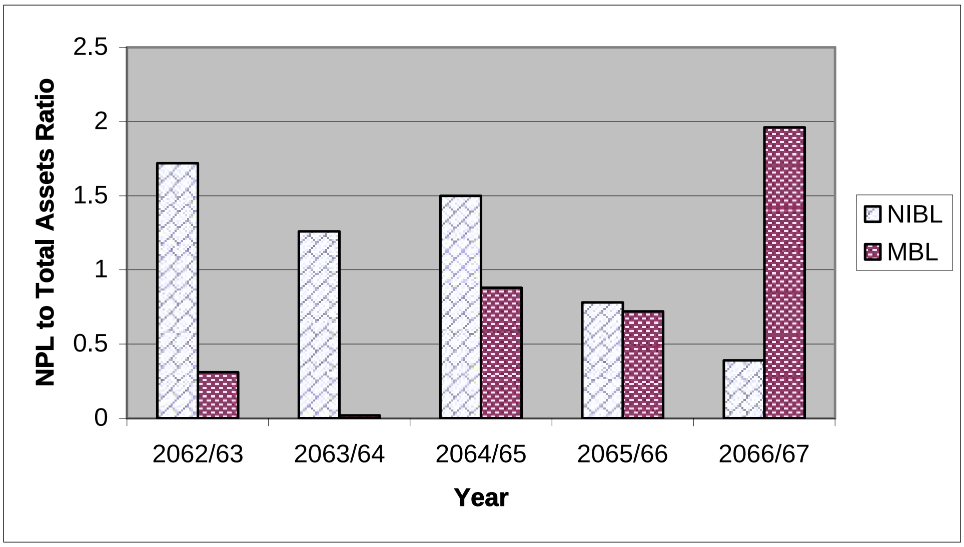
NPL to Total Asset Ratio

FY	NIBL	MBL
2062/63	1.72	0.31
2063/64	1.26	0.02
2064/65	1.5	0.88
2065/66	0.78	0.72
2066/67	0.39	1.96
Average	**1.98**	**1.47**

(Source: Annual Reports of NIBL and MBL)

Figure 4.13

Non-Performing Loan to Total Assets Ratio



From the Table 4.15 and Figure 4.13, we can clearly see the difference between non-performing loan to total assets ratios in the sample periods of both banks NIBL and MBL. Non-Performing Loan to Total Assets ratio of NIBL and MBL were 1.72% and 0.31% that particular fiscal year.

But in the next FY 2064/65, the ratio of both banks had been increased to 1.50% and 0.88% respectively. Comparatively, the ratio of MBL was lower than NIBL which means MBL was more successful to convert the non-performing loans into assets than NIBL. In recent year 2066/67 the ratio of NIBL had been slightly decreased to 0.39% and MBL has increased to 1.96%.

4.5.5 Non-Performing Loan to Total Deposit Ratios

This ratio measures the negative indicators of the banks' deposits. This ratio also measures the proportion of non-performing loans in the total deposits portfolio. As per NRB Directives, the loan falling under category of substandard, doubtful and loss loan is considered as non-performing loan. Higher the ratio implies that poor quality of banks loan in the form of deposits. Hence lower the NPL to total deposits implies best quality of assets of the banks which is desirable.

Table 4.16

NPL to total Deposit Ratio

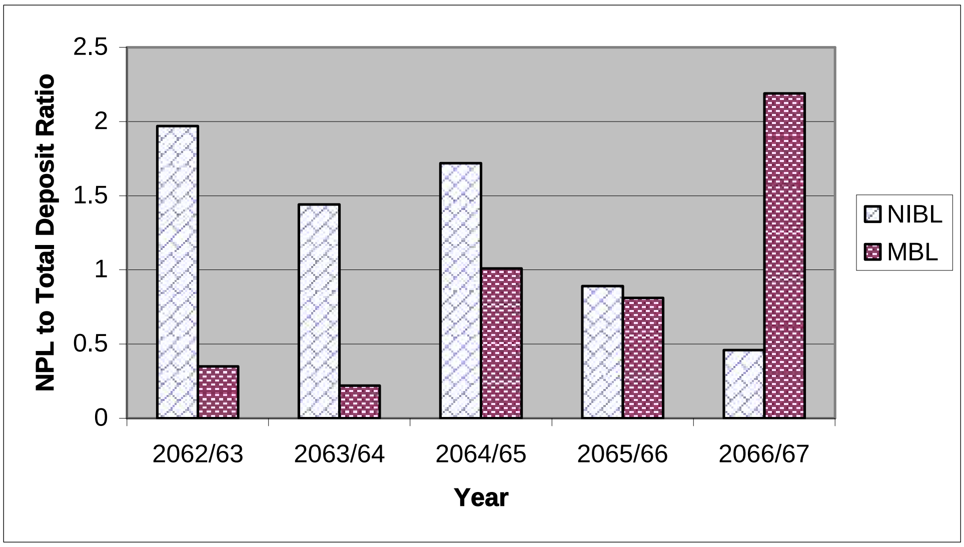
FY	NIBL	MBL
2062/63	1.97	0.35
2063/64	1.44	0.22
2064/65	1.72	1.01
2065/66	0.89	0.81
2066/67	0.46	2.19
Average	**2.29**	**1.70**

(Source: Annual Reports of NIBL and MBL)

From the Table 4.16 and Figure 4.14, we can clearly see the difference between non-performing loan to total deposit ratios in the sample periods of both banks NIBL and MBL. Non-Performing Loans to Total Deposit ratio of NIBL and MBL were 1.97% and 0.35% respectively in FY 2062/63 which means that MBL has the lower ratio than NIBL and indicates that MBL has lower non-performing loans comparatively of NIBL. Similarly, in FY 2063/64 the ratio of NIBL and MBL was 1.44% and 0.22% respectively. The ratio of NIBL and MBL was decreased which means non-performing loan of MBL has been increased in that particular FY.

Figure 4.14

Non-Performing Loan to Total Deposit Ratio



In FY 2065/66 the ratio of non-performing loan to total assets ratio of NIBL and MBL had been decreased to 0.89% and increased to 0.81% respectively which was the good sign for NIBL. Comparatively, MBL has higher ratio than NIBL. In recent year 2066/67 the ratio of NIBL had been slightly decreased to 0.46% and for MBL increased to 2.19% but still MBL has the lowest average ratio in comparison with the ratio of NIBL.

4.5.6 Non-Performing Loan to Total Loan and Advances Ratio

This ratio measures the proportion of non-performing loans in the total loan portfolio. As per NRB Directives, the loan falling under category of substandard, doubtful and loss loan is considered as non-performing loan. Higher the ratio implies that poor quality of banks loan in the form of loans and advances. Hence lower the NPL to total loans and advances implies best quality of assets of the banks which is desirable.

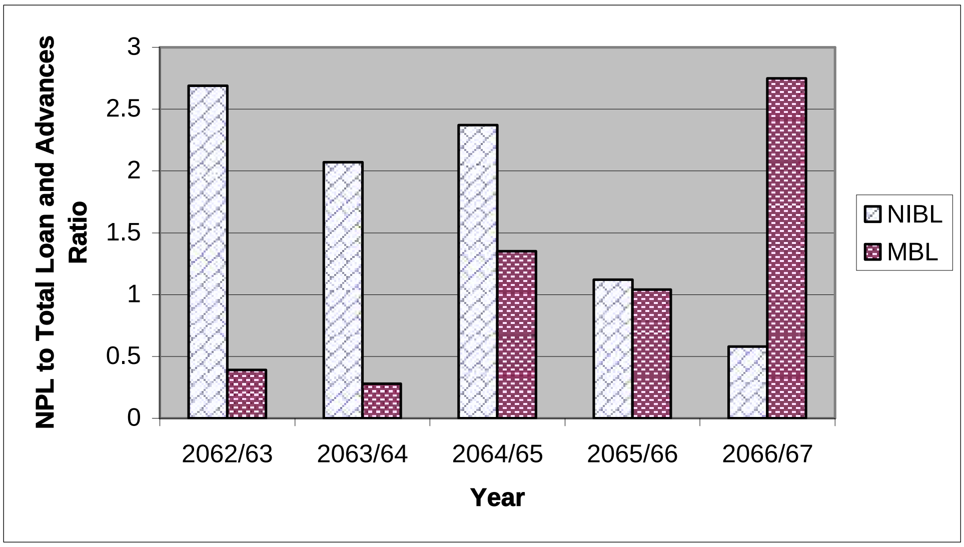
Table 4.17
NPL to Total Loan and Advances

FY	NIBL	MBL
2062/63	2.69	0.39
2063/64	2.07	0.28
2064/65	2.37	1.35
2065/66	1.12	1.04
2066/67	0.58	2.75
Average	**3.52**	**2.32**

(Source: Annual Reports of NIBL and MBL)

Figure 4.15

Non-Performing Loan to Total Loans and Advances Ratio



From the Table 4.17 and Figure 4.15, we can clearly see the difference between non-performing loan to total loans and advances ratios in the sample periods of both banks NIBL and MBL. Non-Performing Loans to Total Deposit ratio of NIBL and MBL were 2.69% and 0.39% respectively in FY 2062/63 which means that MBL has the lower ratio than NIBL and indicates that MBL has lower non-performing loans comparatively of NIBL. Similarly, in FY 2063/64 the ratio of NIBL and MBL was 2.07% and 0.28% respectively. The ratio of NIBL was decreased but the ratio of MBL was tremendously increased which means non-performing loan of MBL has been increased in that particular FY.

Comparatively, MBL has higher ratio than NIBL. Similarly, the ratio of NIBL and MBL in FY 2066/67 is 0.58% and 2.75% respectively. In this year the ratio of NIBL had decreased slightly but the ratio of MBL had increased which means that MBL had been successful in that year to convert its non-performing loans to total loans and advances in comparison with NIBL.

4.6 Adequacy of Loan Loss Provisioning

Nepal Rastra Bank has set up directives to be maintaining loan loss provision for different types of loan of the commercial banks. In this way, this analysis comprises the adequacy of loan loss provision as per NRB directives of NIBL and MBL for the study period. Adequacy is measured by calculating the ratios of loan loss provisioning to loans and advances of different classified loan.

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

4.6.1 Adequacy of loan Loss Provisioning (LLP) for Pass Loan

Table 4.14 presents the adequacy ratio of loan loss provisioning for pass loan for the sample period of the selected banks for the study. A bank is required to maintain 1% loan loss provisioning for its pass loan as per NRB Directives. This ratio is calculated by dividing the amount of LLP of pass loan by the amount of pass loan.

This ratio determines the proportion of provision held on pass loan to pass loan is covered by the provision maintained for pass loan. Higher ratio signifies that the banks are safeguarded against future contingency for loss loan. This ratio also determines that banks have maintained or not the loan loss provision for pass loan as per NRB directives.

Table 4.18
LLP for Pass Loan to Pass Loan (in percentage)

FY	NIBL	MBL
2062/63	0.98	1.0
2063/64	0.99	1.0
2064/65	0.99	0.99
2065/66	0.99	0.98
2066/67	1.00	1.77
Average	**1.04**	**1.12**

(Source: Annual Reports of NIBL and MBL)

From the table 4.18, it is found that NIBL is not strictly following the directives provided by NRB regarding LLP for pass loan. In FY 2062/63 LLP for pass loan of

NIBL is 0.98 which is 0.9 inadequate for pass loan. In FY 2063/64 LLP for pass loan of NIBL is 0.99. In this FY, NIBL has maintained 0.9 more than the required LLP for pass loan. In FY 2063/64, 2064/65, 2065/66 and 2066/67 LLP for pass loan are 0.99, 0.99, 0.99, and 1.0 respectively which are inadequate according to the directives. In FY 2065/66 LLP for pass loan is 1.00 which is according to the directives.

From the Table 4.18, it is found that MBL is following the directives provided by NRB regarding LLP for pass loan. In FY 2062/63, 2063/64, 2064/65, and 2065/66 the LLP for pass loan was 1.0 which is according to the directives. The LLP in next two years slightly decreased to 0.99 and 0.98 respectively. In FY 2066/67 the LLP for pass loan is 1.77.

4.6.2 Adequacy of Loan Loss Provisioning (LLP) for Substandard Loan

Table 4.19 presents the adequacy ratio of loan loss provisioning for substandard loan for the sample period of the NIBL and MBL for the study. A bank is required to maintain 25 percentage loan losses provisioning for its substandard loan as per NRB Directives. This ratio is calculated by dividing the amount of LLP of substandard loan by the amount of substandard loan.

This ratio determines the proportion of provision held on substandard loan of the banks. This measures upto what extent of risk inherent in substandard loan is covered by the provision maintained for substandard loan. Higher ratio signifies that the banks are safeguarded against future contingency for loss loan. This ratio also determines that banks have maintained or not the loan loss provision for substandard loan as per NRB Directives.

Table 4.19
LLP for Substandard Loan to Substandard Loan (in percentage)

FY	**NIBL**	**MBL**
2062/63	11.31	24.99
2063/64	25.16	25.0
2064/65	25.78	25.0
2065/66	25.00	24.99
2066/67	25.36	34.63
Average	**21.0**	**26.37**

(Source: Annual Reports of NIBL and MBL)

From Table 4.19, it is found that NIBL is not strictly following directives provided by NRB regarding LLP for substandard loan. In FY 2062/63 LLP for pass loan of NIBL is 11.31 which is not sufficient for substandard loan. In FY 2063/64 LLP for substandard loan is only 25.16 which is around half percent inadequate. In FY 2062/63, LLP for substandard loan is only 11.31 which is also very low according to the directives. In FY 2063/64, 2064/65, 2065/66, and 2066/67 LLP for substandard loan are 25.16, 25.78, 25.00, and 25.36 respectively which are sufficient according to the directives.

From the Table 4.19, it is found that MBL is following the directives provided by NRB regarding LLP for substandard loan. In FY 2062/63, 2063/64, and 2064/65, the LLP for substandard loan were 24.98, 24.99, and 24.99 respectively. In FY 2066/67 and 2063/64 the LLP for substandard loan were 25.0 which is according to the directives. The LLP in FY 2065/66 was 24.99 and in FY 2066/67 LLP for substandard Loan was 34.63 which is too high than the directives provided by NRB.

4.6.3 Adequacy of Loan Loss Provisioning (LLP) for Doubtful Loan

Table 4.20 presents the adequacy ratio of loan loss provisioning for doubtful loan for the sample period of the NIBL and MBL of the study. A bank is required to maintain 50 percentage loan losses provisioning for its doubtful loan as per NRB Directives. This ratio is calculated by dividing the amount of LLP of doubtful loan by the amount of doubtful loan.

This ratio determines the proportion of provision held on doubtful loan of the banks. This measures upto what extent of risk inherent in doubtful loan is covered by the provision maintained for doubtful loan. Higher ratio signifies that the banks are safeguarded against future contingency for doubtful loan. This ratio also determines that banks have maintained or not the loan loss provision for doubtful loan as per NRB Directives.

Table 4.20

LLP for Substandard Loan to Doubtful Loan (in percentage)

FY	NIBL	MBL
2062/63	12.72	50.0
2063/64	46.80	50.0
2064/65	50.12	50.0
2065/66	50.00	50.0
2066/67	50.01	61.64
Average	**43.83**	**51.66**

(Source: Annual Reports of NIBL and MBL)

From the Table 4.20, it is found that NIBL is failed to maintain the minimum LLP for doubtful loan according to the directives provided by NRB regarding in first four years. In loan were 49.99 and in FY 2066/67 LLP for substandard Loan was 61.64 which is higher than the directives provided by NRB.

4.6.4 Adequacy of Loan Loss Provisioning (LLP) for Loss Loan

Table 4.21 presents the adequacy ratio of loan loss provisioning for loss loan for the sample period of the NIBL and MBL for the study. A bank is required to maintain 100 percentage loan losses provisioning for its loss loan as per NRB Directives. This ratio is calculated by dividing the amount of LLP of loss loan by the amount of loss loan.

This ratio determines the proportion of provision held on loss loan of the banks. This measures upto what extent of risk inherent in loss loan is covered by the provision maintained for loss loan. Higher ratio signifies that the banks are safeguarded against future contingency for loss loan. This ratio also determines that banks have maintained or not the loan loss provision for loss loan as per NRB Directives.

Table 4.21

LLP for Loss Loan to Loss Loan (in percentage)

FY	NIBL	MBL
2062/63	97.84	100
2063/64	98.38	100
2064/65	91.79	100
2065/66	99.01	100

2066/67	99.10	100
Average	**97.60**	**71.42**

(Source: Annual Reports of NIBL and MBL)

From the Table 4.21, it is found that NIBL is not maintaining the minimum LLP for loss loan according to the directives provided by NRB. In FY 2062/63 there is no LLP for loss loan, 2062/63, 2063/64, 2064/65, 2065/66, and 2066/67 LLP for loss loan of NIBL are 97.84, 98.38, 91.79, 99.01 and 99.10 respectively which is not sufficient according to the NRB directives.

From the Table 4.21, it is found that MBL had not maintained the LLP for loss loan before FY 2062/63. But next onwards MBL is successfully maintaining the LLP for loss loans according to the directives provided by NRB. In FY 2062/63, 2063/64, 2064/65, 2065/66, and 2066/67 the LLP for loss loan were 100.0 respectively.

4.7 Analysis of Non-Performing Loan, Loan Loss Provisioning and Net Profit

There are many factors, which directly and indirectly affect the net profit of the organization. NPL is one of the factors which directly affect the net profit the banks. With the increase in NPL, the bank has to maintain more provision for loan loss. Such provision ultimately decreases the net profit of the banks. Therefore, the NPL, Loan loss provisioning and net profit of NIBL and MBL analyzed.

Table 4.22

Non-Performing loan, Loan loss provisioning and Net Profit of NIBL

(amount in Rs.)

FY	Total Non-Performing Loan	% Change	Loan Loss Provisioning	% Change	Net Profit	% Change
2062/63	117,091,823	-	149,647,852	-	116,817,659	-
2063/64	181,435,009	54.95	208,440,985	39.29	152,670,976	30.69

2064/65	280,874,131	54.81	327,108,374	56.93	232,147,098	52.06
2065/66	272,493,041	(2.98)	401,943,787	22.88	350,536,413	51.00
2066/67	421,971,550	54.86	482,672,514	20.08	501,398,853	43.04

(Source: Annual Reports of NIBL)

Figure 4.16

Non-Performing Loan, Loan Loss Provisioning and Net Profit of NIBL

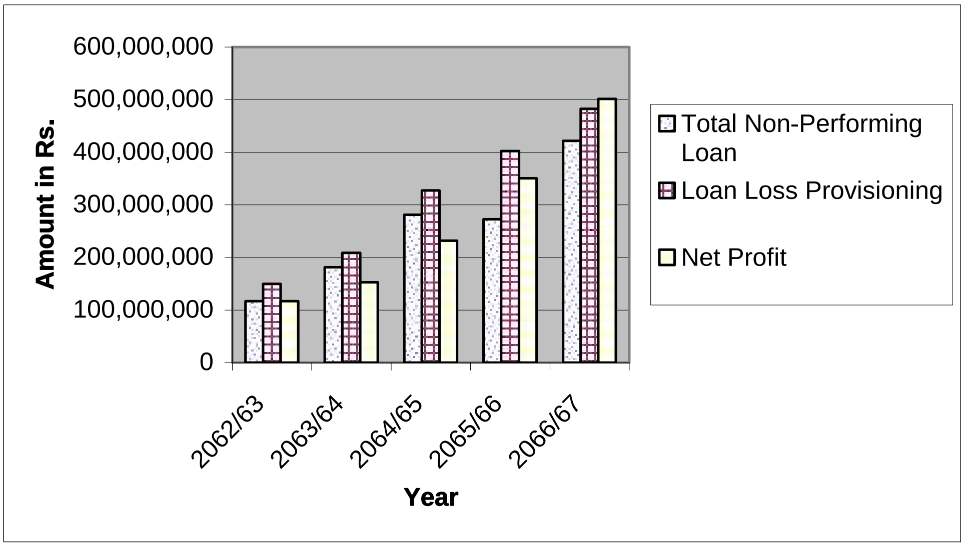


Table 4.23

Non-Performing loan, Loan loss provisioning and Net Profit of MBL

(Amount in Rs.)

FY	Total Non-Performing Loan	% Change	Loan Loss Provisioning	% Change	Net Profit	% Change
2062/63	31,098,986	-	31,699,653	-	15,307,486	-
2063/64	24,983,047	(19.67)	47,680,089	50.41	46,689,945	205.01
2064/65	19,860,891	(20.50)	68,790,307	44.27	84,870,027	81.77
2065/66	16,916,597	(14.82)	78,145,506	13.60	133,996,709	57.88
2066/67	85,168,239	403.46	190,047,722	143.20	74,085,647	(44.71)

(Source: Annual Reports of MBL)

Figure 4.17

Non-Performing Loan, Loan Loss Provisioning and Net Profit of MBL

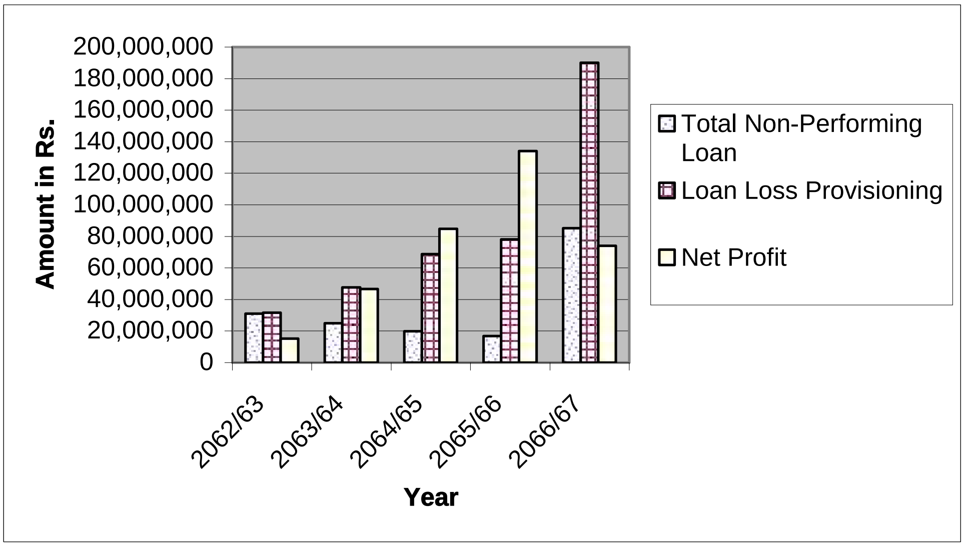


Table 4.23 and Figure 4.17 indicate the status of NPA, LLP and Net Profit of NIBL. In FY 2062/63 Total NPL was Rs. 117,091,823, Total LLP was Rs. 149,647,852 and Net Profit was Rs. 116,817,659. In FY 2063/64, Total NPL was increased by 54.95% but adversely LLP was increased by 39.29% and Net Profit was increased by 30.69%. Because the bank had increased its LLP, there was low increment in Net Profit. The level of Total NPL in FY 2065/66, NPL is further decreased by 2.98%. The bank had increased its LLP by 22.88%, therefore, net profit increased by 51.0% which means lower the LLP, higher the net profit. In FY 2066/67 the level of NPL was increased by

54.86%. Similarly bank had increased its provision by 20.08% which leaded high increment in Net Profit by 43.04%.

Table 4.23 and Figure 4.17 indicate the level of Total NPL, LLP and Net Profit of MBL. In FY 2062/63 Total NPL was Rs. 31,098,986, Total LLP was Rs. 31,699,653 and Net Profit was Rs. 15,307,486. In FY 2063/64, Total NPL was decreased by 19.67% but adversely LLP was increased by 50.41 and Net Profit was increased by 205.01%. Because the bank had increased its LLP, there was low increment in Net Profit. The level of Total NPL in FY 2064/65, NPL is further decreased by 20.50%. The bank had increased its LLP by 44.27%, therefore, net profit increased by 81.77% which means lower the LLP, higher the net profit. In FY 2066/67 the level of NPL was increased by 403.46%. Similarly bank had increased its provision by 143.20% which leaded low increment in Net Profit by -44.71%.

From the Table 4.22 and 4.23 it can be concluded that rising and falling of NPL has some impact on loan loss provision and net profit.

4.8 Trend Analysis of Non-Performing Loan

A trend analysis is sequence of observation of variables made at regular points or intervals of time and arranged in chronological order. Trend analysis is one quantitative method we use to determine patterns in data collected overtime.

Table 4.24 and 4.25 show the trend values of non-performing loan to total loan and advances ratio which clearly shows trend of NPL of NIBL and MBL respectively.

Table 4.24

Trend Values of Non-Performing loan to total loan and advances ratio of NIBL

(In percentage)

FY	**NIBL**	
	Actual Value	**Trend Value**
2062/63	1.98	2.234
2063/64	2.47	2.272
2064/65	2.69	2.31
2065/66	2.07	2.348
2066/67	2.37	2.386

(Source: Annual Reports of NIBL)

From the above table, it is found that the actual value of NPL to Total Loan and

Advances ratio of the bank is increasing and decreasing order, fitting the actual value in the trend line, it is found that the value of NPL to total loan and advances is gradually decreasing. The same analysis is also shown by the Figure 4.18.

Figure 4.18

Trend Line of Non-Performing Loan to Total Loan and Advances Ratio of NIBL

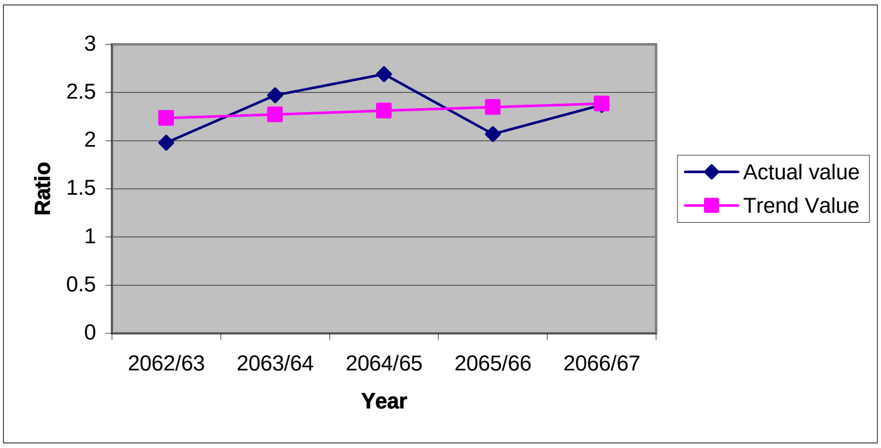


Table 4.25

Trend Values of Non-Performing loan to total loan and advances ratio of MBL

(in percentage)

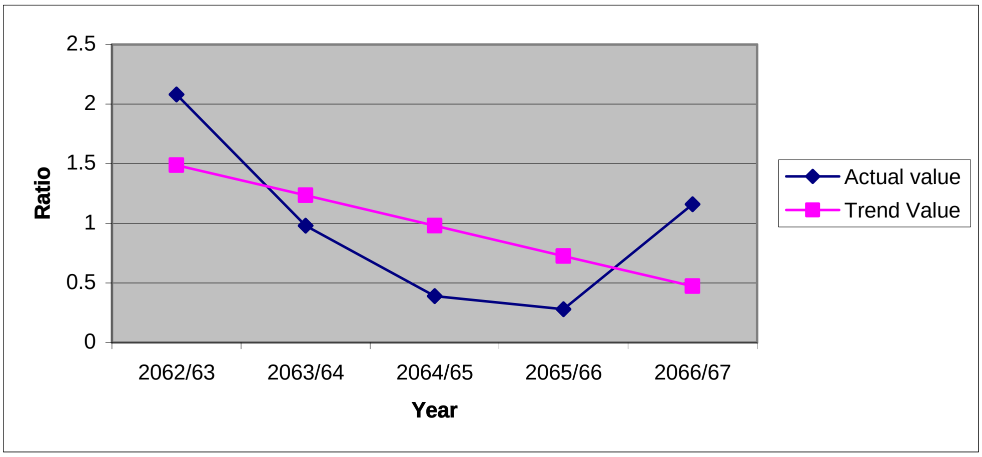
FY	MBL	
	Actual Value	Trend Value
2062/63	2.08	1.488
2063/64	0.98	1.234
2064/65	0.39	0.98
2065/66	0.28	0.726
2066/67	1.16	0.472

(Source: Annual Reports of NIBL and MBL)

From the Table 4.25, it is found that the actual value of NPL to Total Loan and Advances ratio of the bank is higher in FY 2062/63 but in other years it is in decreasing order, and fitting the actual value in the trend line, it is found that the value of NPL to total loan and advances is gradually decreasing. The same analysis is also shown by the following figure.

Figure 4.19

Trend Line of Non-Performing Loan to Total Loan and Advances Ratio MBL



Comparative Analysis of level of NPA

From the data above, comparison between the actual NPA to total loan and advances ratio and trend NPA to total loan and advances ratio of both banks are compared and presented.

Table 4.26

Comparison between Actual and Trend NPA to Total Loans and Advances ratio between NIBL and MBL

FY	NIBL		MBL	
	Actual NPA to Total Loans and Advances ratio	Trend NPA to Total Loans and Advances ratio	Actual NPA to Total Loans and Advances ratio	Trend NPA to Total Loans and Advances ratio
2062/63	1.98	4.324	2.08	3.08
2063/64	2.47	3.52	0.98	2.32
2064/65	2.69	2.716	0.39	1.56
2065/66	2.07	1.912	0.28	0.8
2066/67	2.37	1.108	1.16	0.04

(Source: Annual Reports of NIBL and MBL)

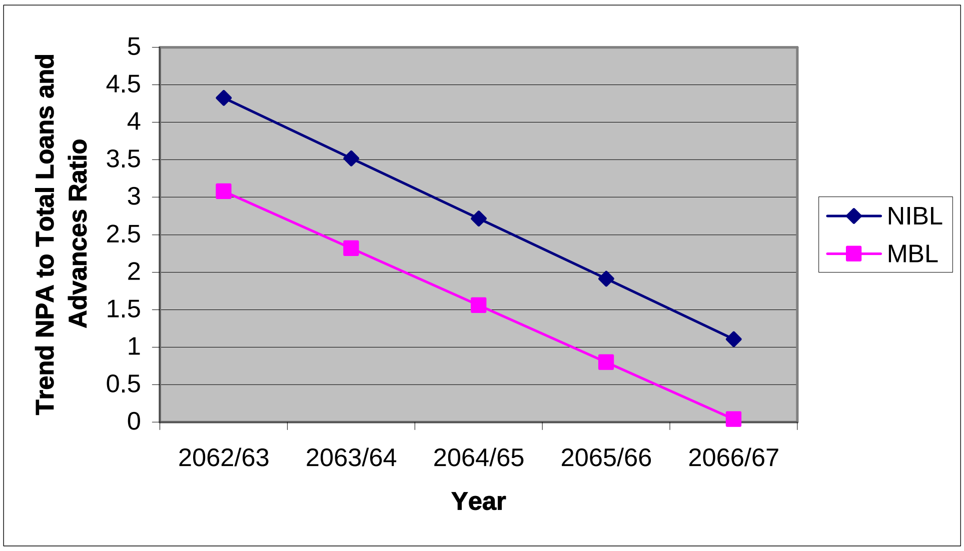
In FY 2062/63, 2063/64, 2064/65, 2065/66 and 2066/67 the ratio of actual NPA to Total Loans and Advances of NIBL and MBL were 1.98 and 2.08, 2.47 and 0.98, 2.69 and 0.39, 2.07 and 0.28, and 2.37 and 1.16 respectively. Similarly, in FY 2062/63, 2063/64, 2064/65, 2065/66 and 2066/67 the trend value of NPA to Total Loans and advances ratio were 4. 324 and 3.08, 3.52 and 2.32, 2.716 and 1.56, 1.912 and 0.8, 1.108 and 0.04 respectively. From the data above and figures below it is found that the level of Actual NPA to Total Loans and Advances Ratio and Trend NPA to Total Loans and Advances Ratio of Machhapuchhre bank is lower than Nepal Investment Bank which means MBL is more successful to convert its Non-Performing Loans into Performing Loans.

Figure 4.20

Actual NPA to Total Loans and Advances Ratio

Figure 4.21

Trend NPA to Total Loans and Advances Ratio



4.9 Correlation Analysis

Correlation analysis is defined as the statistical technique which measures the degree and direction of relationship between/among variables.

4.9.1 Relationship between ROA and NPL

The correlation between ROA and NPL shows the degree of relationship between these two items. Through the measurement of correlation, we can find the affect in the ROA with increment in a unit of NPL. Here ROA is considered as dependent variable and NPL is considered as independent variable.

Table 4.27: Relationship between ROA and NPL

Banks	**Correlation Coefficient**	**Coefficient of Determination (r^2)**	**PE**	**6PE**	**Significant/Insignificant**
NIBL	0.863171	0.74506	0.06499	0.38995	Significant
MBL	-0.288121	0.083014	0.23377	1.402643	insignificant

From the Table 4.27, it is found that in NIBL, NPL and ROA is highly correlated which means increment in a unit of NPL highly increase ROA and decrease in NPL will decrease ROA which is theoretically wrong. There might be some other factors influencing increase or decrease of ROA of NIBL. But in MBL, there is negative relationship between NPL and ROA which means increment in a unit of NPL will decrease ROA and decrease in NPL will increase ROA which proves the theoretical assumption of NPL. Here ROA is considered as dependent variable and NPL is considered as independent variable.

Hypothesis Testing

Bank	t_{cal}	t_{tab}	**Decision**
NIBL	3.822	2.57	H_0 Rejected i.e. sample correlation is insignificant to population correlation
MBL	0.673	2.57	H_0 Accepted i.e. sample correlation is significant to population correlation

From the hypothesis testing, it is found that in NIBL, Null Hypothesis is rejected and Alternative Hypothesis is accepted as t_{cal} is higher than t_{tab}. Hence there is significant difference between population correlation and sample correlation which clearly indicates that the calculated correlation coefficient is wrong and there would have been different correlation coefficient in population correlation or might be exist positive or negative correlation in particular as ROA is not only dependent on NPL. Major factors influencing correlation coefficient is the small sample size because the sample size was taken just for 7 years because of time constrain, difficulty in collecting data. There are some other factors such as highly increasing assets ratio, highly increasing deposits ratio, shareholders' fund, earning per share, highly increasing net profits ratio, etc influenced to have considerable effect on ROA. Also sample size of the presented study was very small which might have influenced the result to show false interpretation.

In population correlation in particular as ROA is highly dependent on NPL.

4.9.2 Relationship between NPL and ROE

The correlation between NPL and ROE depicts the relationship between these two items. Return on Equity is dependent variable and NPL is independent variable. Through the measurement of this correlation, we can find the affect in the ROE with increment in a unit of NPL.

Table 4.28: Relationship between NPL and ROE

Banks	Correlation Coefficient	Coefficient of Determination (r^2)	PE	6PE	Significant/Insignificant
NIBL	0.073176	0.005355	0.25357	1.52143	Insignificant
MIBL	-0.54862	0.300984	0.19248	1.1549	Insignificant

From the Table 4.28, it is found that in NIBL, the relationship between NPL and ROE is positive but very poor or there is almost no relationship between them. Increase in NPL will increase ROE but in very less and decrease in NPL will decrease ROE but in very less. But in MBL, these two parameters are negatively correlated which means increase in NPL will decrease ROE and decrease in NPL will increase ROE which proves the theoretical assumption of NPL. Return on Equity is dependent variable and NPL is independent variable.

Hypothesis Testing

Bank	t_{cal}	t_{tab}	Decision
NIBL	0.164	2.57	H_0 Accepted i.e. sample correlation is significant to population correlation
MBL	1.4672	2.57	H_0 Accepted i.e. sample correlation is significant to population correlation

From the hypothesis testing, in NIBL, Null Hypothesis is accepted as t_{tab} is greater than t_{cal}. Hence, there is no significant difference between population correlation and sample correlation which clearly indicates that there would have been poor correlation between NPL and ROE if population correlation coefficient was taken for the establishment of the relationship. There is poor correlation between NPL and ROE, there may exist positive or negative correlation in particular as ROE is not only dependent on NPL and other several factors such as highly increasing assets ratio, highly increasing deposits ratio, highly increasing market value of share, highly increase in shareholders' fund, earning per share, highly increasing net profits ratio, etc influenced to have considerable effect on ROE. Also, sample size of the present study was very small which might have influenced the result to show false interpretation.

Similarly, in MBL, Null Hypothesis is accepted as t_{cal} is lesser than t_{tab}. Hence there is no significant difference between population correlation and sample correlation which clearly indicates that calculated correlation is correct and there would not have been difference correlation coefficient in population correlation in particular as ROE is highly dependent on NPL.

4.9.3 Relationship between Loan and Advances and NPL

The correlation between loan and advances and NPL shows the degree of relationship between these two items. How a unit increment in loan and advances affect in the unit of non-performing loan is measured by this correlation.

Table 4.29

Relationship between Loan and advances and NPL

Banks	**Correlation Coefficient (r)**	**Coefficient of Determination (r^2)**	**PE**	**6PE**	**Significant/Insignificant**
NIBL	0.8895	0.79122	0.05323	0.31935	significant
MBL	0.2543	0.06467	0.23845	1.4307	

From the Table 4.29, it is found that, in NIBL these two parameters are highly correlated which means increment in NPL positively increasing total loans and advances and decrease in NPL will decrease total loans and advances. In MBL, these two parameters are positively correlated but the relationship between them are poor than NIBL. Increase in NPL will increase total loans and advances and decrease in NPL will decrease total loans and advances but in less.

Hypothesis Testing

Bank	**t_{cal}**	**t_{tab}**	**Decision**
NIBL	4.33	2.57	H_0 Rejected i.e. sample correlation is insignificant to population correlation
MBL	0.5879	2.57	H_0 Accepted i.e. sample correlation is significant to population correlation

From the testing of hypothesis, it is found that in NIBL, Null Hypothesis is rejected and Alternative Hypothesis is accepted as t_{cal} is higher than t_{tab}. Hence there is significant difference between population correlation and sample correlation which means calculated correlation is wrong and there would have been different correlation coefficient in population correlation or might be exist positive or negative correlation in particular as Total Loans and Advances is not only dependent on NPL. There are some other factors such as highly increasing assets ratio, highly increasing deposits ratio, highly increasing net profits ratio, etc influenced to have considerable effect on Total Loans and Advances. Also sample size of the presented study was very small which might have influenced the result to show false interpretation.

In MBL, Null Hypothesis is accepted as t_{cal} is lesser than t_{tab}. Hence there is no significant difference between population correlation and sample correlation which clearly indicates that calculated correlation is correct and there would not have been difference correlation coefficient in population correlation in particular as Total Loans and Advances is highly dependent on NPL.

4.9.4 Relationship between NPL and Net Profit

The correlation between NPL and Net Profit depicts the relationship between these two items. Net Profit is dependent variable and NPL is independent variable. Through the measurement of this correlation, we can find the affect in the Net Profit with increment in a unit of NPL.

Table 4.30

Relationship between NPL and Net Profit

Banks	**Correlation Coefficient**	**Coefficient of Determination (r^2)**	**PE**	**6PE**	**Significant/Insignificant**
NIBL	0.9146	0.83649	0.04168	0.25	Significant
MIBL	-0.17633	0.03109	0.24701	1.48206	Insignificant

From the Table 4.30, it is found that in NIBL, NPL and Net Profit is highly correlated which means increment in a unit of NPL highly increase Net Profit and decrease in NPL will decrease Net Profit which is theoretically wrong. There might be some other factors influencing increase or decrease of Net Profit of NIBL. But in MBL, there is negative relationship between NPL and Net Profit which means increment in a unit of NPL will decrease Net Profit and decrease in NPL will increase Net Profit which proves the theoretical assumption of NPL. Net Profit is dependent variable and NPL is independent variable.

Hypothesis Testing

Bank	t_{cal}	t_{tab}	Decision
NIBL	5.056	2.57	H_0 Rejected i.e. sample correlation is insignificant to population correlation
MBL	0.4005	2.57	H_0 Accepted i.e. sample correlation is significant to population correlation

From the testing of Hypothesis, it is found that in NIBL, Null Hypothesis is rejected and Alternative Hypothesis is accepted as t_{cal} is higher than t_{tab}. Hence there is significant difference between population correlation and sample correlation which clearly indicates that the calculated correlation is wrong and there would have been different correlation coefficient in population correlation or might be exist positive or negative correlation in particular as Net Profit is not only dependent on NPL. There are some other factors such as highly increasing assets ratio, highly increasing deposits ratio, highly increasing market value of share, highly increase in shareholders' fund, earning per share, highly increasing net profits ratio, etc influenced to have considerable effect on Net Prot. Also sample size of the presented study was very small which might have influenced the result to show false interpretation.

In MBL, Null Hypothesis is accepted as t_{cal} is lesser than t_{tab}. Hence there is no significant difference between population correlation and sample correlation which clearly indicates that calculated correlation is correct and there would not have been difference correlation coefficient in population correlation in particular as Net Profit is highly dependent on NPL.

4.10 Major Findings of the Study

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

1. The average performing loan to total assets ratio of MBL remained 66.51% which was highest than NIBL which 57.22%. In FY 2062/63, 2063/64, 2064/65, 2065/66 and 2066/67 the ratios of NIBL and MBL were 44.40% and 62.79%, 51.93% and 55.16%, 64.39% and 61.0%, 53.99% and 72.95%, 62.51% and 79.15%, 60.50% and 67.58% and 62.87% and 66.94% respectively. The figure it is clearly understood that ratios of MBL were higher than ratios of NIBL except in the FY 2062/63 which means MBL was more successful than NIBL to convert the performing loans into assets.
2. The average performing loan to total deposit ratio of NIBL remained 65.71% which is lower than the average performing loan to total deposit ratio of MBL which is 78.71%. In FY 2062/63, 2063/64, 2064/65, 2065/66, and 2066/67 the ratio of NIBL and MBL were 52.34% and 70.56%, 61.88% and 61.23%, 73.26% and 82.35%, 62.10% and 91.33%, 71.36% and 91.47%, 68.19% and 77.66%, and 70.84% and 76.35% respectively. From the data it is found that the ratio of MBL were higher than NIBL except in the FY 2062/63 which means the performance of MBL is better than NIBL.
3. The average performing loan to total loan and advances ratio of NIBL remain 96.48% and MBL was 97.68% which was higher than NIBL. In FY 2062/63, 2063/64, 2064/65, 2065/66, and 2066/67 the ratios of NIBL and MBL were 91.71% and 99.09%, 95.02% and 89.55%, 98.02% and 97.92%, 97.53% and 99.02%, 97.31% and 99.61%, 97.93% and 99.72%, and 97.63% and 98.84% respectively. From the data above, it is found that the ratio of MBL is higher than NIBL in some fiscal years and vice versa.
4. The average non-performing loan to total assets ratio of NIBL remained 1.98% which was higher than MBL (1.47%). In FY 2062/63, 2063/64, 2064/65, 2065/66, and 2066/67 the ratios of NIBL and MBL were 4.01% and 0.58%, 2.62% and 6.44%, 1.30% and 1.29%, 1.37% and 0.72%, 1.73% and 0.31%, 1.28% and 0.19%, and 1.53% and 0.79% respectively. From the above data it is found that the ratios of MBL were comparatively lower than the ratios of NIBL except in FY2063/064. Lower the ratio means better the

performance and it is found that MBL was quite successful than NIBL to convert the non-performing loan into assets.

5. The average non-performing loan to total deposit ratio of NIBL remained 2.29% which was higher than MBL (1.7%). In FY 2062/63, 2063/64, 2064/65, 2065/66, and 2066/67 the ratio NIBL and MBL were 4.73% and 0.65%, 3.12% and 7.15%, 1.48% and 1.75%, 1.57% and 0.91%, 1.97% and 0.35%, 1.44% and 0.21% and 1.72% and 0.90% respectively. From the data above it is clearly known that the ratios of MBL were lower than the ratios of NIBL except in the FY 2063/64. Lower the ratio means better the performance and it is found that MBL was quite successful than NIBL to convert the non-performing loans.
6. The average non-performing loan to total loan and advances ratio of NIBL remained 3.52% which was higher than MBL (2.32%). In FY 2062/63, 2063/64 and 2066/67 the ratio of NIBL and MBL were 8.29% and 0.91%, 4.80% and 10.45%, 1.98% and 2.08%, 2.47% and 0.98%, 2.69% and 0.39%, 2.07% and 0.28%, 2.37% and 1.16% respectively. From the data above it is clearly known that the ratios of MBL were lower than the ratios of NIBL except in the FY 2062/063 and 2063/64. Lower the ratio means better the performance and it is found that MBL was quite successful than NIBL to convert the non-performing loans.
7. As per latest NRB's directives, loan and advances are classified into four categories namely pass, substandard, doubtful and loss loan with respective provisioning 1%, 25%, 50% and 100% on the basis of past dues. Besides this, in case of insured priority and deprived sector loan, provisioning requirements one-fourth of that of normal loan loss provision requirement. Hence, respective provision requirement for pass, substandard, doubtful and loan are 0.25%, 6.25%, 12.5% and 25% of outstanding loan. In case of reschedule or swapped loan, if such loan falls under pass category, minimum provisioning requirement is 12% and if this is the case of priority sector loan, 3.125% provisioning should be provided for probable loss. Further, if the loan is granted only against personal guarantee, the provisioning required for pass, substandard and doubtful is 21%, 45% and 70% respectively.
8. From the analysis, it is found that MBL has almost successful to maintain the

minimum loan loss provision directed by NRB but NIBL has not strictly following the directives of NRB regarding loan loss provision.

9. From the analysis it is found that both banks have maintained sufficient core capital of total risk weighted assets. Regarding the total capital fund ratio in FY 2062/63 NIBL have maintained sufficient total capital fund but MBL has failed to maintain the minimum total capital fund. In FY 2063/64 both banks have maintained the sufficient core capital but in FY 2063/64 NIBL has failed to maintain the minimum total capital fund to total risk weighted assets but MBL has maintained sufficient fund. In FY 2062/63 both banks have maintained total capital but in next FY 2063/64 both bank have failed to maintain minimum total capital to total risk weighted assets. In FY 2065/66 NIBL has failed to maintain total capital but MBL has successfully maintained minimum total capital fund. In FY 2066/67 NIBL has maintained total capital fund but MBL has failed to maintain total capital to total risk weighted assets.
10. The actual values of both banks are in increasing and decreasing order. Fitting the trend value, the figure shows that the level of NPL is gradually decreasing which is good for the financial health of both banks. Though the value of NPL in terms of Rupees is increasing the ratio of Non Performing Loan is decreasing and the ratio of Performing Loan is increasing.
11. Correlation Coefficient between NPL and Loan and advances, NPL and Return and assets (ROA), NPL and Return on Equity (ROE) and NPL and Net Profit were calculated to find out the relationship between NPL and the parameters. From the analysis it is found that there is positive correlation between NPL and Loan and Advances of NIBL and MBL which means increment in Loan and advances leads to increase NPL. The calculation shows that there is significant correlation between NPL and Loan and Advances of NIBL but we can't say there is significant correlation between NPL and Loan and Advances of MBL but there is only positive correlation between them.
12. By the calculation of correlation coefficient between NPL and ROA of NIBL, it is found that there highly positive relation between NPL and ROA which indicates that increment in NPL also leads to increase ROA which is theoretically wrong. Similarly, by the calculation of correlation coefficient between NPL and ROA, there is negative relation between them which means

increment in NPL leads to decrease ROA and decrease in NPL leads to increase in ROA.

13. By the calculation of correlation coefficient between NPL and ROE of NIBL, it is found that there is positive relation but the relation of the parameters is very poor or there is no relationship between them. In MBL the relationship between NPL and ROE is negative which indicates that increase in NPL decreases ROE and decrease in NPL increase ROE.
14. By the calculation of correlation coefficient between NPL and Net Profit of NIBL, it is found that there is highly positive relationship between NPL and Net profit which means, increment in NPL will increase the Net Profit which is theoretically wrong. But it is found in MBL, there is negative relationship es and Net Profit. But NPL with ROE there is no significant difference between population correlation and sample correlation. From the testing of significance of Machhapuchhre Bank, it is found that there is no significant difference between population correlation and sample correlation of NPL with all parameter, which means the calculated correlations are correct even if we take all the samples.

Chapter V

Summary, Conclusion and Recommendations

5.1 Summary

Nepalese commercial banking sector is very competitive. The commercial banks are competing mainly in service in order to put in competitive position, majority of the branches of commercial banks have been adapting differentiation strategy. The response shows that different branches of the similar bank have adapted different strategy and few of the banks have followed more than one strategy at the same time.

This research has aimed at studying the problem of non-performing loan in Nepalese commercial banking sector and recommending the reasonable solution to manage the non-performing loans. It also studied the different aspects of the implementation of NRB Directives by commercial banks. This study was based on the assumption that non-performing loan is such factor which directly affects the net profit of banks. The increment of non-performing loan results in the increment in the volume of loan loss provision of the banks which ultimately results in decline of net profit of banks.

For the purpose of the study, descriptive as well as analytical research design had been adopted. Out of the total 30 commercial banks, two banks were taken as sample using judgmental sampling method. Sample was selected considering the level of NPL. Nepal Investment Bank Ltd. and Machhapuchhre Bank Ltd. were taken as sample for the study. Various research techniques were used such as calculation of standard deviation, calculation of coefficient of variance, time series analysis, calculation of correlation, hypothesis testing, etc. Most of the data in the study were secondary data collected from various annual reports of the selected banks and their respective web sites.

The average performing loan to total assets ratio of MBL remained 66.51% which was highest than NIBL which 57.22%. It is found that the ratios of MBL were higher than the ratios of NIBL except in the FY 2062/63 which means MBL was more successful than NIBL to convert the performing loans into assets.

The average performing loan to total deposit ratio of NIBL remained 65.71% which is lower than the average performing loan to total deposit ratio of MBL which is 78.71%. From the data it is found that the ratio of MBL were higher than NIBL except in the FY 2062/63 which means the performance of MBL is better than NIBL.

The average performing loan to total loan and advances ratio of NIBL remain 96.48% and MBL was 97.68% which was higher than the NIBL. From the data above, it is found that the ratio of MBL is higher than NIBL in some fiscal years and vice versa.

The average non-performing loan to total assets ratio of NIBL remained 1.98% which was higher than MBL (1.47%). From the above data it is found that the ratios of MBL were comparatively lower than the ratios of NIBL except in FY 2062/63. Lower the ratio means better the performance and it is found that MBL was quite successful than NIBL to convert the non-performing loan into assets.

The average non-performing loan to total deposit ratio of NIBL remained 2.29% which was higher than MBL (1.7%). From the data above it is clearly known that the ratios of MBL were lower than the ratios of NIBL except in the FY 2062/63. Lower the ratio means better the performance and it is found that MBL was quite successful than NIBL to convert the non-performing loans.

The average non-performing loan to total loan and advances ratio of NIBL remained 3.52% which was higher than MBL (2.32%). From the data above it is clearly known that the ratios of MBL were lower than the ratios of NIBL except in the FY 2062/63 and 2063/64. Lower the ratio means better the performance and it is found that MBL was quite successful than NIBL to convert the non-performing loans.

From the analysis, it is found that MBL has almost successful to maintain the minimum loan loss provision directed by NRB but NIBL has not strictly following the directives of NRB regarding loan loss provision. From the analysis, both banks have maintained sufficient core capital of total risk weighted assets.

From the trend analysis, the actual value of both banks increasing and decreasing order. Fitting the trend value, the figure shows that the level of NPL is gradually decreasing which is good for the financial health of both banks. Though the value of NPL in terms of Rupees is increasing the ratio of Non Performing Loan is decreasing and the ratio of Performing Loan is increasing. From the study it is found that the levels of NPA in both banks are not in alarming condition. It is quite satisfactory.

Correlation Coefficient between NPL and other parameters like Return and assets (ROA), Return on Equity (ROE), Total Loans and Advances and Net Profit were calculated to find out the relationship between NPL and these parameters. From the analysis their relationship and their significance were tested and verified by the hypothesis testing.

From the testing of significance of Machhapuchhre Bank, it is found that there is no significant difference between population correlation and sample correlation of NPL with all parameter, which means the calculated correlations are correct even if we take all the samples but in NIBL it is found that except correlation of NPL and ROE, other correlation of NPL with other parameters have significant difference between population correlation and sample correlation.

5.2 Conclusion

The condition of Non Performing Loan in Nepal Investment Bank and Machhapuchhre Bank are very fluctuating. From the study it is found that in some fiscal years NPA is low and in some years the level of NPA is high. But from the study it is found that the levels of NPA in both banks are not in alarming condition. They are very satisfactory condition. According to the trend analysis of NPA, it is found that the level of NPA in both banks is gradually decreasing. From the study, it is found that the level of NPA in NIBL is higher than the level of NPA in MBL. Machhapuchhre Bank is successfully converting its NPA into profit.

Regarding the Capital Adequacy Position, NIBL has maintained adequate Capital Adequacy Ratio for Core Capital to Total Risk Weighted Assets and Capital Adequacy Ratio for Total Capital Funds to Total Risk Weighted Assets. Machhapuchhre Bank Ltd. has maintained more than enough Capital Adequacy for both Core Capital and Total Capital Fund.

From the study, it can be concluded that there is relationship between NPL and other factors for example ROA, ROE, Total Assets, Total Deposits, Total Loans and Advances, Loan loss Provision.

From the study, it is found that there are some impacts of NPA in ROA, ROE, Total Assets, Total Deposits, Total Loans and Advances, but the impact is not significant.

The primary guiding factor for recognition of non-performing assets will be the interest Income Recognition and Assets Classifications (IRAC) norms prescribed by NRB. According to the prudential banking and accounting norms, any loans and advances against which neither interest nor principal amount has been settled for a certain period of time known as NPA. Any interest amount on behalf of any loan amounts could not be considered as interest income until it is recovered. Such amount of interest is booked on interest suspense account. The portion of interest suspense increase with the increase of non-performing loans. In the context of Nepali Banking system and Environment, they are classified as external factor and internal factor.

External factors are those factors, which are not in the control of banks, they consist of various unexpected changes in the social, political, economic and other areas of the country. Following are the main external factors which are responsible for the conversion of good loans into bad loans.

- Overall non conducive industrial environment/insecurity

- Integrity of the borrowers
- NRB's guidelines and blacklisting procedures
- Weak loan recovery law and procedures
- Unstable government policies and weak government stand on international policies.

Internal factors are those factors, which are in the control of bank. Following are the main internal factors which are responsible for the conversion of good loans into bad loans.

- Credit policy of the bank
- Management inefficiency and weakness
- Financial indiscipline and inadequacy
- Lack of quality appraisal of loan proposals
- Lack of quality marketing

A multiplicity of factor is responsible forever increasing size of NPAs in banks. A few prominent reasons for assets becoming NPAs are as under.

- Poor credit appraisal system
- Lack of proper monitoring
- Reckless advances to achieve the budgetary targets.
- There is no or lack of corporate culture in the Bank. In adequate legal provisions on foreclosure and bankruptcy.
- Change in economic policies/environment.
- No transparent accounting policy and poor auditing practices.
- Lack of coordination between banks.
- Directed lending to certain sectors.
- Failure on the part of the promoters to bring their portion of equity from their own source or public issue due to market turning lukewarm.

Lending is the major function of any commercial bank and it is the most income generating function of any commercial bank, but there is risk inherent in lending portfolio, banks have to make loan loss provision by categorizing the loans into different category as per the NRB directives. Increasing non performing loan is the serious problem of the banking sector in Nepal. Non-Performing loan reduce the income flow of the bank while claiming additional resource in the form of provisioning and hinder further gainful investment.

Non-performing loan sampled commercial banks has been decreasing gradually. Machhapuchhre bank has good performance n lending its resource and it has very little volume of non-performing loan. Nepal Investment bank has also decreasing non performing figure but in comparison with Machhapuchhre bank, Nepal Investment Bank has higher volume of non-performing loan which should be taken in consider by the authority persons of the bank.

Last decade longs country's political situation due to Maoist insurgency had a great impact in the overall economic situation. Impacts on industries, banking and financial sectors, hotels and tourism, foreign trade and balance of payment, development sectors, agriculture and other lots of business houses had been observed which ultimately affected the National GDP and overall economic condition. In that period most of the hotel and tourism businesses were shut down. By such situation, the business companies couldn't pay their loans and interest. The loans and advances flowed by banks became default because people started to posses their money. Therefore, the level NPA of commercial banks had been increased.

The present political development is likely to create a conducive environment for restoring peace and bringing new opportunities for development activities. Immediately after the declaration of ceasefire, the increase in hotel booking indicates the improvement in tourism activities. Similarly, donor countries have shown their commitments for the physical reconstruction of infrastructures in the country. It is also estimated that due to political stability, foreign investment will increase and the domestic industry and trade activities will flourish. This will help promote both imports and exports. It is believed and hoped that the recent political change in Nepal and the peace agreement between Nepal Government and Maoist will help the country's economic development in coming days and the impact of this will certainly help the commercial banks to convert its non-performing assets into performing assts.

In conclusion, the economic slowdown and recession overvaluation of properties provided as collateral, faulty credit analysis and decision, negative attitude of borrowers are the major causes of NPL in Nepalese commercial banking sector.

Similarly, lack of periodic supervision and monitoring, political pressure in lending, over finance and under finance, misuse of multiple banking by big borrowers has been also playing role to increase the level of NPL. Loan classification and provisioning enables banks to monitor the quality of their lending and to take the remedial action to counter deterioration in the quality of their loan and advances. Likewise, tactful and aggressive follow up of borrowers, accurate valuation of securities and insurance coverage, effective credit analysis of project, strong management team are the measures to resolve the problem of NPL.

Finally, it is concluded that the level of NPL in both commercial banks is not in alarming condition. The situation is quite satisfactory. If the increasing trend remained in coming days; the situation will be unmanageable and alarming. The commercial banks could not give full attention towards supervision their lending and recovering their bad loans perfectly.

5.3 Recommendations

NPA is the emerging challenges for Nepalese commercial banks today and in the future also. It is required to cope the challenge in time and the commercial banks should try to minimize such kind of challenges because NPA reduces the net profit and also it has great impact on capital adequacy, return on assets, return on equity, and other fields too which ultimately affects the performance of a bank. Therefore, the management team of a bank should identify the reason behind increasing NPA and they should try to minimize the increasing NPA. Lower the NPA means higher the profitability and ultimately better the performance of a bank.

Generally, it is assumed that NPA reduces profitability, ROA, ROE of the commercial banks. But from the data analysis in chapter 4 has shown that there is no significant impact of NPA to other parameters. It is found that there is increment in assets, deposits, net profits as well as there is increment in NPA also. Definitely NPA has more or less impact on the profitability and using some mechanism if the commercial banks had been able to reduced NPA, the profitability would be higher than the profitability achieved in the fiscal years.Here are some suggestions and recommendations provided for both of the banks and for overall banking system to reduce the level of NPA.

5.3.1 Major Recommendations

- There should be developed information department which will get all the information about the market situation and help to analyze the problems occurring around the commercial banks;
- There should be established proposal appraisal committee which will review the loan proposals thoroughly and suggest the management whether to provide loan or not.
- Transparency should be maintained while sanctioning loan and advances.
- Management team should monitor and control the corruption occurred while sanctioning and providing the loan
- Sufficient and adequate collateral against loan should accept.
- There should be a team which will review and evaluate the collateral deposited against the loan.
- Sound credit policy or loan lending policy should be developed.
- The directives provided by the NRB should follow strictly.
- Regular monitoring to loan holders' should be organized
- Lower the interest rates according to the market competition so that the loan holders' can repay the interest as well as principal
- Schemes should be launched to encourage the loan holders to repay the loan and interest within time period.
- Skilled human resource should be developed in terms of loan lending and their monitoring providing them training and other opportunities.
- Suggest the government to make stable economic policy.
- There must be coordination among commercial banks to flow the information regarding the loan defaulters developing the information department inside or outside the bank;
- Commercial banks should not attempt unhealthy competition to attract customers towards their banks providing cheap banking facilities;
- Commercial banks should not try to do faulty steps to meet the budgetary targets;
- There must be create some banking mechanism of corporate culture
- Commercial banks should have the information about the changing political

and economic scenario of the country, which will help them to step forward and cope the challenges which will occur in the future.

- faulty defaulters should be identified in time and should adopt precaution measures before the loan goes default
- The regulation regarding loan classification and provisioning is stringent and tighter than previous. Hence NRB should not only impose directives, but also create supportive environment for the commercial banks.
- NRB is recommended to strengthen Credit Information Bureau (CIB) so that commercial banks can get required credit information about borrowers on time.
- It is often said that “Prevention is better than Cure”. Hence, it is recommended for all commercial banks and overall banking systems to take preventive measures before the loan goes to default. All the banks are recommended to have an information system to gather the possible information and activities about its borrowers so that necessary precautions can be taken in time.

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