CHAPTER -I
INTRODUCTION

1.1 Background of the Study

Financial Institutions play an important role in the economic growth and development of the country. They help to mobilize the frizzed and scattered savings of the people and play an intermediary role to make investment of the collected fund in different productive sectors. They help to fulfill the requirements of trade and industry in the country and plays greater role in reducing poverty, raising employment opportunities and raising people's life standard.

Banks are the most important and essential financial institutions in any nation. Banks are differentiated from other financial institutions, as they can't create credit though they accept deposits, but the banks do so. An ordinary banking business consists of changing cash for bank deposits and bank deposits for cash; transferring bank deposits from one person or corporation to another; giving bank deposits in exchange for bills of exchange, government bonds, the secured or unsecured promises of businessmen to repay etc.

Nepalese economy is distinctly different in it's character from the regional economics poverty, less development geographical situation technological backwardness, been backed and dominated by two large economies etc. are the main features of the Nepalese economy still the Nepalese economy is rapidly integrated with the global economy with it's outward oriented policy followed by membership of WTO, SAFTA and BIMSTEC. The country is in process of institutional restructuring of financial sectors. Banking sector constitute as important segment of financial infrastructures of the country. It acts as a bridge between demand and supply of funds and intermediates between surplus unit and deficit "Banking when properly organized, aids and facilities growth of trade and industry and hence of national economy. In the modern economy banks are to be considered not as dealers in many but as the leaders of development. Banks are the storehouses of the countries wealth but are the reservoir of resources necessary for economy development." (Radhaswami and Vasudevan, 1991)

Modern bank's business is not confined in borrowing deposit and lending advances only, it performs a host of other financial activities which has immensely contributed to achieve industrial and commercial progress of every country.

With the membership of WTO, Nepal's financial services sector especially banking sector has opened to foreign competition. Nepal has made the commitments in financial services sectors which to made NRB to be aware of the implications of the WTO membership on the financial sector which will help our economy is to prepare it to face the challenges and maximize the benefits arising from the membership. Accordingly the banking community needs to accept the challenges and to be prepared to enter into global market with proper strategic plan. The most pressing issues are the resolution of non-performing loans, enhancing of capital base and structural transformation. In fact, reforming the financial sector and dealing with non-performing loans (NPL) are among the greatest strategic challenges facing Nepal today (Pradhan 2006).

The gradual expansionary trend observed in both quantity and quality of banking institutions, product and services since the early 1990s reveals the fact that the decade of 1990s remained a 'good time' for Nepalese industry. However, the huge amount of non-performing loans (NPL) and accumulated less in the public sector banks severally undermined the overall central banks try to rescue banks through it's various directives related with banking regulations and norms. It protects the banks as well the depositors and shareholders money by inducing various directives and guidelines management for the sound regulations of the banking system.

In general banks are those financial institutions that offer the widest range of financial services especially credit, savings and payment services and perform the widest range of financial functions of any business firm in the economy. "Bank of Venice" which was established in Venice, Italy in 1157 was the first bank. Commercial banks are restricted to invest their funds in corporate securities. Their business is confined to financing the short-term needs of trade and industry such as working capital financing, finance in fixed assets etc. They grant loans in the form of cash credits and overdrafts. Apart from financing them also render services like collection of bills and cheque, safekeeping of the valuables, financial advising etc to their customers.

According to the American institute of Banking, 'Commercial bank is a corporation which accepts demand deposits subjects to check and make short term loans to business enterprise regardless of the scope of its other services.' In the Nepalese context, the Nepal Commercial Banks Act 2031 B. S. defines a commercial bank as one, which exchanges money, deposits money, accepts deposits, grants loans and performs commercial banking function.

However, the bank in mobilizing its funds should be very careful while investing. The banks should have their own credit policies for the investments in business, projects or other sectors of the economy so that they can get the return from their investments smoothly and as expected without any difficulties. For most banks, loans are the largest and most obvious source of credit risk; however, other sources of credit risk exist throughout the activities of a bank, including in the banking book and in the trading book, and both on and off the balance sheet. Banks are increasingly facing credit risk (or counter party risk) in various financial instruments other than loans, including acceptances, inter bank transactions, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, and in the extension of commitments and guarantees, and the settlement of transactions. Thus, banks should develop and utilize internal risk rating systems in managing credit risk. The rating system should be consistent with the nature, size and complexity of a bank's activities. They must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on-and off-balance sheet activities. The management information system should provide adequate information on the composition of the credit portfolio, including identification of any concentrations of risk.

Banks must have in place a system for monitoring the overall composition and quality of the credit portfolio. They should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios, and should assess their credit risk exposures under stressful conditions. Thus, the research is mainly focuses on non-performing loans in Nepalese commercial Banks.

1.2 Historical Background

In Nepal the evolution of banking has a recent history. In earlier days, involvement of landlords, rich merchants, shopkeeper, goldsmiths, money lenders and other fence to institutional credit in presence of unorganized money market. These unorganized sectors were active in dealing with financial matters. In 15 century, during regime these were an evidence of professional money lenders and bankers. It is further believed that money lending business, particularly for financing the foreign trade with Tibet, became quite popular during reign of Mallas. However, in the absence of any regulatory measures, the unscrupulous money lenders were known to have changed exorbitant rates of interest and other extra dues and loans advance. The establishment of the “Tejarath Adda” during the year 1877 AD was fully subscribed by the government of the banking system. The Tejarath Adda helped the general public to provide credit facilities at very low rate of 5 percent. But main defects of these institutions are that there was no mobilization of savings due to which it faced several financial problems.

Need of banking institution is realized when government started trade with India and Tibet because of the safe transfer of money could be made. This was even supported by the situation caused due to earthquake during 1934 AD where there was a need of finance for the reconstruction of works. We can say the history of modern banking practices began only before the Second World War. Establishment of Biratangar Jute Mill in 1936 marks the beginning of the era of industrialization of Nepal, with the aid of Empirical Bank of India; Nepal bank Ltd was established in 1938 AD as the first commercial bank of Nepal. Later in 1956 AD, first central Bank named as the ‘Nepal Rastra Bank’ was set up with and objectives of suspending, protecting and directing the functions of commercial banking activities. Establishment of NRB, undoubtedly, was an important event in the economic history of Nepal. Following the establishment of NRB, a number of financial institutions were established. Among these another CB fully owned by the government named as Rastriya Banijya Bank (RBB) was established in 1966 AD.

The pace of financial sector development enhance rapidly after the financial liberalization policy then various financial liberalization policy introduced by the government in 1984 AD. Since then, various financial institutions have come into existence to provide the financial needs of the country there by, assisting financial development of the country. At present, there are 25 commercial banks, 59 developments banks, 78 finance companies, 12 microfinance Developments banks, 16 financials cooperatives, 45 NGOS, 1 Nepal stock exchange and other are Employment provident fund and Citizen Investment Trust.

1.3 Brief Introduction of Commercial Banks

Banks undertaking business with the earning profits are commercial banks. Commercial banks pull scattered fund and channels it to productive use. Commercial banks can be of various forms such as Deposit banks, saving banks, Industrial banks, mixed banks etc. Commercial banks render a variety of services. In absence of commercial banks, it would have been impossible to meet the financial needs of the country. Commercial Bank act 1974 defines a commercial: “A commercial banks means bank which deals in exchanging currency, accepting deposit, giving loans and doing commercial transactions.”

However Nepalese financial sector were dominated by two commercial banks, viz. Nepal Bank Ltd. (Semi government) and Rastriya Banijya Bank (Full government owned) till 1984. Commercial Banking Act.1974 was amended in 1984 to increase competition between commercials banks. As result, Nabil Bank Ltd the then Nepal Arab Bank Ltd was established in July 12, 1984 with the partnership of Dubai Bank Ltd., Dubai.

Though the commercial banks were established with the concept of supplying short-term credit and working capital need of industries, they have been providing long-term loans for up to 15 years. After the enforcement to lend in priority and deprived sector, these banks initiated to provide credit to small and cottage Industries, agriculture and Services. At present commercial banks must lend 5 percent of their total lending in priority and deprived sector and among these, 3 percent being compulsory in deprived sector. NRB has a provision of refinance facility also for such loan provided to priority and deprived sector including export credit. Having observed the successes on NABIL Bank Ltd. Based on marketing concept and also because of liberal economic policy adopted by the successive governments, many commercial banks have been established till date. The table No. 1 shows the list of licensed commercials banks as on 15 January 2009.

Table I-1

List of Licensed Commercial Banks mid July 2009

S.No	Name of the Bank	Established Date (A.D)	Operation Date (A.D)	Head Office
1	Nepal Bank Ltd	15/11/1937	15/11/1937	Kathmandu
2	Rastriya Banijya Bank	23/01/1966	23/01/1966	Kathmandu
3	Nabil Bank Ltd	16/07/1984	16/07/1984	Kathmandu
4	Nepal Investment Bank Ltd	27/02/1986	27/02/1986	Kathmandu
5	Standard Chartered Bank Nepal Ltd.	30/01/1987	30/01/1987	Kathmandu
6	Himalayan Bank Ltd	18/01/1993	18/01/1993	Kathmandu
7	Nepal SBI Bank Ltd.	07/07/1993	07/07/1993	Kathmandu
8	Nepal Bangladesh Bank Ltd.	05/06/1993	05/06/1993	Kathmandu
9	Everest Bank Ltd.	18/10/1994	18/10/1994	Kathmandu
10	Bank of Kathmandu Ltd.	12/03/1995	12/03/1995	Kathmandu
11	Nepal Credit and Commerce Bank Ltd.	14/10/1996	14/10/1996	Rupandehi
12	Lumbini Bank Ltd	17/07/1998	17/07/1998	Chitwan
13	NIC Bank Ltd.	21/07/1998	21/07/1998	Biratangar
14	Machhapuchhre Bank Ltd	03/10/2000	03/10/2000	Pokhara
15	Kumari Bank Ltd.	03/04/2001	03/04/2001	Kathmandu
16	Laxmi Bank Ltd.	03/04/2002	03/04/2002	Birgunj
17	Siddhartha Bank Ltd.	24/12/2002	24/12/2002	Kathmandu
18	Agriculture Development Bank Ltd.	16/03/2006	16/03/2006	Kathmandu
19	Global Bank Ltd.	02/01/2007	02/01/2007	Birgunj
20	Citizen Bank International Ltd.	21/06/2007	21/06/2007	Kathmandu
21	Prime Commercial Bank Ltd.	24/09/2007	24/09/2007	Kathmandu
22	Sunrise Bank Ltd.	12/10/2007	12/10/2007	Kathmandu
23	Bank of Asia Nepal Ltd.	12/10/2007	12/10/2007	Kathmandu
24	Development Credit Bank Ltd.	23/01/2001	23/01/2001	Kathmandu
25	NMB Bank Ltd.	26/11/1996	26/11/1996	Kathmandu
26	KIST Bank Ltd.	21/02/2003	21/02/2003	Kathmandu

(Banking and Financial Statistics, Vol. 53, a Journal of Banking Operation Department: NRB, Mid July 2009)

1.4 Focus of the study

Bank deals on monetary matters. Offering credit facilities is one of the basic functions of commercial bank. Out of their total income, on an average 60-70% of income consist from lending activities. Such activities exposed banks to default risk. In other words, the default risk associated with it is evidently high. It is because, bank disburses loans and advances for certain predetermined fixed periods or maturity periods and the borrower must repay the loans within maturity time period but it is not always happen that all the loans are recovered by the maturity time period. Some loans are recovered with the due dates and some are not recovered even after its maturity and remain as non-performing asset of the bank. Non-performing loans are such loans which have least possibility of recovery or unrecoverable within the due dates of loan

In present context, non-performing loan/assets has become one of the most pressing issues among various hurdles in the qualitative development of financial sector. On the basis of available data of Mid-January 2009 from NRB non-performing loan is 5.38 percent of total loan portfolio. As per international standard the acceptable level of non-performing is 5 percent of total loan (Economic report, NRB, 2007/2008). But the conditions of Nepalese Banks are having almost the sign of danger. Increasing non-performing loan is one of the serious problems of the Nepalese Banks. Banks investment in the forms of loans and advances are not giving desired return. Default risk is always high as Banks deal with loans and advances. Banks faces problem when recovering the granted loans that had became NPL/NPA. The two commercial banks namely Nepal Bangladesh Bank Ltd. and Rastriya Banijya Bank has higher proportion of non-performing loan than others. As at mid January 2009 NPL of RBB and NBBL stood at 18.72 and 29.01 percent respectively. Even some private sector banks also had high level of NPL. We can see in national newspaper that some of commercial banks are publishing names of borrowers who default in repayment of loans. Problem of non-performing loans has brought serious attention towards overall banking system. This problem may jeopardize the bank image, which can even lead to failure or bankruptcy.

To overcome these problems NRB has been issuing directive from time to time regarding various aspects of the banks. Loan Loss Provisioning (LLP) is maintained according to the classification of loans which are classified as pass, Sub-standard, Doubtful Loss. As per the directives of NRB aging of overdue by three months, six months and one year required 25%, 50% and 100% provision respectively. The provisioning amount is taken by deducting from the profit of the banks. It means that net profit of the banks will reduce by that amount this shows the impact of loan loss provision (LLP) in the profitability of the Banks.

As a result, bank might have to face problem of capital inadequacy and the bank fails to invest in profitable project. Increase in loan loss provisioning may decrease the Dividends of the Shareholders; it also affects interest made on deposits maintained by depositors, similarly other expenses too. But, still adequate loan loss provision helps to safeguard the depositor money and controls the credit risk. This will help to strengthen the financial position of the bank.

1.5 Statement of problem

The face of banking has changed tremendously after the adoption of financial liberalizations policy since 1980s. Nepal is in process to make banking system more transparent and international delivery standard, which will make our banking sector more competitive. The performance of the banking system in Nepal was mixed old and newly innovated technology. In this competitive environment, the banking system has grown to complex, that it has become increasingly challenging and costly for policy makers to identify and assess risk. Increasing NPAs has stood as one of the challenging problems in front of commercial `of Nepal NRB has also been facing the massive pressures for change to be able to meet the potentially upcoming challenges. Besides lack of effective management, poor information system, weak accounting system, poor credit management ineffective lending practices are enhancing NPA ratio.

The research questions of the study are as follows:

* What is the proportion of non-performing loan in the selected commercial banks?
* What are the factors causing increment of NPL in commercial banks?

* What is the relationship between NPL and LLP?
* What is the impact of loan loss provision on the profitability of the commercial banks?
* What are the trend of the non-performing loan, loan and advance, loan loss provision of selected commercial banks?

1.6 Objectives of the Study

The main objective of this study is to analyze the proportion of Non-performing loan and its effect on overall performance of commercial banks of Nepal. Therefore the study is mainly focused to search out the loopholes in its credit management of banks and similarly its strategies to cope with its non-performing assets.

The specific objectives of the study are summarized as below:

- To find the proportion of non-performing loan in the selected commercial banks.
- To identify the factors leading the accommodation of non-performing loan in commercial banks.
- To find out the relationship between loan and loan loss provision in the selected commercial banks.
- To present the trend of the non-performing loan, loan and advances, loan loss Provision of selected commercial banks.

1.7 Significance of the study

Nepalese financial sector is facing non-performing loan as a serious issues. Though proportion of non-performing loan in commercial banking sector has decreased substantially from 18.79 percent in mid-July 2005 to 13.16 percent in mid-July 2006 (Economic Review, NRB 2005/06), but still, it is a serious issue to be resolved completely. The performance of financial institutions is greatly measured how well they managed their credit. The major impact of NPA lies in the fact that it does not generate income which greatly affects the profitability of is bank. Since the prime sources of income for the bank are generated through income from loan and advances, increase in non-performing assets may lead the bank to failure.

Realizing this truth our banking sector requires serious attention towards the resolution of non-performing loans. Proper research is needed regarding the non-performing loan/assets. This study will be done to deliver some of the present issues, information and data regarding nom-performing loan. It is believed that the study may prove itself to be one of the helping pages for bankers, shareholders, depositors, cooperative, finance companies etc. Moreover, the study will assist to the further researcher, interested person, student etc.

1.8 Methodology of the Study:

The methods of data collection are primary as well as secondary source and mostly withdrawn form the annual report of selected commercial banks of Nepal. Furthermore, the analysis also includes descriptive Non-Performing Loan (NPL) analysis and Loan Loss provision along with the relevant analysis of financials.

Size of the population for the study is total commercial banks in Nepal, out of which five commercial banks are selected as sample for the study. They are Nepal Industrial and commercial Bank Ltd. (NICBL), Nepal Bangladesh Bank Ltd. (NBBL), Rastriya Banijya Bank Ltd. (RBBL), Nepal Investment Bank Ltd. (NIBL) and NABIL Bank Ltd. (NABIL).

The obtained data are analyzed with the help of various fundamental financial and statistical tools. The following data analysis tools will be used for the study:

a) Financial Tools
b) Statistical Tools
c) Trend Analysis
d) Correlation Analysis
e) Diagrammatic and Graphical Representation

1.9 Literature Review:

Review of Literature will be done through reviewing and examining some of the selected books, articles published in journals, bulletins, dissertation papers, magazines, newspaper and websites which can be categorized as below;

a) Conceptual/Theoretical Review

b) Review of Books

c) Review of Relevant NRB Directives

d) Review of Relevant Articles/Journals

e) Review of Related Thesis or dissertation.

1.10 Limitation of Study

Limitations are the factors constructing to perform any task smoothly. The study of non-performing loan in commercial banks will be conducted with in the following limiting factors:

- The study focuses only on the non-performing loan of Nepalese commercial banks. So various other aspects of the banks remain unexplored.
- The period of the study is limited from fiscal year 2003/2004 to 2008/2009.
- Due to time, resources and financial constrains and confidentiality of banks some of the study are ignored.
- Calculation of the study is depending on the accuracy of the data collected.
- The other limitation of the study is that, this study is mainly based on secondary data, interviews, published books, unpublished reports, public documents, annual report of the selected banks, articles of different writers and so on.

1.11 Organization of the study

The study report will be organized into five chapters as following:

Chapter-I (Introduction)

This chapter includes background of banking sector, significance of the study, statement of problem, scope and objectives of the study, limitation of the study and organization of the study.

Chapter-II (Review of Literature)

Under this chapter effort has been made to examine and review some of the selected books, articles published in different economic journals, bulletins, dissertation papers, magazines, newspaper and websites. In brief, this chapter includes review of conceptual/theoretical Review, Review of Books, Review of relevant NRB Directives, Review of Relevant Articles/Journals and Review of Related Thesis.

Chapter III (Research Methodology)

This chapter includes research design, nature of data, data collection technique, methods of data analysis, statistical procedure and tools.

Chapter-IV (Presentation and Analysis of data)

This chapter deals with presentations and analysis of collected data and information through definite course of research methodology, presentation and analyzing of collected data will be done through appropriate statistical, financial and methodology under several headings and sub-headings, various boxes, tables and graph will be used.

Chapter-V (Summary, Conclusion and Recommendation)

This chapter includes summary of the study, conclusion of the study and finally recommendation for further improvement.

CHAPTER –II
REVIEW OF LITREATURE

Review of literature is a way to discover what other research in the area of our problem has uncovered. Under this chapter effort has been made to examine and review some of the selected books, articles published in different economic journals, bulletins, dissertation papers, magazines, newspaper and websites. In brief, this chapter includes review of following.

2.1 Conceptual/Theoretical Review
2.2 Review of Books
2.3 Review of Relevant NRB Directives
2.4 Review of Relevant Articles/Journals
2.5 Review of Related Thesis
2.6 Review of websites

2.1 Conceptual/Theoretical Review

Under this heading concepts and meanings of related terms has been reviewed.

2.1.1 Loan and Advances

Granting of loan and advance is one of the major functions of commercial banks. Loan and advances generate incomes for the bank. Loans and advances are the assets of the bank. Interest income on such loans is the primary source of income of commercial bank. To spread the depositors fund to the borrowers, banks have to analyzed properly and take adequate collateral for the safety purpose as providing loan is a risky business an the other hand. It makes necessary for banks to manage the proper portfolio so that the impact of market failure of any sector will affect least. Therefore, the profitability of the bank depends upon the extent to which loans and advances.

2.1.2 Performing Loan and Non-performing Loan

Performing loans are those loans that repay principle and interest within the prescribed time frame. However, classification of performing loans may be done in different countries as per their own policy. In the context of Nepal, loans that have fallen under 'pass' category, are treated as performing loan.

Non-performing loans are the loans and advances which have least possibility of recover or unrecoverable within the due dates of loans. The term Non-performing loan is popularly known as NPL as well as NPA. In other words, the borrower when does not pay the dues in the form of principle and interest in times the loans are said to be non-performing loans. International Monetary Fund (IMF) defines, NPL as, "A loan is non-performing when payments of interest and principle are due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement or payments are less than 90 days overdue, but there are other good reasons to double that payments will be made in full".

In context of India it is defined like that, "Non-performing asset means an asset or amount of borrower, which has been classified by a bank or financial institution as substandard, doubtful or loss assets, in accordance with the directions or guidelines relating to asset classification issued by the RBI". In context of Nepal, credits need to be classified into four categories, namely pass, substandard, doubtful and loss. Out of these classifications, the loan of the last three categories is called non-performing loan. In other words all loans classified as substandard, doubtful and loss categories are called NPL. Based on this, when the loan is classified as sub-standard due to non-payment of interest or installments for 3 months, it will convert in to NPL. In a business of banking, they normally exposed to credit risk. NPL is not fully avoidable in the banking industry; however, it must be kept at a minimum level as far as possible.

2.1.3 Loan Loss Provision

There is associated risk in every loan. To minimize the risk from possible losses of these loans banks has to allocate same funds as loan loss provision. Loan Loss provision is the accumulated funds that are provided as a safeguard to cover possible losses upon classification of risk inherited by individual loans. The level of provisioning is depended upon the level of NPAs and their quality. Increased portion of NPA generate additional liability of resources to the financial institutions. In other words, higher the NPA, higher the provision as down graded loans need more provision. One percent provision of total credit is minimum requirement as every pass/good loan. However, the ratio of provision may differ from nation to nation, in Nepal, NRB has prescribed 1%, 25%, 50% and 100% provision for pass, substandard, doubtful and loss loan respectively.

2.1.4 Loan classification system

Banks are required to classify their loans and advances on the basis of ageing of the principle. All loans and advance need to be classified into the four types. They are pass loan, substandard loan, and doubtful loan loss. Here, pass loan is performing loan and others are non-performing loans.

2.1.5 Overdue/Past Due

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the date fixed by the bank.

2.2 Review of Books

Mr. Shakespeare Vaidya in his book "Project failures and Sickness in Nepal, challenges to investors for investment risk management" has discussed about the early warning system for investment risk management. In this Book, the author has also envisaged number of examples about crisis created by the banks in the world. As per his view, banking sector cannot ignore any sector of the economy on the basis of its good and bad and there is vital role of financial institutions in regards to bad accounts.

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

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

Finally, he concludes "In order to safeguard the banks from the financial crisis likely to be arise form the project failures and sick units that is non-performing loans the government needs to do a number of things and fast. It must bring a broad rule for poor financial institutions, transferring bad loans to bridge bank or loan recovery agency, removes many non-performing loans from even healthier bank and balance sheets, beef up regulation, supervision and disclosure, improve ability to banks to sell the collateral that backs soured loans, and recapitalized the banking system"(Vaidya, 1998)

Mr. Bhuwan Dahal and Mrs. Sarita Dahal in their book "A hand Book to Banking" have dealt with different aspects of banking. As per their view, banks have gained paramount trust in the public and they are rendering wide range of services covering different state of society.

They stated that loans and advances dominate the asset side of the balance sheet of any bank and earnings from such loans and advances occupy a major space in income statement. “Most of the bank failures in the world are due to shrinkage in the value of the loan and advances. Hence, loan is known as risky asset. Risk of non-repayment on loans is known as credit risk or default risk. Performing loans have multiple benefits to the society while non-performing loan erodes even existing capital. If loan is given to project which is not viable”.

As per their view, there is risk inherent in every loan and efforts should be made to have proper control in every step of loan management. They further suggested that bank should not take risk above certain degree irrespective of returns prospect. “Though all the loans are good at the time of disbursement, with the passage of time, they show the sign of problem. Based on the health of the loan, the loan should be classified and provided accordingly. Provisioning is made as caution against possible losses and to reflect the true picture of banks assets. Hence, there is practice of showing net loan (Total loan-loan loss provision) in financial statements. The bank should comply with the statutory regulation relating to loan classification and provisioning” (Dahal, 2002)

Susan E. Moyer, in “Dictionary of Money and finance” has stated, “Despite differences in policies regarding non-performing loans, the amount and type of non-performing loans are commonly regarded as indicators of loan portfolio quality and, in turn, bank health. Bank analyst and regulators often focus on the ratio of non-performing loans to either total loans or loan loss reserves. (Loan loss reserves represent management’s predictions of loan principle that eventually will be deemed uncollectible). Although ratio of zero are not considered optimal or even feasible, ratios that are unusually high relative to similar banks or overtime indicate bank quality is relatively poor or is declining.

Empirical research indicates that the non-performing loans data disclosed by a commercial bank provides information to stockholders about its value; the larger is the percentage of its loans that are non-performing, the smaller is the market value of equity (Moyer, 1994).

S.Wanye Linder in his book “Total Quality loan Management” has expressed his view about the default loan as Once a default has occurred, it is essential to understand the reasons for the deterioration of the credit and to determine the current state of health of the borrower and guarantor (if any) and the condition, perfection, and validity of any collateral securing repayment. In addition the work out officer must evaluate immediately the institutions potential exposure, if any, to a under liability claim and reduce that exposure in the negotiation and restructuring that follow the default. (S. Wayne Linder, 1995)

2.3 Review of Relevant NRB Directives

NRB issues various directives relating banking regulations and prudential norms for all financial institution i.e. commercial bank, development banks, finance companies and micro-finance institutions. As per the directives issued on August 2005 by NRB, loan classification and provisioning of loans of financial institutions are mentioned an E.Pra Directive no. 2/061/062.

1. **Classification of Loans and Advances**

(a) **Pass Loan :** Loans and advances whose principle amounts are not due and past due for a period up to 3 months fall in pass loans. This loan in this category is defined as performing loans.

(b) **Sub-Standard** : All loans expired by 3 months but which has not crossed 6 months fall in this category.

(c) **Doubtful** :All loans expired by 6 months but which has not crossed 1 year fall in this category.

(d) **Loss:** All loans and advances whose principle are past due for a period of more that 1 (one) year shall be included in this category.

Loans and advances falling in the category of Sub-standard doubtful, and loss are defined as non-performing loan.

Note:

(a) If it is appropriate in this view of he bank management there is not restriction in classifying the loan and advances from low risk category to high-risk category.

For instance, loans falling under sub-standard may be classified into doubtful and loans falling under doubtful may be classified into loss category.

(b) The ‘term’ loan and advances also includes Bill purchase and Discounted.

2. Additional Arrangement in Respect of pass Loan

Loans and advances that are fully secured by gold, silver, fixed deposit receipts and securities shall be included under ‘pass’ category. However, where collateral of fixed deposit HMG securities or NRB Boards is placed as security against loan for other purposes, such loan has to be classified on the basis of ageing.

3. Additional Arrangement in Respect of Loss Loan

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

a) Insufficient security/collateral
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) Misused of loans.
f) Owing to non-recovery, initiation as to auctioning of the collateral has passed 6 months and if the recovery process is under litigation.
g) Loans provided to the borrowers which is included in the blacklist of credit information bureau.
h) If project/business is in non-operative condition or closed.
i) Credit card loan not write off which is dues since 90 days.

4. Additional Arrangement Regarding of Term Loan

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

5. **Principle and Interest should not be collected from current account by overdrawing the account.**

6. **Letter of Credit and Guarantee.**

If non-funded facilities such as letter of credit, guarantees and other liabilities turn into funded liabilities and have to pay by the financial institutions, these credits have to categorized into 'pass loan up to 90 days and if not paid within 90 days then treated as 'loss' loan.

7. **Rescheduling and restructuring of loan**

1. Financial institution may reschedule or restructure loans and advances upon receipts of written plan of action from the borrower citing the following reasons.

(a) Evidence for adequate collateral and documentation regarding loans.

(b) Financial institutions have confidence that loans can be recovered after rescheduling.

Note:

Rescheduling means to extend the loan payment period that have been borrowing by the customer. Restructuring means to change the loan type and terms and conditions and including change in loan payment period.

2. To reschedule or restructuring the loans, it is mandatory that at least 25% of past due interest up to rescheduled or restructuring date should be paid by the borrower. If all interest has been recovered before renewal of loans, it can be categorized into 'pass' loan.

8. **Loan Loss Provisioning**

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

Classification of loan	Loan loss provision
Pass	1 Percent
Substandard	25 Percent
Doubtful	50 Percent
Loss	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".

2. Loan loss provisioning to rescheduled as restructured loans should be as follows:

(a) For rescheduled/restructured loan, loan loss provision should be at least 12 percent.

(b) If priority sector or deprived sector loan which is insured or guaranteed priority sector credit has been rescheduled or restructured, provision should be only 25 percent of above point (a) for such loans (i.e. 25% of 12.50%).

(c) If interest and principle of rescheduled/restructured loan have been served regularly since last two years, such loans can be converted in to 'pass' loan.

3. Priority sector or deprived sector loans which are not insured should be provisioned as per above clause no.1.

4. Where the loan is extended only against personal guarantee, a statement of the assets and equivalent to the personal guarantee amount not claimable by any other shall be obtained. Such loans shall be classified as per above and where the loans fall under the category of pass, substandard and doubtful, in addition to the normal loan loss provision applicable for the category, an additional provision by 20 percentage shall be prepared separately. Hence the loans loss provision required against the personal guarantee loan will be 21%, 45% and 70% for pass, substandard and doubtful category respectively.

Review of Relevant Articles/Journals

By Diwakar Golcha (Second vice-president of FNCCI) in his article, "***Private Sector views a Financial Sector*",** he stated that there is no proper legislation in Nepal, which gives such professions to the borrower as provided in U.S. The government proposed is law, in the name of the bankruptcy Act, by the central bank by issuing different directives, and banks can very easily take over the mortgage and recover the loan but they still cry foul and blame the real sector for all the non-performing loans.

He thinks that NPA of three banks NBL RBB and NIDC are highly discussed and publicized. If we analyses them, we can find that the NPA of three banks have also made the required loan loss provisioning over the same period high and improbable figures of NPA are still of still quoted. There are many companies, which suspended their businesses are or two decade ago, but the banks are still carrying their loan account as NPA in their book. They should have the guts to either foreclose an the collateral or write the loan off in such cases.

Mr. Golchha classified NPA mainly in to two categories.

- Borrowed money never used for the objective it was borrowed for or the loan transactions was done with a fraudulent objective.
- Borrowed money actually invested to create business but the company could not perform due to internal or external factors other than those envisaged during the designing of the project. In such cases the investor along with the bank is genuinely in problem and it should be looked upon according. The promoter should be helped with a new to support and restructure such business (nepalnews.com.np/conents/ englishmonthly/businessage/2004/sectoral.htm).

Mr. Him Prasad Neupane, in his article titled "***Bad Loans of Banking Sector Challenges and Efforts to Resolve"*** It has thrown some views regarding bad loans of banking sector. As mentioned by him there was various types of risk inherent in the credit. One, who managers risk, earns profit. He further added that the recent financial crisis in banking sector is due to weak accounting procedures, defect in loan classification, lack of transparency, loss control measures etc. Like the other writers, Mr. Neupane has also stated that NPL is the indicator of financial crisis and the factors leading to NPL is economic slowdown, recession, bad intention of the borrower, lack of credit policy, increase in interest rates etc. NPL increase resource mobilization cost and reduce profit earning capacity of the bank. He has also mentioned that the international standard of acceptable NPA is 4 percent but there is about 26 percent NPL is Nepalese banking sector which is due to high level of NPL of two nationalized banks. As stated by the writer, the major implications of NPL are banks cannot return depositors money on demand and it limits lending capacity of the bank. The writer has suggested internal and external measure of reducing NPL and its effect. Internal measure comprises classification of loans and advances and providing provisions for probable loss and external measures comprises of help form Credit Information Bureau (CIB), appointment of Asset Management Company (AMC) and Debt Recovery Tribunal (DRT).

He concludes, "Banks must give priority for reducing NPA. He has also mentioned that many countries are adopting various measures for reducing loan loss. Recently the president of Philippines has announced tax rebate system for reducing NPA. Now it is high time to improve bad debts of banking sector with firm determination" (Neupane, 2060).

Bhisma Raj Dhugana, in his article titled, "***AMC: A Vehicle for NPLs Resolution"*** had tried to highlight that, the concept of Asset Management Company (AMC) is one of the recent developments in the institutional structures to resolved the problems of non-performing loans (NPLs) of banks and non-bank financial institutions. However, the financial practitioners have introduced it in the early 1960s and the importance of the same was not widely recognized as it has been today. AMCs are specialized financial intermediaries in managing the non-performing and distressed loans of banks and non-bank financial institutions. The banking system needs to maintain high quality of assets portfolio all the times and adequate level of liquid assets to ensure uninterrupted payment system. When the quality of assets in the banking system deteriorates, the level of NPL rises and banks may face liquidity problem. If the liquidity crises is serve, this may even lead to liquidate the bank. These AMCs have served as the groundwork for banking institutions to recover its boundless coupled with recovery of national economy and stabilizing system.

Further, he stated that to achieve the efficient performance form the financial system, financial institutions need to be operated within their specialized areas. This is why, many specialized financial institutions need to be incorporated that suit to the nature of businesses and activities they undertake in the system. The nature of business that commercial banks undertake does not provide them adequate skill and expertise in handling and managing of NPLs efficiently. Therefore, the efficient managers of commercial banks prefer for disposing the NPLs as soon as possible with the objective of holding adequate level of performing loans all the times. This will help them to improve the profitability and liquidity positions. Therefore, AMCs are the most important institutions to improve the overall quality of assets of the financial system, which consider NPL or distressed loans first and then try to improve the quality of assets. These AMCs can carry out such assignment so easily by adapting various approaches to improve the quality of assets; speedy disposition of un-viable assets.

He concludes that, AMC is a prominent force in dealing with NPLs in the financial system. Nepalese financial system does not have any institution that can undertake and manage NPL and distressed loans of the banking system. Therefore, it is the need of the day to establish an AMC as soon as possible. It must be noted that the AMC that we establish must be suitable to the national situation and meet the need of the economy. Moreover, the AMC should be capable of tackling the problem as well as functional to the task assigned. It must be efficient, practical and solution oriented and it should also be capable of taking necessary step to enhance the operating environment. It has been observed that in some countries, governments have been compelled to arrive at the stage over ship, sooner or later. Therefore, AMC in national level and government ownership it seemed to be effective in terms of economics of scale, efficacy and unbiased performance. So far the life of AMC is establish with finite life to achieve quick recovery and to avoid moral hazard; whereas private sectors seems to be profit oriented aiming at maximizing returns on their investment on the basis of going concern concept (Dhunganga, 2001).

By Maha Prasad Adhikari, in his article, titled, “Non-Performing Loan and Its management” has focused that NPL refers to those loans and advances which are not able to serve the interest and the installment within the given period of time and the internationally acceptable level of NPA is said to be less than 5 percent of total loans and advances. But out of 25 commercial banks, 18 banks have less than 5 percent NPL and one have marginally above 5 percent NPL. NPL level of other 6 banks is quite high and above the standard as well as industry average. Similar, situation is the agriculture Development Bank and some other non-bank financial institutions.

He said that the private sector banks have grown up with the different and improved banking culture. The same culture is applied in the credit operation and it enables to manage their credit with possible stringent manner in most of the private sector banks. However, all private sector banks are not at par. Even private sector banks are also carrying their NPA up to almost 40 percent of their credit portfolio. The average NPA level of private sector banks is 6.58 percent, which is higher than the standard but for below the industry average. Public sector banks are still exposed to high risk in credit and holds huge amount of NPA. The recent attempt to write-off of dead account world minimizes the level of NPA substantially. However, other risk of one time writes off is still high to the individual entities.

He concludes the process of credit risk management start from the formation of appropriate credit policy/guidelines/rules and also comprises of credit approval. Mitigation of the credit, credit documentation processing, credit control, monitoring, follows ups counseling, board over sight and timely recovery actions. When any of these steps is compromised, the loan may convert into the NPL. Once the loan is converted into the NPL, it must be resolved on time with appropriate NPL management strategy and methodology (Adhikary, 2007).

By Chandan Sapkota, in his article titled “untangling the threads associated with defaulters” published in business age (2007 July) has focused that the issue selected to willful default and non-performing loans (NPL) stockpiling in banks is one of the most persistent, stubborn and sticky issues in the economy. This has been one of the most debated issues in the past and still continues to be one of the thorniest issues playing our financial system. It has not only worsened the financial health of the two largest public banks but the whole economy at shock and heaped additional burden on the efficacy of our institutional setting and begs an answer to whether they are really capable of withstanding the after shocks of a drastic action against willful defaulters.

Further, he adds that NPA accounts for over 20 percent of the GDP. Two public banks, Nepal Banks Limited and Rastriya Banijya Bank, now under foreign management, account for most of the NPLs in the country. The impact of loan defaults in commercial banks is not that alarming, though the numbers are pretty worrisome. To maintain sound financial health of the two public banks and to repair the damage by willful defaulters the central bank has already spent more than five billion rupees extracted directly from taxes. This has added per capita additional debt burden of $2.8($1.8 more than the poverty line) on the public. This means that the public are bearing a high cost if negligence and deliberate, unethical actions of the willful defaulters. These are around 80 big willful defaulters associated with 27 leading business houses. The number of blacklisted loans is around 2909, which amounts to almost Rs. 40 billions. The defaulted loans and the amount needed to repair damage emanating from these bad loans have a very high opportunity cost because it could be used in progressive, high yielding development activities. The present government seems to have taken this matter pretty seriously only as a result of increased pressure from large and influential donors like the World Bank, IMF and ADB among others. He also states that if we look at the list of defaulters and people responsible for massive NPLs, it would not be difficult to notice that most of them are major players in the industrial sector at present. The willful defaulters in the list own major factories and companies that are considered to be the backbone of our economy. Several expert-oriented companies are owned by the defaulters. Given this condition we need to consider consequences of action the government is trying to take lately.

He concludes that if the defaulters are forced to sell of their entire property to repay loans, then unpleasant conditions like factory clause and lay offs would surely emerge. There is no reason that under this pretext the government should suspend actions against the defaulters. Taking actions swiftly and directly against the already known defaulter is more optimal, efficient, economic and less cumbersome (Sapkota, 2007).

In a post report titled "***Government Should Support loan recovery drive?"*** published in he Kathmandu post, the reporter had made an endeavor to highlight that the central bank's initiative alone would not suffice to recover loans defaulters. Governor of Nepal Rastra Bank,

. Bijaya Nath Bhattrai asked the government and civil society including media to support loan recovery drive of the commercial banks. Mr. Bhattrai also said that non-performing asset if banking system of the two large commercial banks was still high and a matter of concern. The NPA of the banking system as a whole is 18 percent of present. But, NPA of Nepal Bank Ltd. And Rastriya Banijya Bank is over 50 percent and 43.3 percent respectively and all must put more efforts to recover the defaulted loans and he also asked the commercial banks and other financial institutions to strictly adhere to the directives of the central bank.

The reporter further states that Surendra Man Pradhan, executive director of Bank Regulation Department, NRB, expressed concern every higher incidence of moral hazard and conflict of interest in the Nepali banking system. MR. Predhan also noted that poor banking culture such as bank staff approving loans against overvalued collateral by pocketing 10 percent commission had pushed the two banks to the brim of insolvency. Of the other hand, enumerated globalization of banking, banks involvement in other activities and adaptation and effective implementation of international standards if it's practices a major challenges facing banking regulation in Nepal (Kathmandu Post, June 2007).

In a report titled, **"Write-offs behind fall in Banks' NPL Level"** published in the Himalayan Times, the reporter has attempted the crucial issue of non-performing loan (NPL) ailing the financial sector if Nepal may appear to have been sorted out.

The level of NPL; which stood at a whopping 60 percent prior to the financial sector reforms in 2002 and honored around 30 percent in 2003, has come down to 14.22 percent in 2006. But thereby hangs s story of massive write-off of loans and interest of loans. Nepal Bank Ltd. has written off loans amounting to almost Rs.4 billion and an interest of around Rs.8 billion, pointed out Nepal Rastra Bank. And according to the bank regulatory, even Rastriya Banijya Bank is planning to write off a total of Rs.12 billion loans.

Further, states that the big borrowers have been avoiding loan repayments by getting stay order from courts. While the recently promulgated bank and financial institutions. Act 2063 demarcates the role of NRB in handling the NPL issues of banks; the regulator still clearly lacks the teeth to deal with defaulters with all iron hand. For, instead of being authorized directly to initiative action against them, NRB can be best request the government of Nepal to "take necessary steps" against the defaulters when approved by the commercial banks.

Finally, reporter concludes, "The three step NRB directives to banks a handling bad loans entails: follow up, blacklisting borrowers and than request. NRB for enforcement actions in term of seizing the passport or attaching of properly for auction (The Himalaya Times, Dec 2009).

In a report "***Loan Loss Provision rises notably"*** published in the Kathmandu Post, the reporter had made an endeavor to highlight some facts and figures regarding loan loss provision of commercial banks. "The baking sector is witnessing a huge surge in loan loss provisioning reserves lately. The increment is primarily a result of a directive issued by Nepal Rastra bank (NRB) in 2001 that introduced stringent loan provisioning criteria for commercial banks. As per data released by the central bank, the total loan loss provision in the country's banking sector increased from around Rs.13.18 billion in Mid-April 2003 to RS.9.45 billion In Mid-April 2008. As per the latest NRB figures a remarkable surge has been seen in loan provision of Nepal Bank Ltd. (NBL) and Nepal Bangladesh Bank Ltd (NBBL).

Further, states that apart from the two technically insolvent government-invested banks, loan provision of other joint venture private banks has also risen significantly and the notable increments seen in the loan loss provisioning amounts is due to the eight point prudential directives that the central bank issued in mid-2001 to all commercial banks.

Finally, concludes, “The directives laid down stringent guidelines relating to loan loss provisioning to ensure a good health of the overall banking system. The directives require loans to be provisioned to the extent of cent percent if payment is defaulted for over three months and 50 percent if the period of default extends beyond six months. The earlier directives required progressive provisioning of loans, but allowed a maximum of three years, unlike the present system of just a tear, for loans to be provisioned to the extent of percent” (The Kathmandu Post, June 2009).

By William Poole, in his article titled “A market Solution to secure Banks’ Future” published in BOSS business magazine (2009 August) has focused on the how market reforms plays important role in securing the banks’ future in the economy. As per him, not long, we should all hope, because large banks today, under federal protection, can raise short-term funds more cheaply than their smaller competitors which are allowed to fail.

Further he said that genuine reform requires that four minimal requirements be met, and the sub debt proposal qualifies. First, banks need more capital to protect the federal deposit insurance fund. Second, there must be more market discipline: each bank would be forced to roll over maturing sub debt equal to one percent of its liabilities each year. Third, financial stability requires that a bank not be subject to runs. Sub debt cannot run, because of the 10 years maturity. Fourth, and critically important, some creditors and not just equity owners must be at risk, which is clearly the case with sub debt. Sub debt provides much more market discipline than equity, because a bank in trouble with a weak share price is not forced to do anything. Maturing sub debt, however, does discipline the bank and if the bank cannot roll over the debt, it must shrink by 10 percent to live within its remaining outstanding sub debt. This system is stable because any bank can contract by 10 percent to live within its remaining outstanding sub debt. This system is stable because any bank can contract by 10 percent within a year by letting loans run off and or by selling other assets. It is highly desirable that contraction be managed by the bank itself and not by regulators.

Finally he concludes a reform to the status quo ante, with banks enjoying the benefits of “too big to fail”, does not seem likely, Regulators will not dare risk a repeat performance. Bankers who think that their political influence will control the regulatory process are in for a rude surprise. (The BOSS, September 2009)

Robert Clarke, Former Comptroller of the currency, in March of 1990 expressed in wall street journal titled “Clarke finds lax standards in Farm loans,” concern that banks have failed to set up the procedures to manage lending risks despite the hard lessons taught during the agricultural crisis in the Midwest, the energy crisis in the south west, and the real-estate crisis in the Northeast. He was worried that bank managers operating in healthy parts of the country were not prepared for unexpected economic downturns.”Once the economy starts to weaken all the underwriting deficiencies rise to surface,” he said. (Clarke,1990)

Interview

In an interview with T. Craig McAllister by Business Age, asked question, “The largest laid down in the contract between Nepali regulators and ICC-MT, particularly in terms of reducing the NPA of the bank, were really very high who did ICC(and you in particular) accept to high targets?”

He answered to the question, “We were led to believe that NPA’s were at 38 percent as opposed to the 62 percent we found we out it down a bit, but the government itself has not paid back the money it owns for example over Rs. 200 million in direct guarantees. There was a long gap between the date we signed the contract and the date we actually look over the management while signing the contract, we expected a functioning Asset Management Company (AMC) and Debt Recovery Tribunal (DRT) by the time we look over. But still there is no AMC. Also the DRT come very late. The DRT is now very helpful, but we missed the first two and a half years of the projected. We expected judicial and government support, as in most functioning economies, but it is not there, in regard to large borrower with influence – the economic renegades. ‘Many finance Minister changed during our project and we were called upon to explain thing to each of them. A couple of them did not understand even what ‘willful defaulter’ means. The very first month that we were here we knew we would not be able to reduce NPA to 5 percent or 10 percent. We know same of this money is not going to come back ever. We could not write off policy when they approved a write off policy, we sent our accounts there and it comes back with comments. This went for several times. Now, finally we too have our write off policy and this will be applied at the end of the fiscal year. But, please don’t forget that writing off does not mean forgetting the loan. It is just removed from the balance sheet, but the bank can always continue to try and collect the loan.

Next question arisen, It is said that the problems like high NPA are not limited only to Nepal Bank but across the entire banking sector including the private sector banks. How is the situation in your evaluation?

He says, “The economic renegades have borrowing relationships with many banks you only need to attend a gathering of bankers to hear the groans when certain names are mentioned. When were sitting a consortium meeting, the subject of loan loss provisioning come up and our bank and NRB had 100 percent loan loss provisioning. The banker behind us said they have taken a general provision which means 1 percent. They aren’t recognizing the issues. On the other hand, there are banks that are aggressive and running their banks well” (Business Age July 2006).

Review of Related Thesis

Ms Niva Shrestha (2004) in her study “A Study on Non-Performing Loan and Loan Loss Provisioning of commercial banks “With reference to Nepal bank limited” has made an attempt to analyze various factors that causes accumulation of non-performing loans in selected banks. Her main objectives of the study are to find out the provision and non-performing loan impact of loan loss provision on the profitability of the commercial banks.

She focused on the problems of commercial banks as they have been facing like of smooth functioning of economy, different policies and guidelines of NRB political instability, security problem, poor information system, over liquidity caused by lack of good lending opportunities, increasing non-performing assets etc. In the present context where Nepalese Banks are facing the problem of increasing NPAs more amounts has to be allocated or loan loss provision.

She concluded in effective credit policy, political pressure to lend to uncredit worthy borrowers, overvaluation of collaterals are the major causes of mounting non-performing assets on government owned bank like NBL. Other factors leading to accumulation of NPAs are weak loan sanctioning process, ineffective credit control review and classification of loans enables banks to monitor quality of their loan portfolios and to take remedial action counter deterioration these, establishing recovery cell, hiring assets Management Company are an NPL. “She has found that NBL has very high portion of non-performing loan resulting to higher provision in comparison to NABIL and SCBNL. Even the NBL has highest investment is the most income generating assets i.e. loans and advances, it is in loss. Even the private sector bank, NABIL, has also higher non-performing loan and provision which is higher than acceptable during the study period.

Further, she suggests that resolve the NPA problems immediate remedial action for recovering bad debts and hiring assets management company, explore the new areas of investment, more caution to taken while granting loans, efficient and professional credit appraisal , strictly follow the NRB directives and effective and efficient stringent of NRB and CIB.

Mr. Mohan Khanal (2005), in his study “Impact of Non-performing loan on the performance of Nepalese Commercial banking sector”, has focused that 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. The main objectives of his study is to analyze the capital adequacy position of the Nepalese Commercial Bank, to observe the relations of NPL with return on assets return on equity, return and loan and advances, loan loss provision, total assets, total loan and advances, total deposit, and to identify the factors and causes which play role for the increment of NPL.

He states that lending as the major function of any a commercial bank the most income generating assets of any commercial bank there is equally risk inherent in lending portfolio, banks have to make loan loss provision by categorizing the loan into different category as per the NRB directives. Increasing non-performing loan debate the income flow of the bank while claiming additional resource in the form of provisioning and hinder further gainful investments.

Finally, he conclude that economic that economic slow down 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 underfinanced, misuse of multiple banking by big borrowers has been also playing role to increase the level of NPL. Loan classification and provisioning enable banks to monitor the quality of their lending and to take the remedial actions to counter deterioration in quality of their loan and advances. Likewise, regular, tactful and aggressive follow up of borrowers, accurate valuation of securities and insurance coverage, effective credit analysis of project; strong management teams are the measures to resolve the problem of NPL.

Ms. Sabitri Shrestha (2003) in her thesis “Impact and Implementation of Nepal Rastra Bank (NRB)’s Guidelines (Directives) on Commercial Banks: A study of Nabil Bank Limited” has tried to find out the impact of NRB directives on commercial banks. She has also made effort to find out whether the directives are actually implemented and are being monitored by NRB or not.

She states, “All the changes in NRB directives made both positive and negative impacts on the commercial banks. Even though this study is limited to only two samples i.e. NABIL Bank and Nepal SBI bank, among entire population, it clears the new directives issued by NRB make good impact more than bad impact on the various aspects of the banks the increased provisioning amount has decreased the profitability of commercial banks. Loan exposure has been cut-down to customers due to the borrower limit have been brought down by NRB. Therefore reduction in loan amount results to decrease the interest income from loans, which will decreased the profit of the banks in coming years. On the positive side of new directive, recently the problems of banks are increasing operating cost and decreasing loan amount resulting decrease in profit of the banks. But it shows it is only for short term because the directives are more effective to protect the banks from bad loans, which protect the banks from bankruptcy as well as protection of deposits of depositors, increase in capital adequacy ratio strengthen the banks financial position, loan related provision will made safety of loans except the risk reducing provisions will protect the bank from liquidation. Above all, it can be conclude that newly issues directives are more effective than previous are although it has brought some problems towards banks. To decrease the decreasing profit of the banks they should research the alternatives such like more investments in other business, banks should adopt new technology according to the demand of time and must not depend an only interest income for profits."

Ms. Shama Bhattarai (2004) in her study, " Implementation of directives issued by Nepal Rastra Bank : A comparative study of Nepal SBI Bank Limited and NB bank Limited" has made an attempt to analyze various aspects of NRB Directives with respect to capital adequacy and loan classification and provisioning. As per her view the process of continual review and classification of loans and advances enables banks to monitor the quality of loan portfolios and to take remedial action to counter deterioration of credit quality of their portfolio.

Finally, she concluded that with the new provisions the banks will have its provision amount increasing in coming years and subsequently profitability of the banks will also come down. However, the true picture of the quality of the assets will be pointed in the coming years to come. She recommends, "The banks should be very careful while analyzing the paying capacity of its credits clients. With longer period of past due, the bank will end up increasing its provision which will keep the bottom line low if the bank is not careful."

Mr. Jaya Lal Neupane (2006) in his thesis titled "Study on non-performing loan and loan loss provisioning of commercials banks: with reference to Nepal Bank Limited, Rastriya Banijya Bank and NABIL Bank Limited." His main objectives are to analyze the guidelines and provisions pertaining to loan classification and loan loss provision, proportion of non-performing loan in the selected commercial banks and impact of loan loss provision on the profitability of the commercial banks.

He has pointed out that increasing non-performing loan with higher rate is one of the burning problems of Nepalese financial industry improper credit appraisal system, effective credit monitoring and supervision system, economic slow down, borrowers misconduct, political pressure to lend to un credit worthy parties etc. are the major factors to non-performing assets.

He concluded "NBL and RBB are concentrating in loan recovery and management, trend analysis of loans and advances share decreasing trend of investment. NBL and RBB have increasing trend of provision as both banks are under foreign management which were previously not categorized properly. On the other hand, NABIL has decreasing trend of provision due to their proper management of loan with establishing of recovery cell. All three banks are positive towards generating profit and NBL and RBB also started to operate in profit since 2004 after the management handled by foreign parties. Trend of net profit is increasing and if this trend will be continued, NBL and RBB would generate profit in dramatic way.

Finally, he recommended that all three banks should have proper information system to gather required information of borrowers and their business show that prevention measure can be applied before down grading the borrowers.

Review from websites:

Regarding, the magnitude of Non-performing Assets of Bank in Nepal & how debt recovery problem being addressed in Nepal, it has studied from the website of Debt tribunal Recovery that in the distant past, bank had to deal with only few cases of bad-loans So, they used to take legal actions against chronic defaulters of bank-loans. For the last 10/12 years, banks are suffering from a large chunk of non-performing loans (assets) as a consequence of economic as well as non-economic factors in the country. By international parameter, non-performing assets of a bank should not exceed 10% while such an indicator is estimated to have been crossed 26%(Rs.31 billion in aggregate)mainly due to the increase in willful defaulters in the government, semi-government and private sector banks.

Recovery of bad loans by banks and financial institutions has turned into the big issue in the financial sector of Nepal. This has greatly caused negative impact on bank’s profit, government revenue and the overall financial sector of the country. This calls for an effective system and mechanisms that case the early recovery of debts of banks and also a bank like institutions as specified by Nepal Rastra Bank- the Monetary Authority.

CHAPTER - III
RESEARCH METHODOLOGY

Research Methodology refers to the various sequential steps to be adopted by a researcher in studying a problem with certain objectives in view. In outwards, Research Methodology describes the methods and process applied in the entire subject of the study.

Research Methodology thus, refers to the methods and techniques used in collection, tabulation and analysis of the data and information collected to achieve the objective of the study.

Research Methodology includes research design, population samples, sample selection procedure, nature and sources of data and method of data analysis. These are given as follows:

3.1 Research Design
3.2 Size of population and sample
3.3 Sources of data
3.4 Data collection procedure
3.5 Method of data analysis

3.1 Research Design

A Research Design is the arrangement of condition for collection and analysis of data aims to combine relevance to the research purpose with economy in procedure. "Research design is the plan, structure and strategy of investigations conceived so as to obtain answer to research questions and to control variations" (Wolf and Pant, 2002)

Descriptive research design and analytical research design has been followed for the study. It also seeks to analyze the impact of non-performing loan and loan loss provisioning of selected commercial banks of Nepal.

3.2 Size of population and sample

Size of population refers to the quantitative aspect of the matter on which research study is done. A sample represents only a part of universe (quantity). In sampling method only tiny part of the whole aspect of matter is considered and conclusion about the entire aspect is done on the basis. This research is to study the cause and effect if non-performing loan and loan loss provisioning of selected commercial banks of Nepal. Therefore, all the commercial banks are the population of the study. The census of the population is neither feasible nor desirable fie he purpose of this study. For the selection of the sample from the population purposive random sampling is done. Following commercial banks have been chosen as sample for the study.

a. NIC Bank Limited.
b. Nepal Bangladesh Bank Limited
c. Nepal Investment Bank Limited
d. NABIL Bank Limited
e. Rastriya Banijya Bank

3.3 Sources of data

The data and information needed for the study were collected from various sources. The main sources of the data used for this study is primary as well as secondary data. For the analysis of impact of NPL, secondary data have been collected from published articles, books, newspaper, website, annual reports of the concerned bank, annual report of NRB and Bulletin. Likewise for the study of NPL Primary data in from of questionnaire have been collected from the respondent of concerned banks.

3.4 Data Collection Procedure

For collecting primary data questionnaire, direct interviews, telephonic inquire and field visit has been done in the concerned banks as well as in NRB. Similarly for secondary data various books, journals, websites, around reports of NRB and unpublished dissertation has been obtained by visiting Central library T.U. and Shankar Dev Campus Library.

3.5 Method of data analysis

After the data are collected from various sources, the data are analyzed by means of various tables and figure. Such tables and figures are explained wherever necessary. Data are also analyzed by applying different mathematical, financial and statistical tools.

3.5.1 Financial Tools

Financial analysis is the process of identifying the financial strength and weakness of a firm from the available accounting data and financial statements. The analysis is done by properly establishing the relationship between the items of balance sheet and profit and loss account. (Financial Management 2004, the institute of Chartered Accountants of India). While adopting the financial tools, a ratio is used as benchmark for evaluating the financial position and performance of any firm. Financial analysis is the use of financial statement performance (Wild, Subramanyam and Halsey 2003).

3.5.1.1 Ratio Analysis

Ratio analysis is a widely used tool of financial analysis. The term ratio in it refers to the relationship expressed in mathematical terms between two individual figures or group of figures connected with each other in some logical manner and are selected from financial statements of the concern. A financial ratio helps to express the relationship between two accounting figures in such a way that user can draw conclusion about the performance, strength and weakness of a firm. (Financial Management, 2004 the Institute of Chartered Accountants of India). To make analysis, we can use various ratios. But only those ratios have been calculated which are related to the subject matter.

Loans and Advances to Total Asset Ratio

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

$$\text{Loans and advances to total asset ratio} = \frac{\text{Loans and Advances}}{\text{Total Assets}}$$

Loans and Advances to Total Deposit Ratio (CD Ratio)

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

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

Non-Performing Loans to Total Loans and Advances Ratio

This ratio determines the proportion of non performing loans in the total loans portfolio. Higher ratio implies the bad quality of assets of banks in the form of loans and advances. Hence, lower NPL to total credit ratio is preferred. As per international standard only 5 [percent NPL is allowed but in the context of Nepal 10 percent NPL is acceptable. It is calculated as follows:

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

Loans Loss Provision to Total Loans and Advances Ratio

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

$$\text{Loan Loss Provision Ratio} = \frac{\text{Loan Loss Provision}}{\text{Total loans and Advance}}$$

Provision held to non-performing Loan

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

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

Return on Loans and Advances

This ratio indicates how efficiency the bank has employed its resources in the form of loans and advances. It is the ratio of net profit and total loans and advances of the bank. Net profit reforms to that profit which is obtained after all types of deduction like employees bonus, tax, provision etc. hence this ratio measures banks profitability with respect to loans and advances. Higher the ratio better is the performance of the bank. It is calculated as below:

$$\text{Return on loans and advances} = \frac{\text{Net Profit}}{\text{Total loans and advances}}$$

3.5.2 Statistical Tools

Statistical tools are the mathematical techniques used to facilitate the analysis and interpretation of numerical data. "Statistical Analysis is one particular language, which describes the data and makes possible to talk about the relations and the difference of the variables". (Gupta, S.P. 1997). Following statistical tools have been used in this study.

Percentages

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

$$= \frac{B}{A} \times 100$$

Measures of Central Tendency

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

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

Measures of Dispersion

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

Standard Deviation

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

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

Coefficient of variance (C.V)

The percentage measures of coefficient of standard deviation is called coefficient of variation. The less is the C.V. the more is the uniformity and consistency and vice-versa. Standard deviation gives an absolute measure of dispersion. Hence, where the mean value of the variable based in S.D only. The coefficient of variation measures the relative measures of dispersion, hence capable to compare two variables independently in terms of their variability.

$$\text{Coefficient of variance (C.V)} = \frac{\exists}{\bar{x}} \times 100$$

Correlation Coefficient (r)

Correlation refers to the degree of relationship between two variables. Correlation coefficient determines the association between the dependent variable. If between the variables, increase or decrease in one cause increase or decrease in another, then such variables are correlated variables. “Correlation may be defined as the degree of linear relationship existing between two or more variables. Two variables are said to be correlated when the change in the value of one is accompanied by the change of another variables.” (Sthapit, Joshi, Dangol, 2003). There are different techniques of calculating correlation coefficient. Among various techniques we have used Karl pearson coefficient of correlation. It is calculated as follows:

$$\text{Correlation Coefficient (r)} = \frac{\phi xy}{N\exists_x\exists_y}$$

Where,

$x = X - X$ $\quad$ $y = Y - Y$

$\exists_x$ = Standard Deviation of series x

$\exists_y$ = Standard Deviation of series y

N = No. of pairs of observation.

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

$$r = \frac{\phi xy}{\sqrt{\phi x^2 \, \phi y^2}}$$

The Karl pearsion Coefficient of correlation always falls between -1 to +1. the value of correlation in Minus signifies, the negative correlation and in plus signifies the positive correlation. If

r = 0, there is no relationship between the variables.

r < 0, there is negative relationship between the variables

r > 0, there is positive relationship between the variables

r = +1, the relationship is perfectly positive.

r = -1, the relationship is perfectly negative.

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

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

Where,

r= Correlation coefficient

N= Number of pairs of observation

If r > 6 P.E., then the correlation coefficient is significant and reliable.

If r > P.E., then the correlation coefficient is insignificant and there is no evidence of correlation.

3.5.3 Trend Analysis

Trend analysis is one of the statistical tools, which is used to determine the improvement or deterioration of its financial situation. Trend analysis informs about the expected future values of various variables. The least square method has been adopted to measures the trend behaviors of these selected banks. This method is widely used in practices. The formula of least square method for the straight line is represented by the following formula.

$Yc = a + bx$

Where,

Yc = Trend Values

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

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

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

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

$\sum Y = Na + b\sum X$............................ (i)

$\sum XY = a\sum X + b\sum Y$............................ (ii)

Where, N = Numbers of years.

But for simplification, if the time variable as measures as a deviation form its mean i.e. mid point is taken as the origin, the negative value in the first half of the series balance out the positive values in the second half so that ($\sum X = 0$). The values of constant a & b can easily be determined by using following formula.

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

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

3.5.4 Diagrammatic and Graphical Representation

Diagrammatic and Graphical Representation of information was very important way to communicate findings or data. The old saying that a picture is worth a thousands words in an appropriate one is this context. Data presentation in the form of diagram and graphs can provide a quick and concise insight into the subject under investigation. Hence, bar diagrams, multiple bar diagrams, pie-chart and graphs make it easier to see the relationship of data. Such presentations clearly reveal the relationship between the dependents and independent variables. Similarly, the presentations in graph also evaluate the data for the application of an appropriate statistic.

CHAPTER- IV

PRESENTATION AND ANALYSIS OF DATA

This chapter deals with analysis and presentation of available data as express in the research methodology necessary figures and tables are also presented in this chapter. The data collected from the secondary and primary sources are presented in various ways. Besides, the presented data are analyzed in a skillful manner. The purpose of analyzing the data is to change it form an unprocessed form to a clear presentation. The analysis of data consists of organizing, tabulating performing statistical analysis and drawing inference. The main objective of such analysis is to obtain answer to the research questions or to test the hypothesis. The general purpose of this chapter is to examine the processes by which the meaning and implications of research data can best be extracted. This chapter first explains methods of organizing data by tabulation and then placing the data in presentable from by using figures and tables with the help of financials as well as statistical tools.

Condition of NPL in Present Context of Nepal

As discussed, loans in Nepal classified into four categories, namely pass, Substandard and loss. Out of these classifications, the loan of the last three are classified as non-performing loan based on this, when the loan is classified as substandard due to non-payment of interest or installments for 3 months, it will convert into NPL is not fully available in the banking, industry. However, it must be kept at a minimum level as far as possible. In spite of the internal conflict in the country, Nepal experienced substantial growth in credits during past five years. It is also remarkable from table No. the growth on credit substantially reduced the average level of NPL percentage, while total volume of NPL remains almost same amount where it was in five years back.

Table No. IV-1 Average Level of NPL

Figures in Million

Fiscal Year	Total Loan	NPL amount
2003	111904.40	32095.69
2004	127065.40	28933.41
2005	148366.43	27877.70
2006	194360.82	25580.50
2007	229363.91	24215.85
2008	305638.36	18648.50
Mid July 2009	384315.13	13574.64

Source: NRB, Banking and financial Statistic (Mid July 2009)

Table No. IV-2

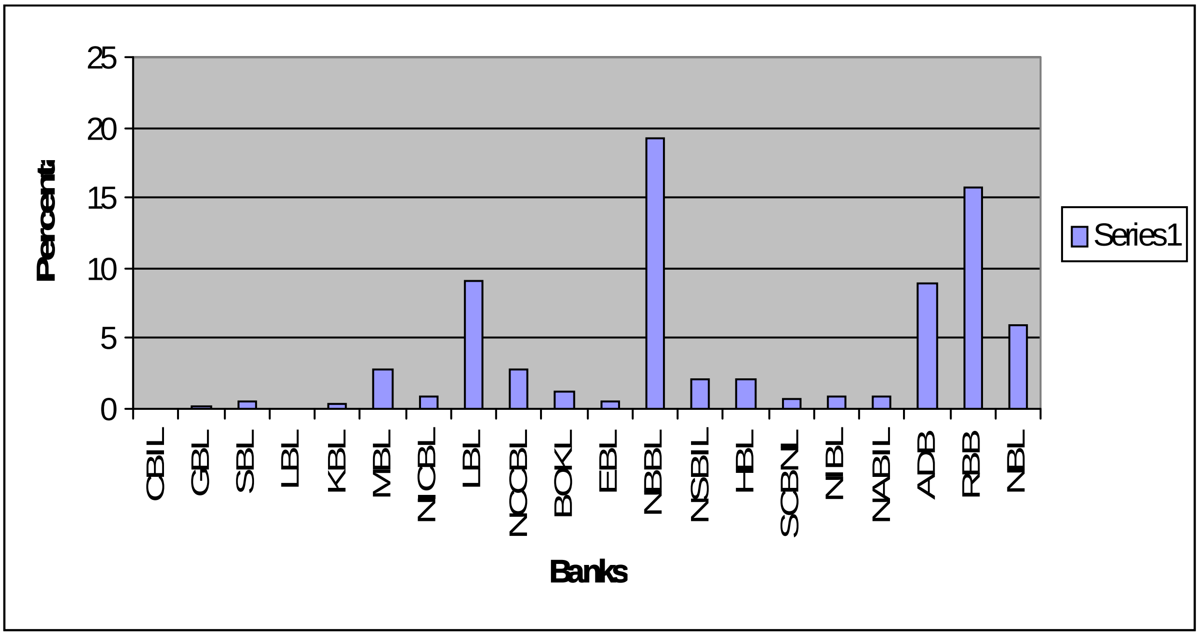
NPL Level of Nepalese Commercial Banks mid July 2009

Banks	NBL	RBB	ADB	NABIL	NIBL	SCBNL	HBL	NSBIL	NBBL	EBL	BOKL	NCCBL	LBL	NICBL	MBL	KBL	LBL	SBL	GBL	CBIL
NPL(%)	5.91	15.68	8.83	0.80	0.82	0.66	2.16	2.02	19.30	0.48	1.27	2.74	9.06	0.90	2.75	0.43	0.05	0.45	0.09	0.00

(Based an provisional data of Mid July 2009, NRB

Note: Out of 26 commercial banks, prime commercial bank, sunrise bank, Bank of Asia, DCBL, NMB and KIST bank are not considered for analysis due to their recent establishment.

Figure IV-1



The internationally acceptable level of NPA is said to be less than 5 percent on total loan and advances. Based on the table No.3, Out of 26 commercial banks, 21 banks have less than 5 percent NPA and one has marginally above 5 percent NPA. NPA level of other four banks is quite high and above the standard as well as industry average. Similar situation is the Agriculture Development Bank and same other non-bank financial institutions.

The private sector banks have grown up with the different and improved banking culture. The same culture is applied into credit operation and it enables to manage their credit with possible stringent manner in most of the private sector banks. However, all private sector banks are not at par which have been seen from the above table. Even private sector banks are also carrying their NPA up to almost 40 percent of their credit portfolio.

Table IV- 3

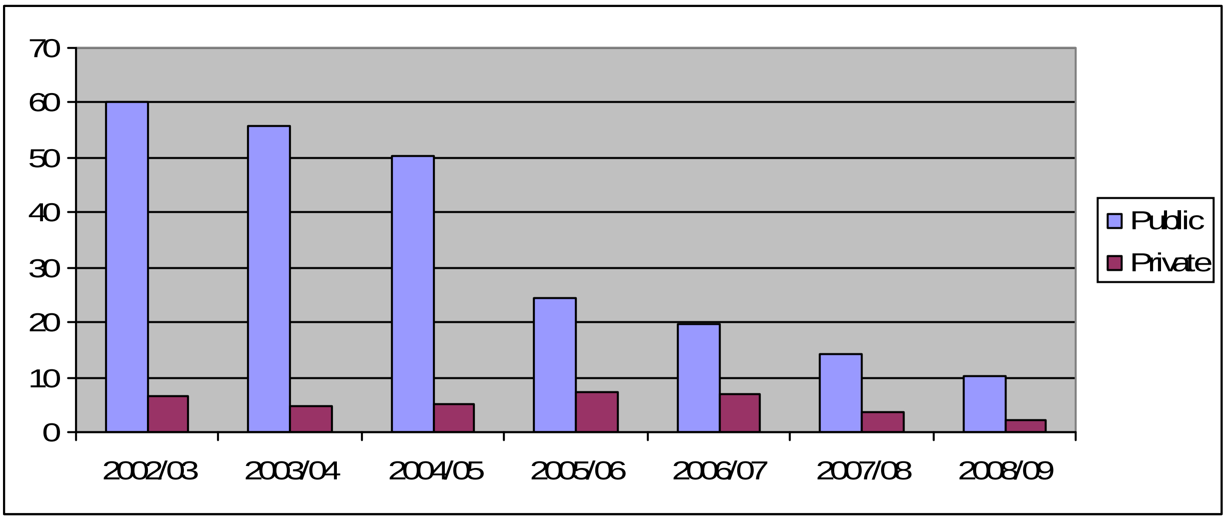
Level of NPA in Public sector bank and Private sector bank (In percentage)

Banks	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Public	60.31	55.69	50.17	24.53	19.7	14.08	10.14
Private	6.47	4.75	5.03	7.37	6.99	3.72	2.10

Source: NRB, Banking and Financial Statistics (Mid-July 2009)

Figure No. IV-2

Level of NPA in Public sector bank and Private sector bank (In percentage)



Source: NRB, Banking and Financial Statistics (Mid-July 2009)

From above table no 4; the average NPA level of private sector banks is 2.10, which is below than standard. Public sector banks are still expose to high risk on credits and holds huge amount of NPA. The average NPA level of public sector banks namely RBB, NBL and ADB comes around 10.14 percent of their gross loan amount.

4.1 Ratio Analysis

4.1.1 Loans and Advances to Total Assets Ratio

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

Table IV-4

Loans and Advances to Total Asset Ratio (%)

Figures in Million

Banks	Particulars	Mid July					Mean	S.D.	Cov.
		2005	2006	2007	2008	2009			
NIC	L & A	4895.4	6882.8	9107.6	11446.5	13889.3	26.13	24	91.85
	T.A.	40490.7	49221.4	58991.2	15451.4	92123.8			
	Ratio	12.09	13.98	15.44	74.08	15.08			
NIBL	L & A	10295.4	13007.2	17482	27145.5	36250.4	63.21	3.2	5.06
	T.A.	16637.9	22007.2	28572.8	40205.5	54634.5			
	Ratio	61.88	59.10	61.18	67.52	66.35			
NBBL	L & A	8739.8	9010.7	8302.8	8420.0	8507.9	54.57	2.54	4.65
	T.A.	15540	16721.8	14282.3	15584.2	16829.9			
	Ratio	56.24	53.89	58.13	54.03	50.55			
NABIL	L & A	11078	13021.3	15657.1	21514.6	27816.6	56.54	3.03	5.36
	T.A.	18614.9	24134.6	29660.4	38478.6	45941.6			
	Ratio	59.51	53.95	52.79	55.91	60.55			
RBB	L & A	28614	26863.8	25214.8	27353.6	31464.1	33.78	1.93	5.71
	T.A.	77594.1	81087.1	72041.3	84686.2	99662.6			
	Ratio	36.88	33.13	35	32.30	31.57			

Source: NRB, Banking and Financial Statistics (Mid-July 2009)

The above table no. 4 exhibits the loan and advances to total assets of 5 banks for five consecutive years. This ratio shows fluctuating trend in all the banks. The mean ratio of NIC, NIBL, NBBL, NABIL and RBB are 26.13, 63.21, 54.57, 56.54 and 33.78 respectively. Hence, among the five banks, NIBL has the highest proportion of loans and advances in the total assets structure followed by NBBL, NABIL, RBB and NIC. This refers that NIC has the lowest degree of investment in risky assets. The management of NABIL is risky averse they have invested higher proportion of their assets in risk free or nominally risky assets like treasury bills, debenture, National Saving Bonds (NSBs) etc.

The standard deviation of NIC, NIBL, NBBL, NABIL and RBB are 24, 3.2, 2.54, 3.03 and 1.93 respectively. Similarly the Cov of NIC, NIBL, NBBL, NABIL and RBB are 91.85, 5.06, 4.65, 5.36 and 5.71 respectively

4.1.2 Loans and Advances to Total Deposit Ratio

This ratio is also known as credit deposit ratio (CD ratio). The core banking function is to mobilize the funds obtained from the depositors to borrowers and earn profit and CD ratio is the fundamental parameter to ascertain fund deployment efficiency of commercial bank. In other words this ratio is calculated to find out how successfully the banks are utilizing their total deposits on credit or loans and advances and better earning, however, liquidity requirements also needs due consideration. Hence 70 percent-80 percent CD ratio is considered as appropriate. This ratio is calculated by dividing total credit or loans and advances by total deposits of the bank.

Table IV- 5

Loans and Advances to Total Deposit Ratio (%)

Figures in Million

Banks	Particulars	Mid July					Mean	S.D.	Cov.
		2005	2006	2007	2008	2009			
NIC	L & A	4895.4	6882.8	9107.6	11446.5	13889.3	84.81	5.27	6.21
	T.D.	6243.3	8765.8	10068.3	13078.5	15579.9			
	Ratio	78.41	78.52	90.46	87.52	89.15			
NIBL	L & A	10295.4	13007.2	17482	27145.5	36250.4	73.75	3.84	5.21
	T.D.	14254.8	18927.3	24488.9	34451.8	46697.9			
	Ratio	72.22	68.72	71.39	78.79	77.63			
NBBL	L & A	8739.8	9010.7	8302.8	8420.0	8507.9	78.30	7.17	9.16
	T.D.	12125.5	13014.8	9464	10883.7	9995.6			
	Ratio	72.08	69.23	87.73	77.36	85.12			
NABIL	L & A	11078	13021.3	15657.1	21514.6	27816.6	70.44	3.93	5.58
	T.D.	14586.8	19348.4	23342.4	31915	37348.3			
	Ratio	75.95	67.30	67.08	67.41	74.48			
RBB	L & A	28614	26863.8	25214.8	27353.6	31464.1	53.65	7.51	14
	T.D.	43489.2	45700.7	50192.6	57990.8	67976.3			
	Ratio	65.80	58.78	50.24	47.17	46.29			

The above table No. 5 exhibits the loans and advances to total deposit ratio of five commercial banks for five consecutive years. This ratio shows fluctuating trend in all the five banks. The mean ratio of NIC, NIBL, NBBL, NABIL and RBB are 84.81 percent, 73.75 percent, 78.30 percent, 70.44 percent and 53.65 percent respectively. Hence, NIC has highest proportion of loans and advances in the total deposits followed by NBBL, NIBL, NABIL and RBB. It signifies that NIC, NIBL, NABIL and NBBL have been ahead in utilizing depositor's money on loans and advances with the objective to earn profit. This refers that RBB has slightly low investment in the form of loan and advances other than four banks. The standard deviation of NIC, NIBL, NBBL, NABIL and RBB are 5.27, 3.84, 7.17, 3.93 and 7.51 respectively. Similarly the Cov of NIC, NIBL, NBBL, NABIL and RBB are 6.21, 5.21, 9.16, 5.58 and 14 respectively

4.1.3 Loan Loss Provision to Total Loan and Advances Ratio

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

Table IV- 6

Loan Loss Provision to Total Loans and Advances Ratio (%)

Figures in Million

Banks	Particulars	Mid July					Mean	S.D.	Cov.
		2005	2006	2007	2008	2009			
NIC	LLP	174.7	244.7	225.6	20.7	199.7	2.24	1.30	58.4
	L & A	4895.4	6882.8	9107.6	11446.5	13889.3			

	Ratio	3.57	3.56	2.48	0.18	1.44			
NIBL	LLP	256.2	374.3	442.7	537.2	584.4	2.30	0.45	19.57
	L & A	10295.4	13007.2	17482	27145.5	36250.4			
	Ratio	2.49	2.88	2.53	1.98	1.61			
NBBL	LLP	1184.5	1691.9	3633.7	3301.4	2376.3	28.65	11.54	40.28
	L & A	8739.8	9010.7	8302.8	8420.0	8507.9			
	Ratio	13.55	18.78	43.76	39.21	27.93			
NABIL	LLP	392	352.9	356.3	404.6	409.1	2.38	0.71	29.83
	L & A	11078	13021.3	15657.1	21514.6	27816.6			
	Ratio	3.54	2.71	2.28	1.88	1.47			
RBB	LLP	15214.4	13593.1	8967.5	7709.4	6483.4	37.63	12.59	33.46
	L & A	28614	26863.8	25214.8	27353.6	31464.1			
	Ratio	53.17	50.60	35.56	28.18	20.61			

The above table No. 6 exhibits the ratio of Loan loss Provision to loans and advances of NIC, NIBL, NBBL, NABIL and RBB for five consecutive years. The figure represent in the above table No.6 shows that RRB has highest ratio through out the study period and also shows increasing trend. NIC shows the least ratio during the study period. The mean Loan Loss ratio of NIC, NIBL, NBBL, NABIL and RBB are 2.24 percent, 2.30 percent, 28.65 percent, 2.38 percent and 37.63 percent respectively. This ratio of RBB is significantly high in comparison to other four banks. Higher LLP indicates poor and ineffective credit policy, higher proportion of non-performing assets and poor performance of the economy. Hence, the greater ratio of NBBL and RBB suggest that there is high proportion of NPL in the total loan and advances and decreasing trend of loan loss provision ratio of NIC, NIBL and NABIL explain that they have been successful to reduce its non-performing loan resulting to decreasing LLP. The standard deviation of NIC, NIBL, NBBL, NABIL and RBB are 1.30, 0.45, 11.54, 0.71 and 12.59 respectively. Similarly the Cov of NIC, NIBL, NBBL, NABIL and RBB are 58.4, 19.57, 40.28, 29.83 and 33.46 respectively

4.1.4 Non-Performing Loans to Total Loans and Advances Ratio

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

Table No. 7

Non-Performing Loans to Total Loans and Advances Ratio (%)

Figures in Million

Banks	Particulars	Mid July					Mean	S.D.	Cov.
		2005	2006	2007	2008	2009			
NIC	NPL	185.43	179.55	1001.10	98.30	123.11	3.83	3.75	97.91
	L & A	4895.4	6882.8	9107.6	11446.5	13889.3			
	Ratio	3.79	2.61	10.99	0.86	0.89			
NIBL	NPL	280.87	272.49	421.97	309.40	301.98	1.84	0.73	39.67
	L & A	10295.4	13007.2	17482	27145.5	36250.4			
	Ratio	2.73	2.09	2.41	1.14	0.83			
NBBL	NPL	1832.94	2927	3645.90	2945.30	1355.95	29.66	10.03	33.82
	L & A	8739.8	9010.7	8302.8	8420.0	8507.9			
	Ratio	20.97	32.48	43.91	34.98	15.94			
NABIL	NPL	144.51	182.60	178.30	171.40	220.72	1.09	0.25	22.94
	L & A	11078	13021.3	15657.1	21514.6	27816.6			
	Ratio	1.30	1.40	1.14	0.80	0.79			
RBB	NPL	13689.30	8045.50	6876.50	5951.80	4955.97	28.51	10.82	37.95
	L & A	28614	26863.8	25214.8	27353.6	31464.1			
	Ratio	47.84	29.95	27.27	21.76	15.75			

The above table No. 7 exhibits the ratio of non-performing loans and advances of NIC, NIBL, NBBL, NABIL and RBB for five consecutive years. The figures represented in the above table No. 7 shows that NBBL has the highest ratio through out the study period. NABIL shows the least ratio during the study period. NABIL's decreasing trend of NPL is the result of effective credit management of bank and its effort of recovering bad debt through establishment of recovery cell. The mean non-performing loan to the total loans and advances ratio of NIC, NIBL, NBBL, NABIL and RBB are 3.83 percent, 1.84 percent, 29.66 percent, 1.09 percent and 28.51 percent respectively. The ratio of NBBL is significantly high. Not only have NBBL but also another bank i.e. RBB had also high proportion of NPL which is higher than the acceptable standard of 10 percent. The other three banks NIC, NIBL and NABIL have lower NPL as prescribed by international standard i.e. 5 percent. The standard deviation of NIC, NIBL, NBBL, NABIL and RBB are 3.75, 0.73, 10.03, 0.25 and 10.82 respectively. Similarly the Cov of NIC, NIBL, NBBL, NABIL and RBB are 97.91, 39.67, 33.82, 22.94 and 37.95 respectively

4.1.5 Provision Held to Non-Performing Loan Ratio

This ratio refers to the proportion of provision held to non-performing loan of the banks. This ratio measures up to what extent of risk inherent in NPL is covered by the total loan loss provision. Higher ratio signifies that the banks are safeguard against future contingencies that may create due to non-performing loan or in other words banks have caution of provision to cope the problem that may be cause due to NPL. Hence, higher the ratio better is the financial position of the bank.

Table No. 8

Provision Held to Non-Performing Loan Ratio (%)

Figures in Million

Banks	Particulars	Mid July					Mean	S.D.	Cov.
		2005	2006	2007	2008	2009			
NIC	LLP	174.7	244.7	225.6	20.7	199.7	87.26	57.69	66.11
	NPL	185.43	179.55	1001.10	98.30	123.11			
	Ratio	94.21	136.29	22.54	21.06	162.21			
NIBL	LLP	256.2	374.3	442.7	537.2	584.4	140.13	39.02	27.85
	NPL	280.87	272.49	421.97	309.40	301.98			
	Ratio	91.22	137.36	104.91	173.63	193.52			

NBBL	LLP	1184.5	1691.9	3633.7	3301.4	2376.3	101.89	42.01	41.23
	NPL	1832.94	2927	3645.90	2945.30	1355.95			
	Ratio	64.62	57.80	99.67	112.09	175.25			
NABIL	LLP	392	352.9	356.3	404.6	409.1	217.15	31.68	14.59
	NPL	144.51	182.60	178.30	171.40	220.72			
	Ratio	271.26	193.26	199.83	236.06	185.35			
RBB	LLP	15214.4	13593.1	8967.5	7709.4	6483.4	134.17	18.91	14.09
	NPL	13689.30	8045.50	6876.50	5951.80	4955.97			
	Ratio	111.14	168.95	130.41	129.53	130.82			

The above table No. 8 exhibits the ratio of provision held to non-performing loan of NIC, NIBL, NBBL, NABIL and RBB for five consecutive years. The figure represented in the above table No. 8 shows the NABIL has highest ratio through out thee study period. The mean ratio of NIC, NIBL, NBBL, NABIL and RBB are 87.26 percent, 140.13 percent, 101.89 percent, 217.15 percent and 134.17 percent respectively. This ratio of NABIL is significantly high in comparison to other four banks and NIC has least ratio of provision. Among the five banks NIBL, NABIL and RBB has the highest ratio of provision and NIC and NBBL has the lowest ratio of provision during the study period. The standard deviation of NIC, NIBL, NBBL, NABIL and RBB are 57.69, 39.02, 42.01, 31.68 and 18.91 respectively. Similarly the Cov of NIC, NIBL, NBBL, NABIL and RBB are 66.11, 27.85, 41.23, 14.59 and 14.09 respectively

4.1.6 Return on Loans and advances

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

Table IV- 9

Return on Loans and advances Ratio (%)

Figures in Million

Banks	Particulars	Mid July					Mean	S.D.	Cov.
		2005	2006	2007	2008	2009			
NIC	NP	114	97	158	243	317	1.98	0.35	17.81
	L & A	4895.4	6882.8	9107.6	11446.5	13889.3			
	Ratio	2.33	1.41	1.73	2.12	2.28			
NIBL	NP	232	350	501	696.73	900.62	2.57	0.21	7.96
	L & A	10295.4	13007.2	17482	27145.5	36250.4			
	Ratio	2.25	2.69	2.87	2.57	2.48			
NBBL	NP	-650	-1457	392.7	800.41	2472.19	3.94	14.16	371.21
	L & A	8739.8	9010.7	8302.8	8420.0	8507.9			
	Ratio	(7.44)	(16.17)	4.73	9.51	29.06			
NABIL	NP	520.1	635.3	674	746.47	1031.05	4.21	0.55	12.98
	L & A	11078	13021.3	15657.1	21514.6	27816.6			
	Ratio	4.69	4.88	4.30	3.47	3.71			
RBB	NP	1620.32	1687.60	1681.66	1770.56	2032.23	6.31	0.35	5.48
	L & A	28614	26863.8	25214.8	27353.6	31464.1			
	Ratio	5.66	6.28	6.67	6.47	6.46			

The above table No. 9 exhibits the ratio of return on loans and advances of NIC, NIBL, NBBL, NABIL and RBB for five consecutive years. The figure represented in the above table shows that RBB has the highest ratio throughout the study period. Above table also shows the Net profit of all sample banks in increasing trend, however, the NBBL during the first two years has gone on loss so, has shown negative ratio but last three years it has been able to earn the reasonable profit. Comparing all five sample banks, NBBL has the highest net profit. The standard deviation of NIC, NIBL, NBBL, NABIL and RBB are 0.35, 0.25, 14.16, 0.55 & 0.35 respectively. Among the five banks NIBL has the least deviation with the least degree of variation in this ratio. NBBL has the highest deviation with highest degree of variation. So, it can be concluded that though NABIL & NIBL have the higher exposure on loans and advances banks have least ratio of return on loans and advances than of the NBBL & RBB. It can be said that these two banks are able to earn the Net profit comparatively satisfactory during the five year period. NBBL, though has gone on loss on first two years but it has able to recover it's loan and advances which can be turn into one of the highest profit in FY2009 than other sample banks.

Figure IV- 3

Performing Loan, Non-performing Loan and Loan Loss Provision of NIC bank

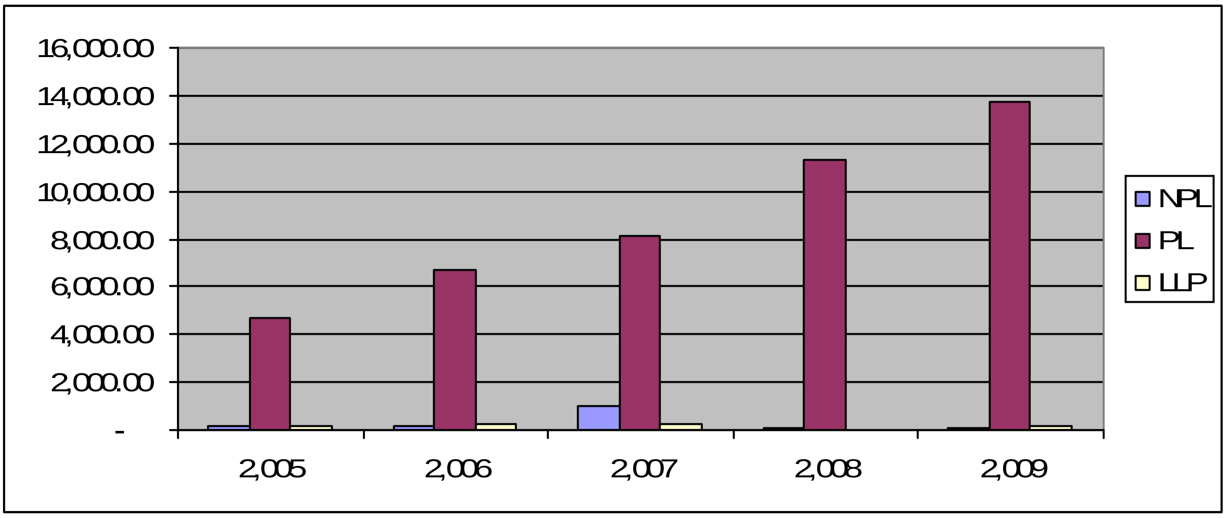


Figure IV-4

Performing Loan, Non-performing Loan and Loan Loss Provision of NIBL

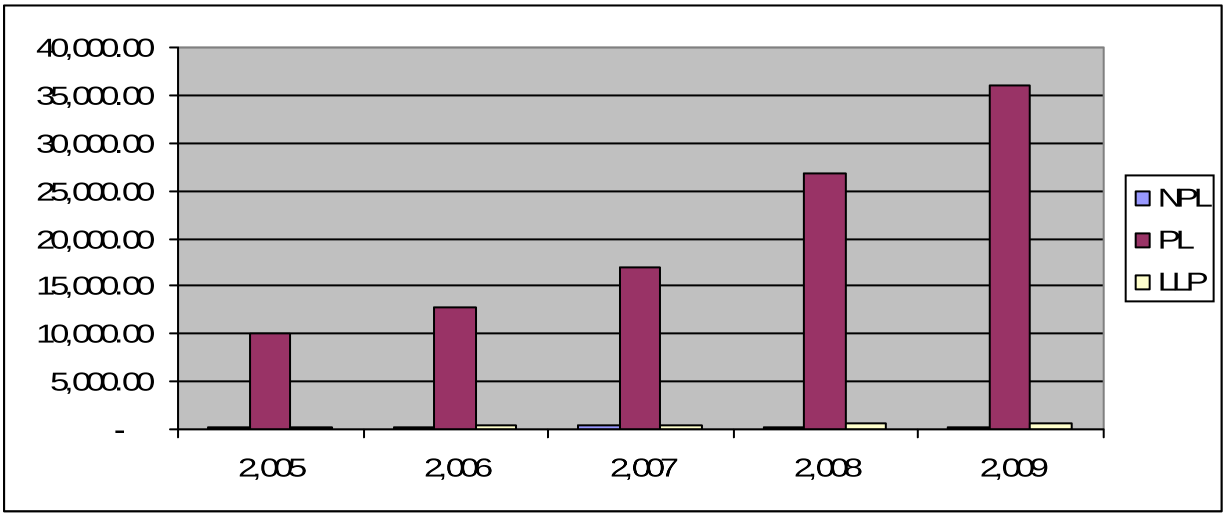


Figure IV- 5

Performing Loan, Non-performing Loan and Loan Loss Provision of NBBL

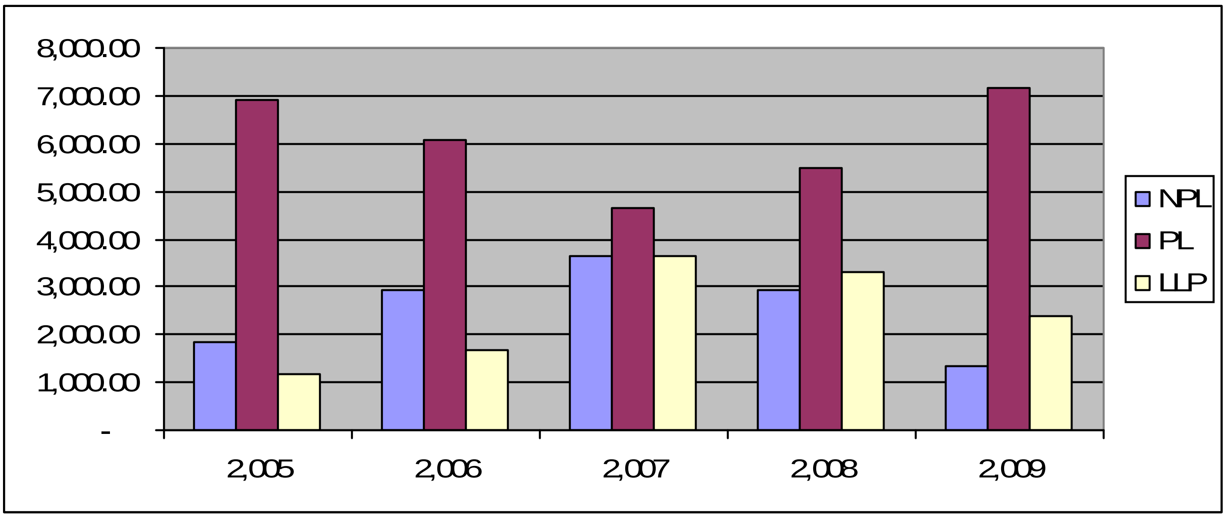


Figure IV- 6

Performing Loan, Non-performing Loan and Loan Loss Provision of NABIL

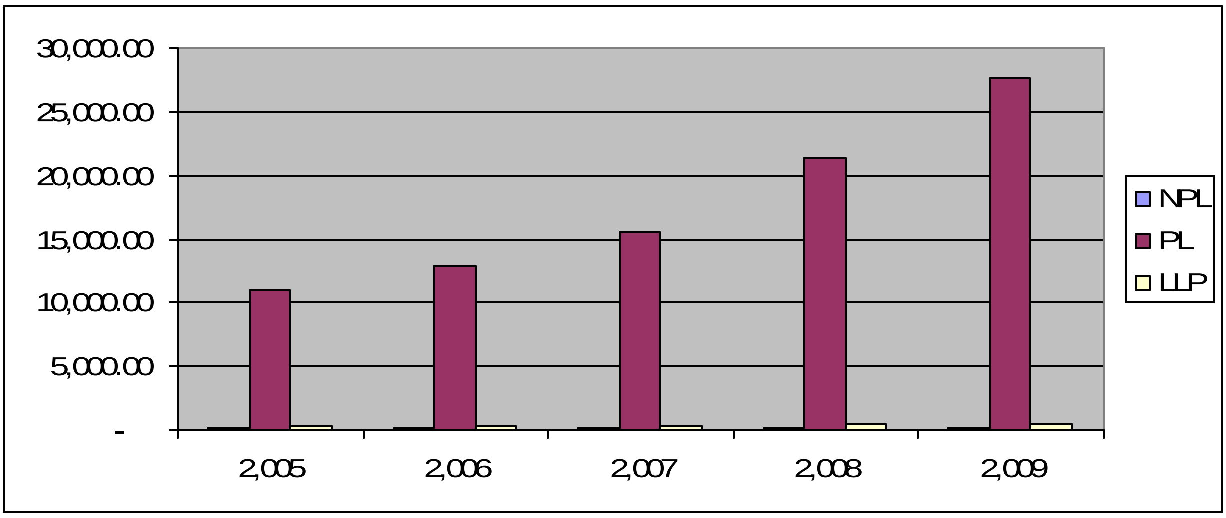
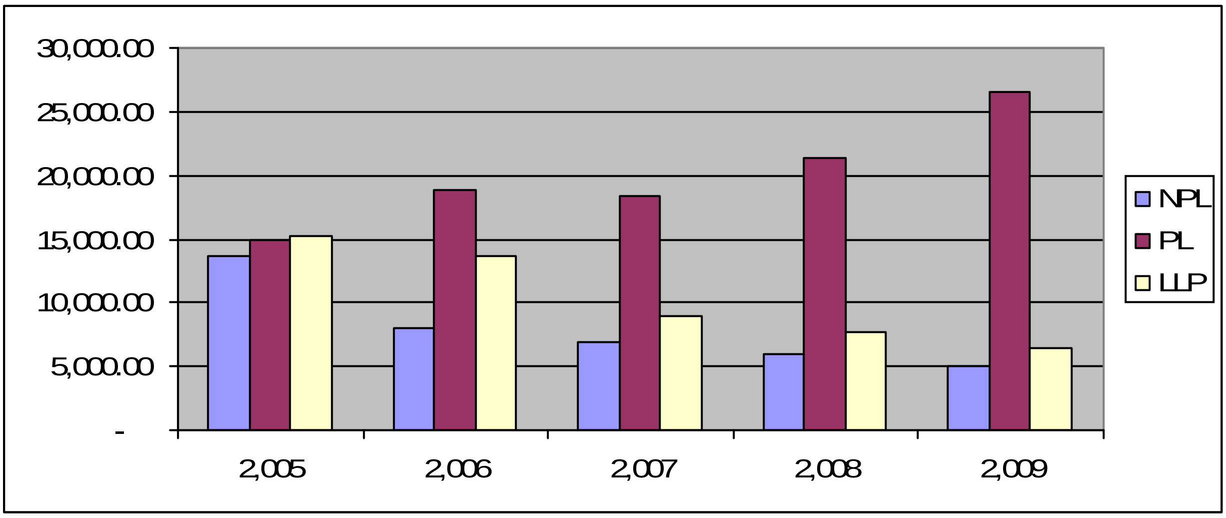


Figure IV- 7

Performing Loan, Non-performing Loan and Loan Loss Provision of RBB



4.1 Correlation Analysis

4.2.1 Correlation between Loan Loss Provision and Loans and Advances

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

Table IV- 10

Correlation between LLP and Loans and Advances

Base figures of latest 5 years

Banks	Correlation Coefficient (r)	Probable error (P.E)	6 P.E.
NIC	-0.31	0.27	1.64
NIBL	0.94	0.03	0.21
NBBL	-0.84	0.09	0.52
NABIL	0.66	0.17	1.02
RBB	-0.24	0.28	1.70

The above table No. 10 explains the relationship between loans & advance and loan loss provision. The correlation coefficient of NIC, NIBL, NBBL, NABIL & RBB are -0.31, 0.94, -0.84, 0.66 &-0.24 percent respectively. Here, NIC, NBBL and RBB have the negative correlation and other two NIBL & NABIL have positive correlation coefficient. On the other hand, NIC, NBBL, NABIL and RBB significant and reliable correlation coefficient as their correlation is less than 6PE. Similarly, NIBL has insignificant correlation coefficient as its correlation is more than 6PE during the period of study.

4.2.2 Correlation between Loan Loss provision and Non-performing loan

The correlation between LLP describes the relation between LLP & NPL. How a unit increases in NPL effects the LLP is exhibited by this correlation. Here, Non-performing loan is independent variable and LLP is dependent variable. As discussed earlier NPL are the loan falling on the category of substandard, doubtful and loss loan and the respective provisioning requirement is 25%, 50% and 100%. Higher the NPL higher will be the provisioning amount.

Table IV- 11

Correlation between LLP and NPL

Base figures of latest 5 years

Banks	Correlation Coefficient (r)	Probable error (P.E)	6 P.E.
NIC	0.39	0.25	1.53
NIBL	0.22	0.29	1.72
NBBL	0.61	0.19	1.14
NABIL	0.18	0.29	1.75
RBB	0.89	0.06	0.37

The above table No. 11 shows the relationship between LLP and NPL. The all banks show the positive relationship between them, which mean increment in NPL leads to increment of LLP. The correlation coefficient of NIC, NIBL, NBBL, NABIL and RBB are 0.39, 0.22, 0.61, 0.18 and 0.89 respectively. Since the correlation coefficient of RBB is greater than 6 times the value of P.E the correlation coefficients is reliable. In other words, the LLP of RBB is highly correlated with the non performing loans during the study period and the increases in LLP of banks are doe to increase in NPL. The correlation of NIC, NIBL, NBBL and NABIL are 0.39, 0.22, 0.61 and 0.18 respectively and it is less than 6 times the value of P.E. hence, there is positive correlation between NPL and LLP of those banks but correlation coefficient are insignificant.

4.2.3 Correlation between Loans and Advances and Total Deposit

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

Table IV- 12

Correlation between Loans and advances and Total Deposit

Base figures of latest 5 years

Banks	Correlation Coefficient (r)	Probable error (P.E)	6 P.E.
NIC	0.99	0.003	0.02
NIBL	0.99	0.001	0.007
NBBL	0.94	0.04	0.21
NABIL	0.99	0.007	0.05
RBB	0.63	0.18	1.09

The above table No. 12 shows that correlation between loans and advances and total deposits. It shows there is high degree of positive correlation between loans and advances and total deposits in all banks. The respective value of correlation coefficient of NIC, NIBL, NBL, NABIL and RBB are 0.99, 0.99, 0.94, 0.99 and 0.63 respectively, except RBB all values of correlation coefficient are greater than 6 times the value of their respective probable error. Hence, it can be interpreted that the correlation between these all banks are significant. That means increase in volume of total deposit leads to increment in loans and advances of all banks.

4.2.4 Correlation between Non-performing Loans and loans and Advances

This correlation coefficient shows the degree of relationship between the NPL and loans and advances. The NPL is independent variable and loans and advances is dependent variable. It shows how a unit of change of loans and advances effects to the NPL and what is the relation of them. It means how NPL is affected due to the change (increase or decrease) of loans and advances of banks.

Table IV- 13

Correlation between NPL and Loans and advances

Base figures of latest 5 years

Banks	Correlation Coefficient (r)	Probable error (P.E)	6 P.E.
NIC	-0.11	0.30	1.79
NIBL	0.04	0.30	1.80
NBBL	-0.22	0.29	1.72
NABIL	0.81	0.10	0.62
RBB	-0.08	0.30	1.79

The above table No. 13 shows the correlation coefficient between NPL and loans and advances. The correlation coefficient of NIC, NBBL and RBB are -0.11, -0.22 and -0.08 respectively which shows there is negative correlation coefficient but it is significant. Similarly, NIBL and NABIL have positive correlation coefficient between NPL and loans and advances but the NIBL have significant relation and NABIL have insignificant relation between NPL and loans and advances during the study period.

4.2.5 Correlation Coefficient between NPL and Total Assets

The correlation coefficient shows the degree of relationship between the NPL and total assets for the study period. In this correlation coefficient, NPL is independent variable and total assets are dependent variable. It shows how a unit of change in total assets affects the NPL.

Table IV- 14

Correlation between NPL and Total Assets

Base figures of latest 5 years

Banks	Correlation Coefficient (r)	Probable error (P.E)	6 P.E.
NIC	0.16	0.29	1.76
NIBL	0.06	0.30	1.80
NBBL	-0.63	0.18	1.08
NABIL	0.81	0.11	0.63
RBB	-0.51	0.22	1.34

The above table No. 14 shows the relationship between the NPL and total assets for five consecutive years. Here NIC, NIBL and NABIL show the positive correlation i.e. 0.16, 0.06 and 0.81 respectively. Where NBBL and RBB show the negative correlation i.e. -0.63 and -0.51. The correlation of NIC, NIBL NBBL and RBB are insignificant as their 6 P.E. is greater than their correlation coefficient. The correlation of NABIL is significant during the study period.

4.2 Trend Analysis

Trend analysis is a statistical tool, which helps to forecast the future values of different variables on the basis of past tendencies of variable. Trend analysis informs about the expected future values of various variables. Among the various methods to determine trend the least square method is widely used in practices. Hence in this study also least square method has been adopted to measure the trend behavior of these selected banks. However, trend analysis is based on the assumption that past tendencies continues in the future. Under this heading the effort has been made to calculate trend values of following variables from mid July 2004 to mid July 2009 and forecast is done for next five years from mid July 2010 to mid July 2014.

4.3.1 Trend analysis of Loans and advances

The values of average loans and advances (a) rate of change of loans and advances (b) and trend values of loans and advances five banks for 10 years from mid July 2005 to mid July 2014 are as follows.

Table IV- 15

Trend Value of Loans and Advances

Figures if Million

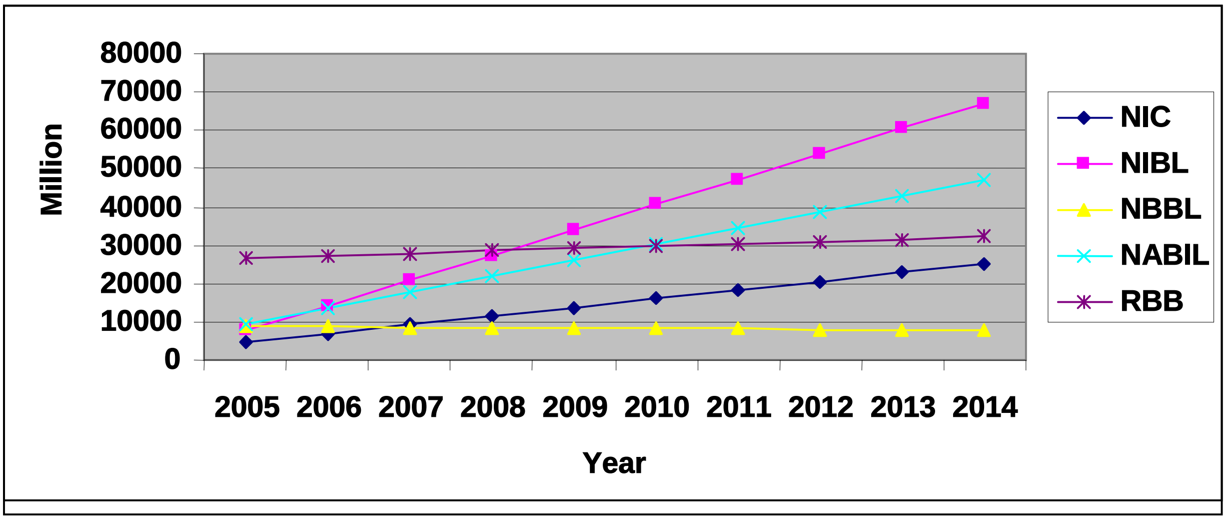
Mid July	Banks				
	NIC a=9244.32 b=2255.15	NIBL a=20836.1 b=6604.83	NBBL a=8596.24 b= -105.45	NABIL a=17817.52 b=4197.05	RBB a=27902.06 b=619
2005	4734.02	7626.44	8807.14	9423.42	26664.06
2006	6989.17	14231.27	8701.69	13620.47	27283.06
2007	9244.32	20836.1	8596.24	17817.52	27902.06
2008	11499.47	27440.93	8490.79	22014.57	28521.06
2009	13754.62	34045.76	8385.34	26211.62	29140.06
2010	16009.77	40650.59	8279.89	30408.67	29759.06
2011	18264.92	47255.42	8174.44	34605.72	30378.06
2012	20520.07	53860.25	8068.99	38802.77	30997.06
2013	22775.22	60465.08	7963.54	42999.82	31616.06
2014	25030.37	67069.91	7858.09	47196.87	32235.06

The above table No. 15 shows that four banks have an increasing trend of loans and advances. Similarly, NBBL have decreasing trend of loans and advances because it have negative increasing rate of -105.45 Million per year. The average loans and advances of NIC is Rs. 9244.32 million which is increasing at the rate of 2255.15 million every year. Hence, expected loans and advances of NIC are supposed to increase from Rs.16009.77 in 2010 to 25030.37 in 2014. NIBL's average loans and advances is 20836.01 and are increasing every year at the rate of Rs.6604.83. Accordingly loans and advances of NIBL's are expected to be increase from Rs.40650.59 in 2010 to 67069.91 million in 2014. The average loans and advances of NBBL is 8596.24 million and decreasing every year at the rate of 105.45 million. Accordingly loans and advances of NBBL are expected to be decrease from Rs. 8279.89 in 2010 to 7858.09 million in 2014. The average loans and advances of NABIL are 17817.52 which is increasing at the rate of Rs. 4197.05 million every year. Hence, the expected loans and advances of NABIL are supposed to increase from Rs. 30408.67 million in 2010 to 47196.87 million in 2014. Similarly, the average loans and advances of RBB are 27902.06 and increasing at the rate of Rs. 619 million every year. Accordingly loans and advances of RBB are expected to be increase from Rs. 29759.06 million in 2010 to 32235.06 million in 2014.

NIBL has the highest increasing trend among the five commercial banks. Even though, RBB, NABIL and NIC shows increasing trend, rate of increment of these three banks is lower than NIBL. Similarly NBBL has increase its Loan and advances in 2006 comparison to 2005, then it is decrease by around 708 million in 2007, after that loan and advances of NBBL has got slight increasing trend. As a result, it has the negative trend value of loans and advances. From this it can be interpreted that NIBL, RBB, NABIL and NIC has policy of increase in investment of loans and advances. Following figure No.8 represents the trend line of loans and advances of five banks for 10 consecutive years.

Figure IV-8

Trend value of loans and advances



4.3.2 Trend Analysis of Non-Performing Loan

The calculated values of average non-performing loan (a) role of change of NPL (b) and trend value of NPL for 10 years from mid July 2005 to mid July 2014 are as follows.

Table IV-16

Trend Value of Non-Performing Loan

Figures if Million

Mid July	Banks				
	NIC a=317.50 b=-20.59	NIBL a=317.34 b=7.91	NBBL a=2541.42 b=-93.57	NABIL a=179.51 b=14.12	RBB a=7903.81 b=-1956.04
2005	358.68	301.52	2,728.55	151.262	11815.89
2006	338.09	309.43	2,634.99	165.384	9859.85
2007	317.50	317.34	2,541.42	179.506	7903.81
2008	296.91	325.26	2,447.85	193.628	5947.78
2009	276.32	333.17	2,354.28	207.75	3991.74
2010	255.73	341.08	2,260.71	221.872	2035.71
2011	235.14	348.99	2,167.15	235.994	79.67
2012	214.55	356.91	2,073.58	250.116	-1876.37
2013	193.96	364.82	1,980.01	264.238	-3832.40
2014	173.38	372.73	1,886.44	278.36	-5788.44

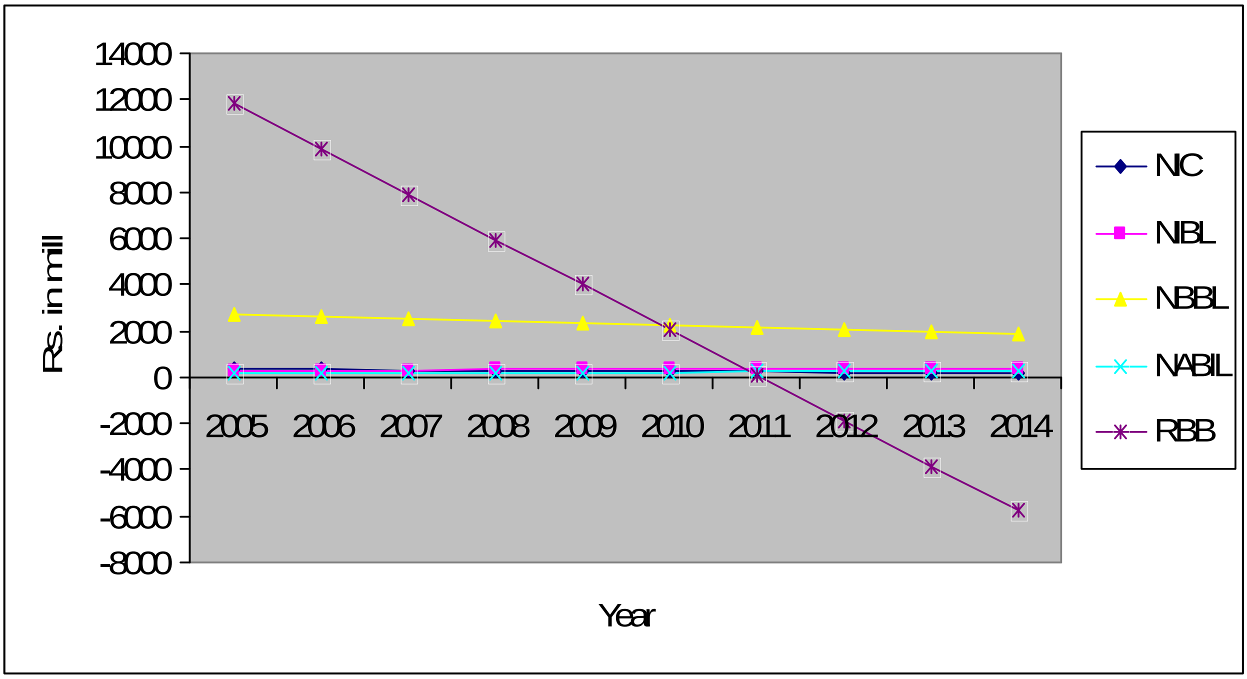
The above table No. 16 shows that NIC, NBBL and RBB has decreasing trend but NIBL and NABIL have increasing trend of NPL. The average NPL of NIC is Rs.317.50, which is decreasing at the rate of Rs. 20.59 million every year. NPL is expected to decrease from Rs.255.73 in 2010 to Rs.173.38 million in 2014. NIBL's average NPL is Rs.317.34 million, which is increasing every year at the rate of Rs.7.90 million. Hence, the expected NPL of NIBL is supposed to increase from Rs.341.08 million in 2010 to Rs. 372.73 million in 2014. The average NPL of NBBL is Rs.2541.42 million which is decreasing at the rate of Rs.93.57 million every year.

Accordingly NPL of NBBL is expected to decrease from Rs.2260.71 million in 2010 to 1886.44 million in 2014.

NBBL have significantly high non-performing loans in the total volume of loans and advances; however it is in decreasing trend due to efforts of recovery cell. NIBL and NABIL have also high non-performing loans. It also shows increasing trend, if this trend continuous NIBL and NABIL will also be severally affected by the problem of increasing non-performing loan. Even though NPL of NIC, NIBL, NABIL and RRB are relatively lower than the NPL of NBBL. Following figure No. 9 represents the trend line of non-performing loans of five banks for 10 years.

Figure IV-9

Trend value of Non-Performing Loan



4.3.3 Trend Analysis of Loans Loss Provision

The calculated value of average loan loss provision (a) rate of change of LLP (b) and trend values of LLP for 10 years from mid July 2005 to mid July 2014 of the five banks are as follows.

Table IV-17

Trend Value of Loan Loss Provision

Figures if Million

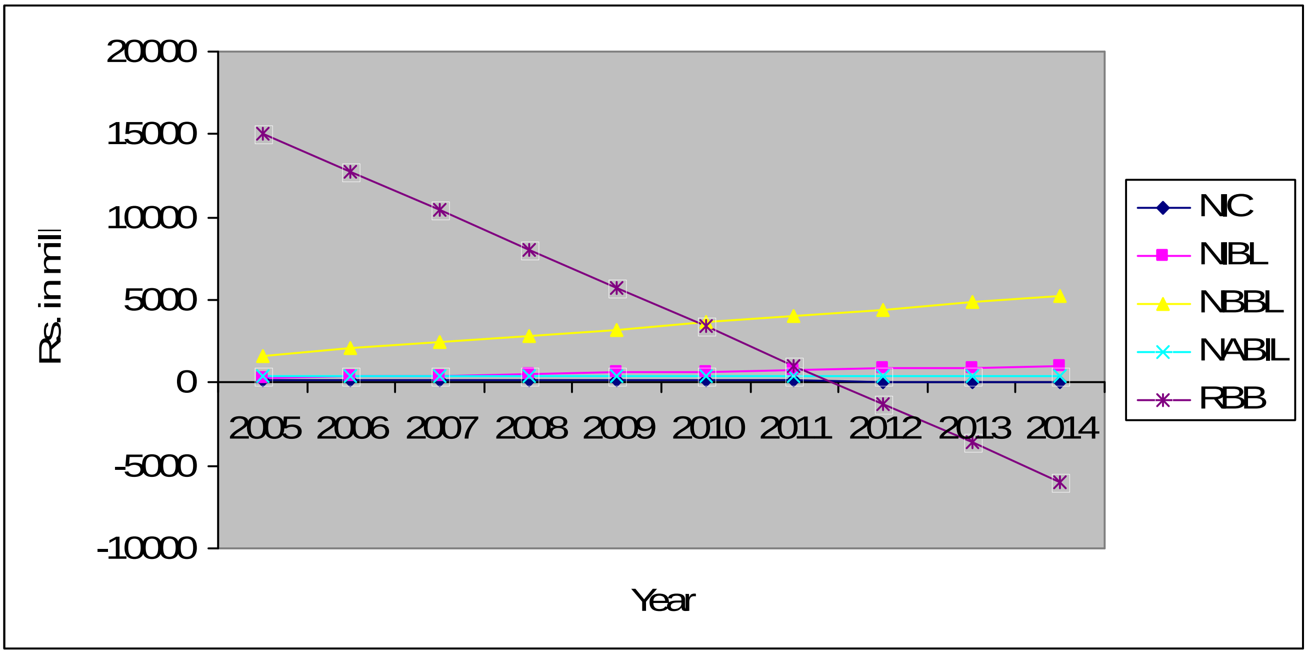
Mid July	Banks				
	NIC a=173.08 b=-17.40	NIBL a=438.96 b=81.93	NBBL a=2437.56 b=399.31	NABIL a=382.98 b=8.59	RBB a=10393.56 b=-2334.57
2005	207.88	275.10	1,638.94	365.8	15062.70
2006	190.48	357.03	2,038.25	374.39	12728.13
2007	173.08	438.96	2,437.56	382.98	10393.56
2008	155.68	520.89	2,836.87	391.57	8058.99
2009	138.28	602.82	3,236.18	400.16	5724.42
2010	120.88	684.75	3,635.49	408.75	3389.85
2011	103.48	766.68	4,034.80	417.34	1055.28
2012	86.08	848.61	4,434.11	425.93	-1279.29
2013	68.68	930.54	4,833.42	434.52	-3613.86
2014	51.28	1012.47	5,232.73	443.11	-5948.43

The above table No.17 shows that NIC, NBBL and RBB has decreasing trend but NIBL and NABIL has increasing trend of Loan Loss Provision. The average LLP of NIC is Rs.173.08 million, which is decreasing at the rate of Rs.17.40 every year. LLP is expected to decrease from Rs.120.88 million in 2010 to Rs.51.28 million in 2014. NIBL's average LLP is Rs.438.96 million, which is increasing at the rate of Rs.81.93 million every year. The expected LLP of NIBL is supposed to increase from Rs.684.75 million in 2010 to Rs.1012.47 million in 2014. The average LLP of NBBL is Rs.2437.56 million, which is increasing every year at the rate of Rs.399.31 million. Hence, the expected LLP of NBBL is supposed to increase from Rs.3635.49 million in 2010 to Rs.5232.73 million in 2014. The average LLP of NABIL is Rs.382.98 million, which is increasing at the rate of Rs.8.59 every year. The expected LLP of NABIL is increasing from Rs.408.75 million in 2010 to Rs.443.11 million in 2014. The average LLP of RBB is Rs.10393.56 million, which is decreasing at the rate of Rs.2334.57 every year. The expected LLP of RBB is supposed to decrease from Rs.3389.85 million in 2010 to Rs.-5948.43. The above calculation shows the negative figure of

LLP of RBB. Banks should provision at least 1% for the pass category loan. So, LLP should not in negative figure. However, it is in decreasing trend. The LLP of NIC, NABIL and RBB is lower than the other two banks, NBBL and NIBL, they shows increasing trend which is an indication of increment of NPL in the total assets quality. Following figure No. 10 represents the trend line of LLP of five banks for 10 years.

Figure IV-10

Trend value of Loan Loss Provision



4.3.4 Trend Analysis of Net profit

The calculated values of average Net profit (a) rate of change of Net profit (b) and trend values of Net profit for ten years from mid July 2005 to Mid July 2014 of the five banks are as follows:

Table IV- 18

Trend Value of Net profit

Figures if Million

Mid July	Banks				
	NIC a=185.80 b=55.20	NIBL a=536.07 b=168.40	NBBL a=311.66 b=850.18	NABIL a=721.38 b=113.31	RBB a=1758.48 b=90.68
2005	75.40	199.28	(1,388.70)	494.77	1577.12
2006	130.60	367.67	(538.52)	608.077	1667.80
2007	185.80	536.07	311.66	721.384	1758.47
2008	241.00	704.47	1,161.84	834.691	1849.15
2009	296.20	872.86	2,012.02	947.998	1939.83
2010	351.40	1041.26	2,862.20	1061.305	2030.51
2011	406.60	1209.66	3,712.38	1174.612	2121.19
2012	461.80	1378.06	4,562.56	1287.919	2211.86
2013	517.00	1546.45	5,412.73	1401.226	2302.54
2014	572.20	1714.85	6,262.91	1514.533	2393.22

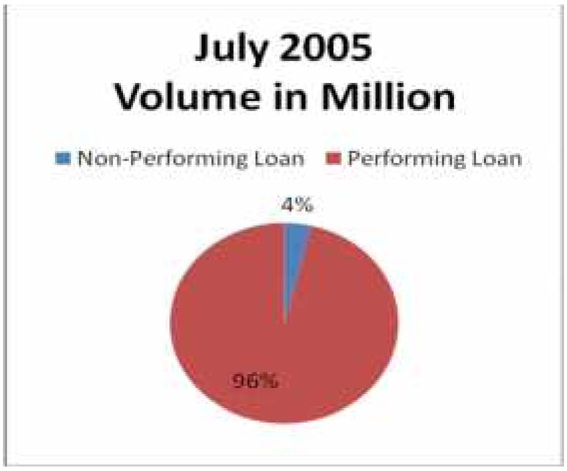
The above table no18 shows that all the banks have increasing trend of net profit. NBBL has the net loss during first two years but other three years it has increasing trend in Net profit.

4.4 Comparison of Credit Quality of Subjected Banks:

In the following figures there is a comparison between the year 2005 and 2009 that is what had happened within five years.

Figure IV-12

Comparison of Credit Quality of NIC



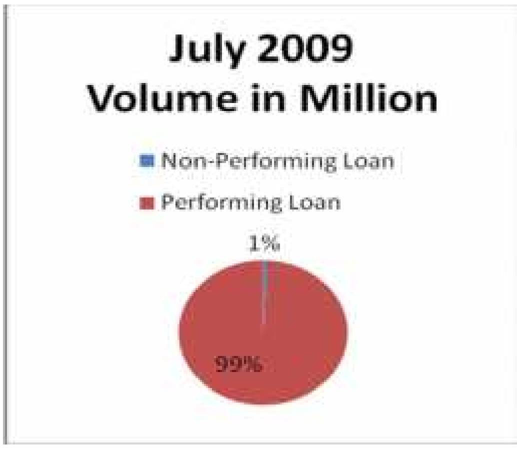
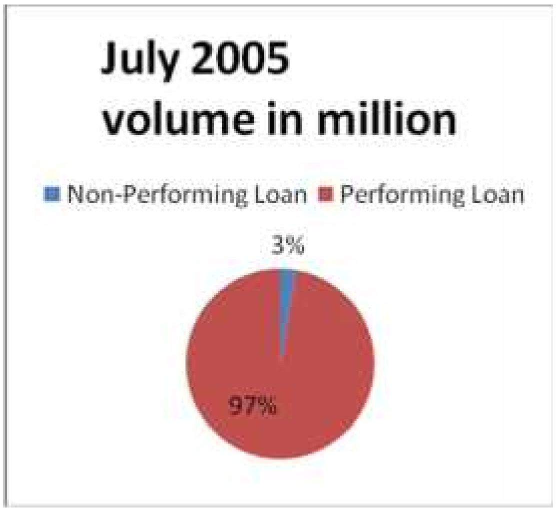


Figure IV- 13

Comparison of credit quality of NIBL



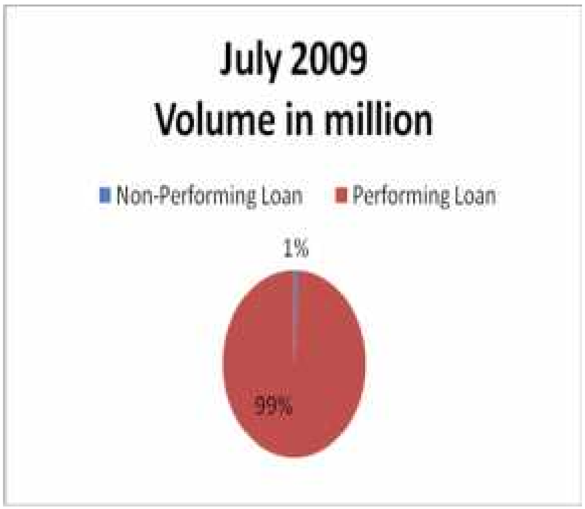
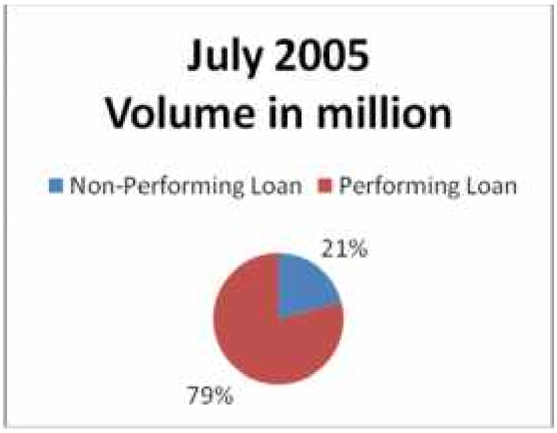


Figure IV- 14

Comprison of credit quality of NBBL



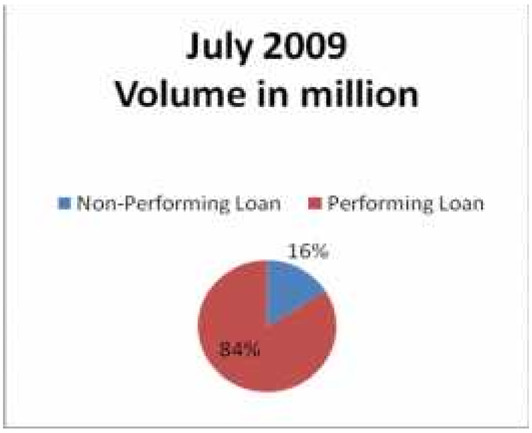
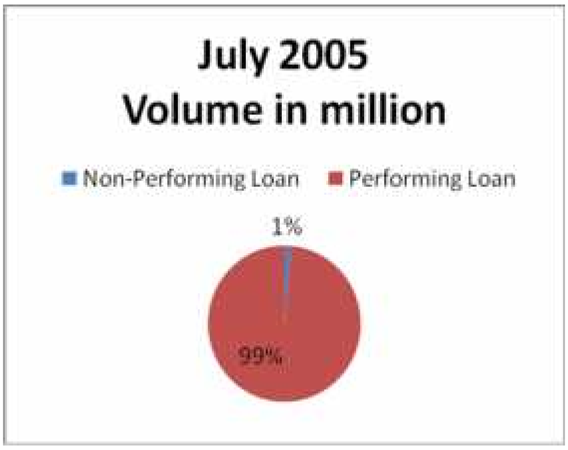


Figure No. 15

Comprison of credit quality of NABIL



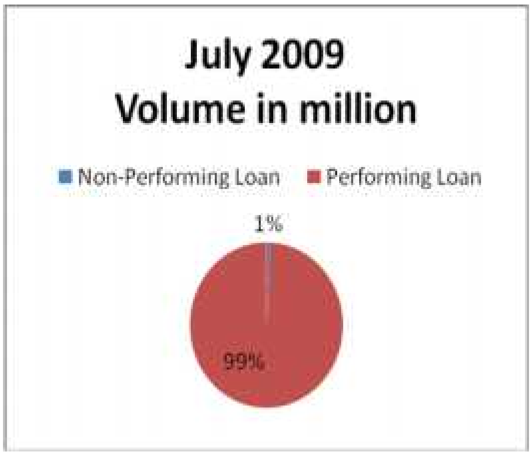
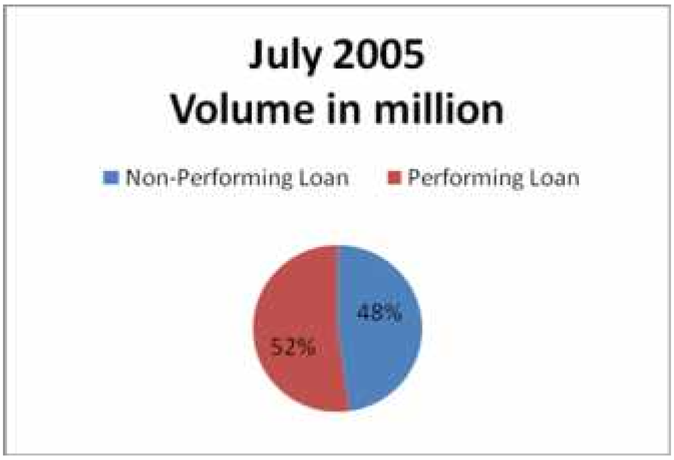
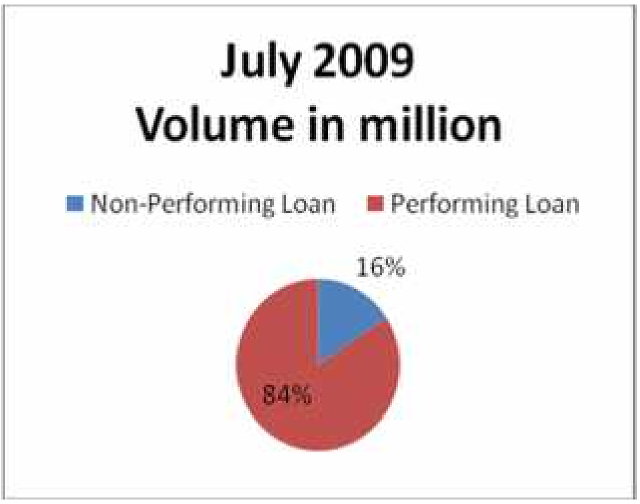


Figure No. 16

Comprison of credit quality of RBB





4.5 Major findings of the study:

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

- The average loans and advances to total assets ratio of NIC, NIBL, NBBL, NABIL and RBB are found to be 26.13 percent, 63.2 percent, 54.57 percent 56.54 percent and 33.78 percent respectively during the study period. The low ratio of NIC and then RBB is the indication of risk averse attitude of the management or they have policy of investing low in the risky assets like loans and advances. It has higher proportion of their investment in risk free assets like treasury bills, national saving bonds etc.In case of RBB, it can be said that the bank has adopted tight strategy regarding the investment in risky assets as showns by its five years ratio comparatively. NIBL and NABIL have the higher ratio, which indicates they are aggressive in investment on risky assests on the other hand also indicates that low degree of safety interms of liquidity.

- The loans and advances to total deposit or CD ratio shows the how successfully the bank uses their collected fund in loans and advances. It means that it indicates the mobilization of resources. The average CD ratio of NIC, NIBL, NBBL, NABIL and RBB are 84.81 percent, 73.75 percent, 78.30 percent, 70.44 percent and 53.65 percent respectively. NIC has the highest average ratio but the RBB has the relatively lower ratio.The average ratio of NABIL and NIBL is relatively moderate. Even though NABIL and NIBL has relatively higher ratio, and least deviation ratio during the period of study as a result these two banks have least covariance in comparison to other three banks which indicates that the least consistentancy. Whereas at the same period, RBB has the higher deviation and variation though it has low CD ratio. NIBL has the least deviation as well as variablity during the study period.

- The average ratio of non-performing loans to total loans and advances indicates the proportion of non-performing loans to total loans and advances. The average ratios of NIC, NIBL, NBBL, NABIL and RBB are 3.83 percent, 1.84 percent, 29.66 percent, 1.09 percent and 28.51 percent respectivley. That means 96.17 percent, 98.16 percent, 70.34 percent, 98.91 percent and 71.49 percent of performing loans of NIC, NIBL, NBBL, NABIL and RBB are respectively. RBB and NBBL have relatively the higher ratio of NPL to total loans and advances while NABIL has the least ratio. NIC and NIBL also has least ratio but not less the NABIL.

- Loan loss provision of RBB is found to be significantly higher which is around 37.63 percent. NBBL has also relatively the higher ratio i.e.,28.65 percent. NIBL, NABIL and NIC have the average ratio i.e.2.30 percent and 2.38 percent and 2.24 percent respectively.Since higher ratio is an indication of higher non-performing loan in the total loans and advances RBB's significantly higher ratio is the result of higher proportion of NPL in the total loans.Even though NBBL also has relatively higher ratio of NPL in the total loans and advances than other three banks, it is able to bring it in decreasing trend in last five years.

- The average ratio of provision held to non-performing loan of NIC, NIBL, NBBL, NABIL and RBB was found to be 87.26 percent, 140.13 percent, 101.89 percent, 217.15 percent and 134.17 percent respectively.NABIL has significantly higher ratio in comparison to other four banks, which portrays that the bank has adequate provision against non-performing loan but this ratio of NIC and NBBL is comparatively lower. NIBL and RBB are moderate in this ratio, where, RBB has the least deviation and NIC shows the highest variability in this ratio.

- The main objectives of the commercial banks is to earn profit through out the mobilization of the funds. The role of return on loans and advances revealed that how far banks are able to earn or failed to earn return on loans and advances.Though looking back the past two years NBBL & RBB failed to earn return or least rate of return but during the recovery period of their past three years ratio shows how these two banks efficiently recovered it’s bad loans which turn into higher rate of loans and advances i.e., 3.94 and 6.3 respectively. RBB with an average of 6.31 percent return on loans and advances has the highest ratio as it is ahead in generating net profit and NABIL has recorded second highest return on loans and advances i.e,4.21.NIBL and NBBL are moderate with an average of 2.57 percen t and 3.94 percent respectively return on loans and advances. NBBL has the highest variablility where as RBB has the least variablility during the study period.NIC has the lowest rate of return among five banks and least deviation .

- The correlation coefficient between LLP and loans and advances of NIC, NIBL, NBBL, NABIL & RBB are -0.31, 0.94, -0.84, 0.66 & -0.24 respectively. Here, correlation coefficient of NIC, NBBL and RBB is negative and other two banks NIBL and NABIL have positive correlation. It is found that NIBL and NBBL have the significant and reliable correlation coefficient as their correlation is less than 6P. NIC,NABIL and RBB have the insignificant correlation coefficient as it is found their correlation coefficient is greater than more than 6P.E.

- The correlation between LLP and NPL reveals that there is positive correlation between LL P and NPL in all the five banks. As earlier, mentioned higher provision needs to be provided for NPL, higher the NPL higher would be the LLP. The correlation coefficients between these two variables in NIC,NIBL, NBBL, NABIL & RBB are 0.98, 0.22, 0.61, 0.18 and 0.89 respectively.The correlation coefficient between loan Loss Provising and Non Performing loan of all five banks are significant, however it is found relatively lower correlation coefficient in NABIL. The reason behind this is relatively lower proportion of NPL in total loan portfolio of NABIL.

- While analyzing correlation betweeen loans and advances and deposit, it has been found that all five banks have higher degree of positive correlation between these two variables, however RBB has lower degree of correlation coefficient between these two variables. The respective correlation coefficient of NIC, NIBL, NBBL and NABIL are 0.99, 0.99,0.94 and 0.99 which are significant reliable. RBB correlation coefficient is insignificant.

- The correlation between NPL and loans and advances shows the degree of relationship of NPL and total assets of commercial banks. The correlation of NIC, NIBL,NBBL , NABIL and RBB are -0.11,0.04,-0.22,0.81 and -0.08 respectively. NIBL and NABIL have positive correlation coefficient between NPL and loans and advances where as other remaining three banks have negative correlation between these two variables. Similarly,among five banks four banks except NABIL correlation coefficient are insignificant but NABIL has significant relationship between these two variables as it's correlation coefficient is less than 6P.E.

- The correlation between NPL and total assets shows the degree of relationship of NPL and total assets of commercial banks. The correlation of NIC, NIBL, NBBL,NABIL and RBB are 0.16, 0.06, -0.63, 0.81 and -0.51 respectively. NBBL and RBB have negative correlation coefficient and other three banks have positive correlation coefficient between these two variables. However, NABIL has significant relation between these variables as it's correlation coefficient is less than 6P.E.

- Trend analysis was done on the basis of past five years and forecast was made for next five years. The trend of loans and advances showed increasing trend in four banks except in NBBL which has shown slightly decreasing that is because of its negative rate of value of trend in loans and advances i.e with

Rs.105.45million in next forecasted years.It could be said due to first two years of study period bank has increased its lending with around Rs.1000 million but after consecutive next three years it has adopted conservative policy for the lending. Among other four banks NIBL has higher rate of increament i.e Rs.6604.83million.Similarly, NIC, NABIL and RBB have forcasted rate of Rs.2255.15million,Rs.4197.05million and Rs.619million every year respectively.

- From the trend analysis of NPL, it is found that NPL is increasing incase of NIBL and NABIL however in case of NIC, NBBL and RBB it is in decreasing trend. In case of dreasing trend in NIC, NBBL and RBB it is found decreasing at the rate of Rs.20.59million, Rs.93.57million and Rs.1956.04million respectively in every year which is could be said due to it's effective efforts towards recovering baddebts.

- From the trend analysis of LLP, it is found that LLP is expected to increase in coming year in case of NIBL, NBBL and NABIL and incase of other two banks NIC and RBB it is expected to decrease.The LLP of NIBL,NBBL and NABIL are increasing at the rate of Rs.81.93million, Rs.399.31 million and Rs.8.59 million every year respectively. Similarly, In case of NIC and RBB, LLP is decreasing at the rate of Rs.17.40million and Rs.2334.57million respectively. These could be said due to the expected actions towards reducing the NPL throug effective efforts in recovery of bad loans.

- From the trend analysis of net profit, it is found that NP is expected to increase in all five banks.But comparatively, among five banks NBBL is expected to increase it's net profit in coming years at the rate of Rs.850.18million every year.Similarly, NIBL and NABIL are expected to increase their net profit at the rate of Rs.168.40million and Rs.113.31million every year respectively. However, in case of NIC and RBB the net profit increase at the rate of Rs.55.20 million and Rs.90.68 million respectively.

CHAPTER-V
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Banking sector has occupied an important role in the economic development of any country. The existence of a well commercial banking system is one of the strengths of an efficient financial sector. The main objective of the commercial bank is to collect or accept an ideal and unproductive saving of a kind of customers through different accounts and encourage the other to use the same in same productive and profitable projects. But, commercial banks are facing more or less problems which hinder them to meet their desired objectives. Among such problems Non-Performing loan is also the serious issue of the commercial banks.

This research has aimed at studying the non-performing loan in Nepalese commercial banking sector and recommending the reasonable solution for the management of non-performing loan. It is also studied the different aspects of the implementation of NRB directives by the 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 loans results in the increment in the volume of loan loss provision of the banks which ultimately results in decline if net profit of the banks. For the purpose of the study, descriptive as well as analytical research design had been adapted. Out of the total 26 commercial banks five banks were taken as sample using judgmental sampling method. Sample was selected considering the level of NPL. NIC, NIBL, NBBL, NABIL and RBB were taken as sample for the study.

The study used both primary as well as secondary data; the primary data were based on questionnaire and interviews conducted with the employees of concerned departments of banks while secondary data were collected mainly from financial statements and websites of the sampled banks. The data collected from various sources were recorded systematically and presented in appreciated form of tables and charts. And these data were analyzed using different mathematical, statistical, financial and graphical tools. The bank selected for the study consists of private sector as well as public sector banks. The study was made for the year 2005, 2006, 2007, 2008 and 2009 i.e. FY 2061/62, 2062/63, 2063/64, 2064/65 and 2065/66. Similarly, trend analysis is done to forecast the future.

NIBL has the highest proportion of the loans and advances in the total assets structure followed by NABIL, NBBL, RBB and NIC. NIC has relatively lower loans and advances on the total asset structure. Though comparatively NIC's ratio of total loans and advances is lower it doesn't reflects that banks lending is lower than others, however it's due to the effect of total assets proportion. So, Credit deposit ratio shows the same for the bank that is 84.81 percent. In spite of the acceptable Credit deposit ratio all banks have more than 50 percent in average. It also shows risk adverse attitude of management of RBB which is comes around 53.65 percent than other four banks. Accordingly, variation between the credit and deposits of these banks also reflects their lending attitude; among all five banks RBB has the highest variability between the lending and deposit where as NIBL has the least one. NIC, NIBL and NABIL have the least NPL and as a result have least LLP. The less orientation towards lending has made this back successful to have low non-performing loans. On the other hand, it can be said that these banks are able to maintain below the acceptable level of non-performing loans in their total loans i.e., 5 percent. Even though NBBL and RBB has achieved remarkable return during last two years, there nonperforming loans in total loans is much more higher than acceptable loans i.e.,29.66 percent and 28.51 percent respectively and thus as a result has higher in provision in loan loss. However, the high return of NABIL than other two banks is not only the proper lending function but due to low deposit cost, high fee based income, high deposit of foreign currency and exchange earning e.t.c

There is positive correlation between two banks i.e., NIBL and NABIL in their loan loss provision and loans and advances and other three banks, NIC, NBBL and RBB have negative correlation which is due to increment in loans and advances. Amount to be provisioned depends upon the non-performing loans and its quality. Correlation between LLP and NPL of all five banks shows the positive relationship and showing significant reliable results. However, data has shown that banks whose NPL is comparatively high has made provision more and vice versa. In case of correlation between loans and advances and total deposits all banks have positive relationship however in case of NIC, NIBL and NABIL have to put concern to increase the total deposits in compare to total loans and advances because loans and advances increases when deposits increases.

5.2 Conclusions:

Before globalization and financial liberalization in the mid 1980s only two commercial banks that are Nepal Bank Ltd. and Rastriya Banijya Bank in operation. The liberalization paves the way for the establishment of private banks including the foreign joint ventures. As a result, at present twenties commercial banks are in operation. Banking system of Nepal has undergone through significant change since liberalization. Free market operation in the area of interest rate, foreign exchange rate and diversified banking products which are latest developments in the banking sector. Though banking system in Nepal is not so multifaceted when compare to that of developed countries, it has definitely grown to become more complex in recent years.

Further, Electronic and Internet Banking services offered by the commercial banks indicated adaptation of advanced technologies and it has placed additional supervisory concern and challenges. NRB has recognized and accepted those challenges. Steps are taken to strengthen supervisory capacity by increasing efficient and professional manpower and introducing new technologies.

Lending as the function of any commercial bank and it is the most income generating assets 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. NPL arises due to lack of guiding roles at the beginning and also comprises of credit appraisal, poor credit appraisal, poor credit monitoring, lack of timely recovery action, economic slowdown, borrowers' misconduct and overvaluation of collateral etc.

From the study, it has been found that NBBL and RBB have very high portion of NPL resulting higher provision, Hence, even the bank has the higher investment in the most income generating assets (riskier assets) they have to take stringent action to control over the loans turn in bad loans and efficient recovery measures to recover those loans that had turn into bad ones. In case of other three banks they are in satisfactory condition, NABIL can be said based on these indicators that, one of the good bank as the NPL is among all four banks it has lowest and maintain the satisfactory CD ratio though RBB has lowest then it but it's due to control over the lending in few years back after the huge loss due to default.

In conclusion, it can be said that ineffective credit policy, political pressure to lend to un credit worthy borrower's, overvaluation of collateral are the major causes of occurring NPLs. Similarly, lack of periodic supervision and monitoring, 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 actions to counter deterioration in quality of their loan and advances. Likewise, regular, 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. Formulation of special recovery policies for short period of time, formation of National Credit Restructuring cell, hiring Assets Management Company are also measures to resolve the problem of NPL.

Finally, it can said that the level of NPL in sampled commercial banks not very alarming but if the same trend of lending remained in up comings days, no doubt the situation will become unmanageable and serious. However, regarding these the NRB time to time circulars toward the commercial banks for different prevention actions and directives are circulated based on which the commercials banks should take prevention. So, the commercial banks should give full attention towards supervising their lending and recovering their bad loans perfectly.

5.3. Recommendations

- As going through out the findings it has found out that two makes RBB and NBBL should be more serious regarding bringing down the NPL below the acceptable level. As well as it is also recommended that NIC should also be more conscious regarding the NPL and CD ratio. They should make remedial actions for new loans. Hiring Assets Management Company is recommended to these banks to reduce the current NPL.

- NABIL contribution of loans and advances is relatively low. Entire economy is largely dependent upon the proper execution of lending function by commercial banks. Low level of lending means, low level of investment resulting to low level of productivity, which may ultimately affect negatively on the national economy. Loans and advances on one hand is the highest income-generating asset and on the other hand it also helps to upgrade the economic health of the country. Hence, NABIL is recommended to increase its investments in productive sector in the form of loans and advances.

- Policy should be formed in such a way that more and more NPL should be recovered. It is always better to get principle rather loose principle and interest both. That's why, reduction in interest rate/penalty interest rate, rescheduling, waiver of whole or part of interest due can be followed.

- Faulty credit analysis of project is one of the major causes of non-performing loan. Therefore, effective credit analysis of project should be made before giving loan to borrowers.

- It is always better to write of the unproductive loans. That's why write off should be continued in the policy of banks.

- If the collateral given to banks can be marketed easily, if the borrowers are willful defaulter, then it would be better to seek legal treatment. Collateral should be auctioned as fast as possible.

- Banks should revamp their financial supervisory system concerned with the health of bank management, introduction of a strict accounting system and transparency in managerial level. Moreover, improvement in corporate governance, including elimination of cronyism and transparency of corporate management should be advanced under government initiatives.

- All these five banks are recommended to go through the NRB directives and they are also suggested to come up with a strong internal audit department to ensure that the directives are properly implemented.

- All the efforts become in vain unless human resources are trained and motivated. Periodic/workshop/seminar should be conducted to update and upgrade the knowledge and skills of the employees regarding NPL.

- Bank approach to comprise as a recovery option will be based an analysis of bank's strength and weaknesses. The parameters for such analysis should be quality of assets charged to bank, collateral cover i.e. its value and marketability, means of borrower, stage of legal action etc. Based on the status of borrowers and depending on the merits of each case, waiver either in full or part of interest or penal interest if charged can be done.

- It is better to take prevention measures before the loans turn into bad loans. So, full effort by banks should be a given for gathering lot of information about the activities of its borrowers and proper supervision and monitoring of collateral.

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APPENDIX I
Brief profile of the subjected Banks

The following are the brief introduction of the subjected banks of this research:

- NIC Bank Limited

NIC Bank Limited was established in 1998 under the company Act, 1964 with an objective of carrying out commercial banking activities under the commercial bank act, 1974. Which was started its operation from Biratnagar and newly structured products cover personal loan, home loan, vehicle loan mortgaged loan, education loan, time loan etc. NIC bank limited assures its excellence in the offering of its products and services. Bank direction is guided towards obtaining new challenges and opportunities.

Performance Review

Total deposit of the bank reached Rs.15579.9 million and Loan and advances was Rs.13889.3 million till Mid-July 2009. The total income of the bank was Rs.317 million in Mid-July 2009. The NPL of the bank was at 0.89% of the loan and advances as at mid-July 2009.

- Nepal Investment Bank Limited

Nepal investment Bank Limited (NIBL), previously Nepal Indosuez Bank Limited, was established on 21st January 1986 as a third joint-venture bank under the company act, 1964. The bank is managed by Banquet Indosuez Paris in accordance with joint-venture and technical services agreement signed between it and Nepali promoters. The main objective of the bank is to provide loans and advances to the agriculture, industries and commerce and to provide modern banking services to the people.

Performance Review

Total deposit of the bank reached Rs.46697.9 million and Loan and advances was Rs.36250.4 million till Mid-July 2009. The total income of the bank was Rs.900.62 million in Mid-July 2009. The NPL of the bank was at 0.83% of the loan and advances as at mid-July 2009.

- Nepal Bangladesh Bank Limited

Nepal Bangladesh Bank Limited, a joint-venture bank with IFIC Bank limited of Bangladesh, was established in June 1994 under the Company act, 1964. The prime objective of this bank is to render banking services to the different sector like industries, traders, businessman, priority sector, small entrepreneurs and weaker section of the society and every other people who need banking services. The bank is managed IFIC Bank Limited, Bangladesh in accordance with the joint venture and technical services.

Performance Review

Total deposit of the bank reached Rs.9995.6 million and Loan and advances was Rs.8507.9 million till Mid-July 2009. The total income of the bank was Rs.900.62 million in Mid-July 2009. The NPL of the bank was at 15.94% of the loan and advances as at mid-July 2009.

- **NABIL Bank Limited**

NABIL, the first joint-venture commercial bank, was incorporated in 1984. Dubai bank limited was the initial foreign joint-venture partner with 50 percent equity investment. The shares owned by Dubai Bank Limited were transferred to Emirates Bank International Limited; Dubai sold its entire 50 percent equity holding to National Bank Limited, Bangladesh. National Bank Limited, Bangladesh is managing the bank in accordance with the technical services agreement signed between it and the bank on June 1995.

Performance Review

Total deposit of the bank reached Rs.37348.3 million and Loan and advances was Rs.27816.6 million till Mid-July 2009. The total income of the bank was Rs.1031.05 million in Mid-July 2009. The NPL of the bank was at 0.79% of the loan and advances as at mid-July 2009.

Rastriya Banijya Bank

Rastriya Banijya Bank (RBB) is the fully government owned, and is the largest commercial bank in Nepal. RBB was established on January 23, 1966 (2022 Magh 10 BS) under the RBB Act. RBB provides various banking services to a wide range of customers including banks, insurance companies, industrial trading houses, airlines, hotels, and many other sectors. RBB has Nepal's most extensive banking network with over 125 branches.

Performance Review

Total deposit of the bank reached Rs.67976.3 million and Loan and advances was Rs.31464.1 million till Mid-July 2009. The total income of the bank was Rs.2032.23 million in Mid-July 2009. The NPL of the bank was at 15.75% of the loan and advances as at mid-July 2009.

APPENDIX-II

Calculation of Mean, S.D and C.V. of loan and advances to Total Asset Ratio of NIC and NBBL (Sample Calculation)

NIC:

Years (Mid July)	Ratio (X) %	$(X-\bar{X})$	$(X-\bar{X})^2$
2005	12.09	-14.04	197.12
2006	13.98	-12.15	147.62
2007	15.44	-7.72	59.6
2008	74.08	47.95	2299.20
2009	15.08	-11.05	122.10
N = 5	$\phi X = 130.67$		$\phi\ (X-X)^2 = 2825.64$

We have,

Mean $(\bar{X}) = \frac{\phi X}{N} = \frac{130.67}{5} = 26.13$ %

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

$= \sqrt{\frac{2825.64}{5}} \quad = 24$

Coefficient of Variance (Cov.) = $\frac{\exists}{\bar{X}} \times 100 \quad = \frac{24}{26.13} \times 100 \quad = \quad 91.85$

NBBL:

Years (Mid July)	Ratio (X) %	$(X-\bar{X})$	$(X-\bar{X})^2$
2005	56.24	1.67	2.79
2006	53.89	-0.68	0.46
2007	58.13	3.56	12.67
2008	54.03	-0.54	0.29
2009	50.55	-4.02	16.16
N = 5	$\phi X = 272.84$		$\phi\ (X-X)^2 = 32.37$

We have,

Mean $(\bar{X}) = \frac{\phi X}{N} = \frac{272.84}{5} = 54.57$ %

Standard Deviation $(\exists) = \sqrt{\sum(X-\bar{X})^2}$

N

$$= \sqrt{\frac{32.37}{5}} = 2.54$$

Coefficient of Variance (Cov.) = $\frac{\exists}{\overline{X}} \times 100 = \frac{2.54}{54.57} \times 100 = 4.65$

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

Calculation of Correlation Coefficient, P.E. and 6 P.E. of NIC and NBBL (Sample Calculation)

NIC:

Years (Mid-July	Loans and advances (X)	LLP (Y)	$x=x-\overline{X}$	$y=Y-\overline{Y}$	x^2	y^2	xy
2005	4895.4	174.7	-4348.92	1.62	18913105	2.6244	-7045.25
2006	6882.8	244.7	-2361.52	71.62	5576777	5129.4244	-169132
2007	9107.6	225.6	-136.72	52.52	18692.36	2758.3504	-7180.53
2008	11446.5	20.7	2202.18	-152.38	4849597	23219.6644	-335568
2009	13889.3	199.7	4644.98	26.62	21575839	708.6244	123649.4
N = 5	ϕX = 46221.6	ϕY =865.4			ϕx^2=50934010	ϕy^2=31818.688	ϕxy=-39527

We have, Karl Pearson Correlation Coefficient

$$\text{Correlation (r)} = \frac{\sum XY}{\sqrt{\sum X^2 . \sum Y^2}}$$

$$= \frac{-39527}{\sqrt{50934010 X\ 31818.688}}$$

= -0.310496072

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

$$= \frac{0.6745\ (1-(-0.310496072)^2)}{\sqrt{\ }}$$

$$\overline{\quad 5 \quad}$$

= 0.27

6 P.E. = 6 *0.27 = 1.63

NBBL:

Years (Mid-July	Loans and advances (X)	LLP (Y)	$x=x-\overline{X}$	$y=Y-\overline{Y}$	x^2	y^2	xy
2005	8739.8	1184.5	143.56	-1253.06	20609.47	1570159.364	-179889
2006	9010.7	1691.9	414.46	-745.66	171777.1	556008.8356	-309046
2007	8302.8	3633.7	-293.44	1196.14	171777.1	1430750.9	-350995
2008	8420.0	3301.4	-176.24	863.84	31060.54	746219.5456	-152243
2009	8507	2376.3	-88.34	-61.26	7803.956	3752.7876	5411.708
N = 5	ϕX = 46221.6	ϕY =865.4			ϕx^2 =317358.1	$\phi y^{2=}$4306891.432	ϕxy= -986762

We have, Karl Pearson Correlation Coefficient

$$\text{Correlation (r)} = \frac{\sum XY}{\sqrt{\sum X^2 . \sum Y^2}}$$

$$= \frac{-986762}{\sqrt{317358.1 \times 4306891.432}}$$

= -0.844025958

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

$$= \frac{0.6745\ (1-(-0.844025958)^2)}{\sqrt{5}}$$

= 0.086607

6 P.E. = 6 *0.086607 = 0.519642

Similarly the Correlation Coefficient, P.E. and 6 P.E. between different variables of the five banks have been calculated.

Calculation of Trend Value of Loans and Advances of NIC and NBBL

NIC:

Years (Mid-July	Loans and Advances (Y)	Deviation from Mid July 2007 (X)	X^2	XY	Yc = a+bx Yc =9244.32 +2255.15*x
2005	4895.4	(2)	4	-9791	4734.02
2006	6882.8	(1)	1	-6883	4734.02
2007	9107.6	0	0	0	9244.32
2008	11446.5	1	1	11447	11499.47
2009	13889.3	2	4	27779	13754.62
N = 5	ϕY = 46221.6	ϕX = 0	ϕX^2 = 10	ϕXY = 22551.5	46221.60

Here,
When, ϕX = 0 from the two normal equations,

$$a = \frac{\phi Y}{N} = \frac{46221.6}{5} = 9244.32 \qquad b = \frac{\phi XY}{\phi X^2} = \frac{22551.5}{10} = 2255.15$$

Thus,
Average loan and advances (a) = Rs. 9244.32
Rate of change of Loans and advances (b) = Rs. 2255.15

Hence the equation of straight line trend is Yc= a+bx
Yc =9244.32+2255.15x

Expected Trend values of loans and advances (2010-2014)

Years (Mid July)	Deviation from Mid-July 2001 (X)	Yc = a + bx Yc = 9244.32+2255.15xx
2010	3	16009.77
2011	4	18264.92
2012	5	20520.07
2013	6	22775.22

2014	7	25030.37

NBBL:

Years (Mid-July	Loans and Advances (Y)	Deviation from Mid July 2007 (X)	X^2	XY	Yc = a+bx Yc =8596.24+ -105.45*x
2005	8739.8	(2)	4	-17479.6	8807.14
2006	9010.7	(1)	1	-9010.7	8807.14
2007	8302.8	0	0	0	8596.24
2008	8420.0	1	1	8420	8490.79
2009	8507.9	2	4	17015.8	8385.34
N = 5	ϕY = 42981.2	ϕX = 0	$\phi X^2 = 10$	ϕXY =-1054.5	

Here,
When, ϕX = 0 from the two normal equations,

$a = \frac{\phi Y}{N} = \frac{42981.2}{5} = 8596.24$ $\quad$ $b = \frac{\phi XY}{\phi X^2} = \frac{-1054.5}{10} = -105.45$

Thus,
Average loan and advances (a) = Rs. 8596.24
Rate of change of Loans and advances (b) = Rs. -105.45

Hence the equation of straight line trend is Yc= a+bx
Yc =8596.24+-105.45x

Expected Trend values of loans and advances (2010-2014)

Years (Mid July)	Deviation from Mid-July 2001 (X)	Yc = a + bx Yc = 8596.24+-105.45xx
2010	3	8279.89
2011	4	8174.44
2012	5	8068.99
2013	6	7963.54

2014	7	7858.09

Similarly, the trend values for other variables of the five banks have been calculated.

APPENDIX-III

Figures picked out from Balance Sheet and profit and loss account of sampled Banks

Total Assets

Figures in Million

	NIC	NBBL	NIBL	NABIL	RBB
2005	40490.7	15540	16637.9	18614.9	77594.1
2006	49221.4	16721.8	22007.2	24134.6	81087.1
2007	58991.2	14282.3	28572.8	29660.4	72041.3
2008	15451.4	15584.2	40205.5	38478.6	84686.2
2009	92123.8	16829.9	54634.5	45941.6	99662.6

Total Deposits

Figures in Million

	NIC	NBBL	NIBL	NABIL	RBB
2005	6243.3	12125.5	14254.8	14586.8	43489.2
2006	8765.8	13014.8	18927.3	19348.4	45700.7
2007	10068.3	9464	24488.9	23342.4	50192.6
2008	13078.5	10883.7	34451.8	31915	57990.8
2009	15579.9	9995.6	46697.9	37348.3	67976.3

Net Profits

Figures in Million

	NIC	NBBL	NIBL	NABIL	RBB
2005	114	-650	232	520.1	1620.32
2006	97	-1457	350	635.3	1687.60
2007	158	392.7	501	674	1681.66
2008	243	800.41	696.73	746.47	1770.56
2009	317	2472.19	900.62	1031.05	2032.23

Non-Performing Loan

Figures in Million

	NIC	NBBL	NIBL	NABIL	RBB
2005	185.43	1832.94	280.87	144.51	13689.30
2006	179.55	2927	272.49	182.60	8045.50
2007	1001.10	3645.90	421.97	178.30	6876.50
2008	98.30	2945.30	309.40	171.40	5951.80

2009	123.11	1355.95	301.98	220.72	4955.97

Loans and advances

Figures in Million

	NIC	NBBL	NIBL	NABIL	RBB
2005	4895.4	8739.8	10295.4	11078	28614
2006	6882.8	9010.7	13007.2	13021.3	26863.8
2007	9107.6	8302.8	17482	15657.1	25214.8
2008	11446.5	8420.0	27145.5	21514.6	27353.6
2009	13889.3	8507.9	36250.4	27816.6	31464.1

Loan Loss Provision

Figures in Million

	NIC	NBBL	NIBL	NABIL	RBB
2005	174.7	1184.5	256.2	392	15215.4
2006	244.7	1691.9	374.3	352.9	13593.1
2007	225.6	3633.7	442.7	356.3	8967.5
2008	20.7	3301.4	537.2	404.6	7709.4
2009	199.7	2376.3	584.4	409.1	6483.4

Source**:** Annual Reports (2004/2005 to 2008/2009) of Sampled Banks.