NON-PERFORMING ASSETS IN NEPALESE COMMERCIAL BANKS

(A Comparative Study of Nepal Bank Limited And Nepal Credit And Commerce Bank Limited)

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CHAPTER –I

INTRODUCTION

1.1 Background of the Study

Commercial banks are major financial institutions, which occupy quite an important place in the framework in every economy because they provide capital for the development of industry. Commercial banks formulate sound investment policies to make it more effective, which eventually contribute to the economic growth of country. The bound policies help commercial banks maximizing quality and quantity of investment and hereby achieve the own objective of profit maximization and social welfare. Formulation of sound investment policies and co-ordinate and planned efforts pushed forward the forces of economic growth.

Loan management is the essence of commercial banking; consequently the formulation and implementation of lending policies are among the most important responsibilities of directors and management. Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit. Loan management effects on the company's profitability and liquidity so it is one of the crucial decisions for the commercial banks. The banks take almost care in analyzing the creditworthiness of the borrowing customer to ensure that the interest and the principal amount on loans are timely recovered without much trouble and legal process for the recovery. A sound lending policy is essential for the good performances of the bank are further to attain economic objectives directed towards acceleration of the development. Lending policy should be carefully analyzed and the banks should be careful while performing its credit creation effectively and to minimize the risk factor.

The wave of rising expectation and aspiration of people at present context of society, realized the need for rapid socio-economic development in the nation building process. The government has imparted a dynamic role and assigned the public sector with greater responsibility in fulfilling national goals and objectives. With this realization, the government initiated to build up multi-sector infrastructure in the fields of agriculture, industry, commerce, public works, transport, etc. In this context, banking was seen as a major supportive industry to uplift the economic condition of nation and its residents. Therefore, the government has adopted a liberal economic policy regarding operations of banks. About the financial liberalization process it is stated that the interest rate deregulation, curtailment or elimination of directed credits, lifting entry and exit barriers for financial intermediaries, restructuring of banking system and institution for regulatory and supervisory mechanism is some of the key components of such liberalization. This led to the influx of commercial banks in Nepal resulting today into 28 commercial banks. NABIL (previously Nepal Arab Bank Limited), the first joint venture bank in Nepal which was established on 2041 B.S. after adopting financial and economic liberalization policy by the government.

The first financial institution was introduced during the prime-ministership of Ranodip Singh (1933 B.S.) in the name of “Tejrath Adda” for granting loan to employees and public against security of gold silver and other treasures. Banking in true sense started with the inception of Nepal Bank Limited, a semi-governmental bank in 1994 B.S. NBL had a responsibility of attracting public out from the dominance of Sahu Mahajans and introducing banking services as well. After 20 years having an objective of developing banking practice, Nepal Rastra Bank started its operations from 14^{th} Baisakh, 2013 BS. Nepal Bank Limited was only one commercial bank until 2022 BS. To develop a speedy and competitive banking service by reaching nooks and corners of the country, a fully government owned bank – Rastriya Banijya Bank was established in 2022 B.S.

Despite all these efforts, financial sector was found sluggish. The traditional financial system could not provide the public a quality service. Thus, the government initiates a liberal competition, which started to attract foreign investments. A foreign joint venture bank was established in 2041 B.S. with the name of Nepal Arab Bank Limited (now NABIL), which was the first joint venture commercial bank in Nepalese financial history. NABIL started knocking the doors of customers breaking the trend of knocking the doors of banks by customers (Bhattarai, 2006: 4-6).

It has been fully established that economic development of any country can be achieved only through a balanced growth in the field of industry, trade commerce and agriculture. And it has equally self-evident that commercial banks play vital role in the development of these fields. Therefore, productivity and competitiveness of commercial banks is very essential.

Lending is the primary business of any commercial bank and interest earned from them is the main source of income. Once the loan is given, it is supposed that the repayment of interest and principal shall have to be served without any hindrance. But it is not always true. Loans and interests are not always paid so easily by all the customers. Loans lended to the customers come under the Assets heading of balance sheet; and those loans which are not paid in time are considered as Non Performing Loan or Non Performing Assets (NPA). The criteria that determine a loan as NPA varies in different countries. In Nepalese scenario, Nepal Rastra Bank has classified the loans and advances as Non Performing Assets which are due for more than 90 days. Whatever the criteria is, the unhidden fact is that the NPA affects the banks operation and growth adversely. NPA has several impacts on financial institutions. Investments become worthless as expected return cannot be realized on the one hand and on the other hand, due to provisioning required for the risk mitigation, the profitability is directly affected. Similarly, monitoring expenses of such loans are costly too. Therefore, proper management, cost efficiency and speedy disposal of Non Performing Assets (NPA) are the most critical tasks of banks today to remain competitive. The problem of NPA in banks and financial institutions has been a matter of grave concern not only for the banks but also the real economy in general, as NPA can choke further expansion of credit which would impede the economic growth of the country. Any bottleneck in the smooth flow of credit is bound to create adverse repercussions in the economy. NPA is not therefore the concern of only lenders but also the public at large. Similarly, profit making is one of the major mottos of commercial banks and reducing the operating cost is one of the main deterministic factors to increase profitability. So, cost efficiency is also a major area of concern of commercial banks (Thapa, 2008:20-22).

A number of international researches show that there is a negative relationship between cost efficiency and NPA. Cost-inefficient banks may tend to have loan performance problems for a number of reasons. For example, banks with poor senior management may have problems in monitoring both their costs and their loan customers, with the losses of capital generated by both these phenomena potentially leading to failure.

Some other researches also show that there is a positive relationship between cost efficiency and NPA. They show that controlling extra cost such as underwriting and loan monitoring expenditures in order to achieve cost efficiency may reduce the operating cost in short run but it leads towards the increase in NPA in long run.

Till the date there are 28 commercial banks in Nepal. Agriculture Development Bank (ADB) has also been listed in 'A' class financial institutions two years ago. Therefore, there are 28 ‘A’ class financial institutions (commercial banks). Till the period of this study, a new commercial bank has also been found to be licensed to practice commercial banking operations in Nepal.

Besides, there are 63 Development Banks, 12 Micro Credit Development Banks, 78 Finance Companies, 16 Cooperatives Societies and 46 NGOs conducting financial transactions operating under the rules and regulations of Nepal Rastra Bank (NRB; Banking and Financial Statistics, 2010).

1.1.1 Introduction to Sample Banks

a) Nepal Bank Limited (NBL)

The Nepal Bank Limited was established in 1994 B.S. with the government initiative as the first commercial bank of the country. From its beginning years of operations NBL has been semi private and semi-government organization. Although the bank has to pass through a number of difficulties during its early years, yet it has done pioneering work in taking the banking habit to people, who were generally used to the traditional practices of monetary transactions in the non- monetized sector. Since NRB was founded only as late as 1956, for a few years the Nepal Bank Limited has to manage, apart from commercial functions almost all banking transactions including those of the government, however limited. The government to this bank also entrusted the entire business of note exchange and related activities. Up to 1965, before the establishment of the RBB, the bank was an authorized agent of the Rastra bank. In places where the RBB does not have branches, it undertakes a number of activities including the foreign exchange buying and selling business. The Nepal Bank has agencies in India, United States, Britain, Switzerland and West Germany. In those early years, the main functions of the bank were government exchange, business and the advancing the money to the public against gold and silver. Gradually, its transactions widened with expanding banking and commercial activities. The Nepal Bank was set up a time, when banking was little known in the country, all banking activities being limited to money lending.

The commercial bank’s capacity to operate effectively also depends on its being able to provide the best possible banking facilities for its customers and in the long run the provision of facilities for deposit in foreign currencies would probably turn out to be in the best financial interest or the country, in consideration of all these aspects.

b) Nepal Credit and Commerce Bank Limited (NCCBL)

Nepal Credit & Commerce Bank Ltd. (NCCBL) formally registered as Nepal - Bank of Ceylon Ltd. (NBOC), commenced its operation on 14th October, 1996 as a Joint Venture with Bank of Ceylon, Sri Lanka. It was the first private sector Bank with the largest authorized capital of NRS. 1,000 million. The Head Office of the Bank is located at Siddhartha Nagar, Rupandehi, the birthplace of LORD BUDDHA, while its Corporate Office is placed at Bagbazar, Kathmandu.

The name of the Bank was changed to Nepal Credit & Commerce Bank Ltd., (NCC Bank) on 10th September, 2002, due to transfer of shares and management of the Bank from Bank of Ceylon, an undertaking of Government of Sri Lanka to Nepalese Promoters.

At present, NCC Bank provides banking facilities and services to rural and urban areas of the Kingdom through its 17 branches. The Bank has developed corresponding agency relationship with more than 150 International Banks having worldwide network.

1.2 Statement of the Problem

The main focus in this thesis is on the problem of Non-Performing Assets (NPAs) which seems to be confronting the Nepalese Banking Sector with several far-reaching implications. Taking cognizance of the fact that banking business involves a great deal of risk in terms of its borrowing and lending operations, it is observed that transactions involving credit risk are a key source of earnings in consonance with a bank’s business strategy. It is argued that even though the banks conduct comprehensive risk management from the perspective of their overall credit risk portfolio in addition to an assessment of individual credit risk assets including loans and advances, in actual practice these turn out to be non-productive and non-rewarding and eventually tend to become Non-Performing Assets. Needless to emphasize, these Non-Performing

Assets obviously have a deleterious impact on banks' ability in the matter of recycling of the credit as also on their overall profitability. It is mainly on account of the fact that the amounts of money get locked up in Non-Performing Assets and, as such, is not available for further productive use. In the ultimate analysis it also adversely impacts the profitability of our banking sector. Nepalese Banking Sector is set to be plagued to a considerable extent by the problem of NPA and is crying for the appropriate policy measures to cope with the said problem which is considered to be relatively more severe as compared to the international standards.

Against such a backdrop, an objective assessment of the problem and the search for appropriate remedial measures in respect of the commercial banks in Nepal is likely to be both informative and rewarding from the view point of its academic worth as also from that of policy making for the future.

Commercial banks are the apex entities of economy in any nation for prompting different business activities such as agriculture, trade, industry and commerce. As such activities get momentum; excess dependency on agriculture sector about livelihood will automatically be reduced. Hence necessity of these institutions have been realized the must. In addition to this, NBL and NCCBL have been providing a nice platform for the businessmen who plan to capitalize future opportunities with both financial and technical support which helps on the increment of entrepreneurial activity.

As shown above, number of financial institution in the country is growing rapidly. Competition among such institutions is on a rise as all these institutions are elevating themselves in the financial market. In this taut environment, NBL and NCCBL are standing with weak financial position regarding to NPA. In NBL, the management is foreign and the audit process is very slow. Endowing loan without proper analysis was the great error of both the banks. Even the banks have strong credit manuals, the NPA level of these banks are still high in comparison with the other banks in Nepal. No company can earn smoothly without well managed loan portfolio. Hence, I have taken NPA in NBL and NCCBL as my thesis topic trying to make an open scenario about NPAs in these banks.

1.3 Objective of the Study

The general objective the study is to discuss, examine and evaluate the financial information and position of NBL and NCCBL in term of non-performing loan. These are the specific objectives which have been considered for this study.

a) To study the efficiency of management on recovery of loan
b) To study the sources and uses of funds of sample banks.
c) To compare the Non-performing loan level between two banks.
~~e)~~d) To analyse the opinion of credit heads and opinion of credit clients.

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1.4 Research Questions

While giving the supportive framework to the research study, the following questionnaires have been designed to be the main problem areas of the study and hence all tasks will be performed to provide the answers to these questions:

a) What is the efficiency of management on recovery of loan?
b) What are the sources and uses of funds sample banks?
c) Whether the Non-Performing loan level of two banks are same or not?

1.5 Significance of the Study

There is no doubt in our minds that loans and advances are the major source for generating profit of all commercial banks. Nepal, being one of the poorest countries in the world is in need of additional capital investment to score higher rate of economic growth. The study of NPA of NBL and NCCBL will be beneficial for:

Shareholders:

Shareholders are the true owners of the company. This study will be useful to them for acquiring answers to the following questions.

- What is the position of the loans given by the bank?
- Why the bank is not earning much?
- To what extent is the bank gaining from the loans?

Management:

This study will be helpful to compare and analyze own with other regarding performance via: success or failure in loan management, effectiveness and own evaluations.

Outsiders:

Customers, creditors, competitors, investors, financing agencies, stock exchange, personnel can get information about the performance of NBL's and NCCBL's NPAs with the help of this analysis.

Policy Makers:

Officers of government, ministry, central bank, and security exchange and tax office can formulate appropriate policy regarding commercial banks with the help of this study.

Government:

Government sector is responsible for making several kinds of policy decisions. This report comprising of the study of commercial banks may provide a beautiful insight to form and thus bring policies conducive to banking sector.

All other interested individuals & parties:

This study is also significant to all other interest individuals and parties those wishing to have some potential knowledge regarding profitability of the sampled commercial banks. This study may provide a valuable insight to the concerned parties who want to become investors in the shares of such companies.

1.6 Limitations of the Study

There are some inherent limitations in this research study which are presented below:

i. The study was confined only to the fiscal years 2004/05 to 2008/09. So the generalization was based on these periods only.
ii. Only two banks, namely NBL and NCCBL were selected for the study. Comparison with only these two out of so many contemporary firms may not present the clear position of any firm.
iii. Reports were based mainly on the published data of the sampled banks, which have been manipulated with.
iv. Most of the data were secondary, which itself was a limiting factor. But for the clarification purpose some primary data were also collected.

1.7 Organization of the Study

The study has been divided into five chapters and they are as given below.

The first chapter comprises of general background entering the study, brief profile of the banks under study, significance of the study, objectives of the study, limitations of the study and organization of the study.

The second chapter includes the review of previous researches, reports and articles, books and journals on NPA. The third chapter includes the research method, research design, data collection procedure, tools for analysis (Statistical and financial tools), methods of analysis and presentation.

The fourth chapter includes presentations and analysis of data to indicate the computed facts on NPA level on NBL and NCCBL. The fifth chapter summarized the whole thesis report, presenting findings of all analysis along with concluding remarks with recommendations. Bibliography and appendices are also enclosed at the end of the thesis.

CHAPTER- II
LITERATURE REVIEW

2.1 Introduction

The first chapter highlighted the background, statement of the problem, objectives of the study, research questions, significance of the study, and limitation of the study. This chapter provides the concept and bases for the study. Review of literature mainly covers two parts. The first section of this chapter includes theoretical framework whereas second part is confined to review of those studies carried out by previously to the research topic for objective meeting. In this chapter, the overall concept and view of “non-performing assets” will be streamlined through the review of relevant literature related to this study**.** Literature refers to the detail of things and provides valuable inputs to this study. Only by knowing what others have said, one can be realistic for useful and relevant study. It is an analytical expression concerned with topics. The following sources are used for the study:

- Books
- Journals
- Annual Reports
- Research Works

2.2 Conceptual Framework

One of the important and major roles banking sector plays is of lending business or giving away loans. Lending business is generally encouraged because it has the effect of funds being transferred from the system to the productive purpose, which eventually results into strong economic growth. The main con of this business if that it carries credit risk, which arise from the failure of the borrower to fulfill its contractual obligations either during the course of a transaction or on a future obligation. Non-performing Assets here after called NPA, also called non-performing loans, are loans, made by a bank or finance company, on which repayments or interest payments are not being made on time. Banks usually treat assets as non-performing if they are not serviced for some time. If payments are late for a short time a loan is classified as past due. Once a payment becomes really late (usually 90 days) the loan classified as non-performing. If any advance or credit facility granted by a bank to borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to the respective borrower as non-performing without having any regard to the fact that there may still be certain advances/credit facilities having performing status.

2.2.1 Meaning of Non-performing Assets

"The term non-performing asset is, "loans or advances whose credit quality has deteriorated such that full collection of principal and /or interest in accordance with the contractual repayment terms of the loan or advances are in question" (Dhanuskodi, 2006:7).

"An asset which ceases to generate income of the bank is called non-performing asset. The past due amount remaining uncovered for the two quarter consequently the amount would be classified as NPA for the whole year. It includes borrowers' defaults or delays in interest or principal repayment" (Dhanuskodi, 2006:7).

Lending is the primary business of any commercial bank and interest earned from them is the main source of income. Once the loan is given, it is supposed that the repayment of interest and principal shall have to be served without any hindrance. But it is not always true. Loans and interests are not always paid so easily by all the customers. Loans lended to the customers come under the Assets heading of balance sheet; and those loans which are not paid in time are considered as Non Performing Loan or Non Performing Assets (NPA). The criteria that determine a loan as NPA varies in different countries. In Nepalese scenario, Nepal Rastra Bank has classified the loans and advances as Non Performing Assets which are due for more than 90 days. Whatever the criteria is, the unhidden fact is that the NPA affects the banks operation and growth adversely. NPA has several impacts on financial institutions. Investments become worthless as expected return cannot be realized on the one hand and on the other hand, due to provisioning required for the risk mitigation, the profitability is directly affected. Similarly, monitoring expenses of such loans are costly too. Therefore, proper management, cost efficiency and speedy disposal of Non Performing Assets (NPA) are the most critical tasks of banks today to remain competitive. The problem of NPA in banks and financial institutions has been a matter of grave concern not only for the banks but also the real economy in general, as NPA can choke further expansion of credit which would impede the economic growth of the country. Any bottleneck in the smooth flow of credit is bound to create adverse repercussions in the economy. NPA is not therefore the concern of only lenders but also the public at large. Similarly, profit making is one of the major mottos of commercial banks and reducing the operating cost is one of the main deterministic factors to increase profitability. So, cost efficiency is also a major area of concern of commercial banks (Dhanuskodi, 2006:9-11).

A number of international researches show that there is a negative relationship between cost efficiency and NPA. Cost-inefficient banks may tend to have loan performance problems for a number of reasons. For example, banks with poor senior management may have problems in monitoring both their costs and their loan customers, with the losses of capital generated by both these phenomena potentially leading to failure (Dhanuskodi, 2006:12).

Some other researches also show that there is a positive relationship between cost efficiency and NPA. They show that controlling extra cost such as underwriting and loan monitoring expenditures in order to achieve cost efficiency may reduce the operating cost in short run but it leads towards the increase in NPA in long run.

It is to be noted that quite often; genuine borrowers face the difficulties in raising funds from banks due to mounting NPAs. Either the bank is reluctant in providing the requisite funds to the genuine borrowers or if the funds are provided, they come at a very high cost to compensate the lender's losses caused due to high level of NPAs. Therefore, quite often corporate prefer to raise funds via commercial papers where the interests on working capital charged by banks are higher.

A high level of NPA compared to similar lenders may be a sign of problems, as may a sudden increase. However this needs to be looked at in the context of the type of lending being done. Some banks lend to higher risk customers than others and therefore tend to have a higher proportion of non-performing debt, but will make up for this by charging borrowers higher interest rates, increasing spreads. A credit lender will almost certainly have lower NPA than a credit card specialist, but the latter will have higher spreads and may well make a bigger profit on the same assets, even if it eventually has to write off the non-performing loans (Dhanuskodi, 2006:15).

Accordingly, NPA would be an advance where:

i. interest and /or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan,
ii. the account remains 'out of order' for a period of more than 180 days, in respect of an overdraft/ cash Credit),
iii. the bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted and
iv. Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

2.2.2 The Factors Leading to NPA

- Business Failure:

A business failure is one of the main factor which leads to NPA. A business firm takes loan from a bank and repays the loans and interest from the cash flow originated by the business. If the business cannot generate sufficient cash inflows, the business itself cannot repay the loans and interest to the banks leading to NPA

- Diversification of Funds

Diversification of funds here implies to that the loans generated from the bank are used for other purpose or not used solely for the purpose for which the bank has granted the loan to the business firm or an individual. When the funds are not fully or totally used for the purpose for which it is granted by the bank, there might be the chances of improper cash flows as per the calculation of both the bank or business firm or individuals resulting in NPA (Dhanuskodi, 2006:17).

- Recession

Recession is the period where all business is on the slump. During the slump time of a business, some newly started business cannot cope with the situation and they even will not have retained earnings to pay the interest or repayment schedule for sometime which also leads to NPA.

- Inefficient management

If a management of a business is inefficient there would be misappropriate calculations and last but not the least

- Labor problems

Labor problems arise mainly due to inefficient management or with the conflicts. If the labors are not satisfied with the management they will not give their best efforts for the company and even in some cases the labors with the support from the labor union close down the factory for indefinite period (Dhanuskodi, 2006:19).

2.2.3 Steps to be Enforced to Maintain NPA Level in Banks

The origin of the problem of rapidly increasing NPAs lies in the quality of managing credit risk by the banks concerned. Imperative thing that we lack is having adequate preventive measures in place via, fixing pre-sanctioning appraisal responsibility and having an adequate post-disbursement supervision. Banks concerned should continuously monitor loans to identify accounts that have potential to become non-performing. The global norm if gross NPAs of banking sector are about 5 percent whereas in Nepal it is much higher. Hence, there is a long way to go before we can say that the NPAs of our banks and financial institutions are under control. To maintain the NPAs in bank/ financial institution, the management should enforce the following steps after the credit facility to their respective clients (Dhanuskodi, 2006:21).

~~2.1.2.1~~2.2.3.1 Regular monitoring of loans and advances:

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Loan monitoring job should be immediately started after the completion of legal documentation and disbursement of the credit facilities and to be kept continuing till the final settlement of entire liabilities. On the basis of monitoring, loan accounts are categorized as performing or non-performing. Thus, it helps to take necessary measures to minimize the possible credit losses (Batra, 2003:14).

The primary objective of loan monitoring should be to ensure the policy guidelines of the bank/ financial institutions should be strictly compiled in extending credit facilities. The main objective of loan monitoring efforts is to maintain the good quality of assets and protect the assets from being classified, to maintain the system of advance warning in the decline of the business of the client and his/her intention and to maintain the psychological pressure on the client as regard to his/her obligation to pay the interest and principal, to improve financial discipline of the client, to ensure the timely payment of interest and principal to avoid the transfer of interest income to the interest suspense account and bad debts and to understand the root of the problem faced by the client in course of business.

The overall responsibility of monitoring the client should be of the Branch Manager and the Head of Credit and Trade Finance Department. However, in order to gain high efficiency in monitoring, responsibility could be delegated to the official of the Bank. If the number of credit clients is high, then the responsibility of monitoring the client shall be divided among the official clearly indicating that who is responsible for the client. The Performance Appraisal of the officials can also be done based on the quality of client (Batra, 2003:15).

Once the loan documentation has been executed in accordance with the sanction letter, the monitoring of it shall be done to assess the loan documentation as executed as per sanction term and as specified in the Credit and Trade Finance Manual, and to assess that the checklist of loan documentation has been duly filled up and signed by authorized officer as a token of compliance of documentation. Disbursement of credit facilities should be done only after all the required documentation is completed.

Credit Liability Report (CLR) should be referred for monitoring the total exposure of the borrower, the status of the credit facilities covering the single obligor limit, date of expiry of the credit facilities, matured deals status etc. The monitoring of Clean Bill should be done to ensure that all the clean bills are purchased only upon approval by the approving authorities, to ensure that these purchased bills are realized within reasonable time period, to ensure whether the operation department has brought it to the notice of the Officer who had recommended or approved for necessary follow-ups, if it is not settled in time and to ensure that no overdraft is allowed to create without pre-arrangement to settle the bill purchase returned un-paid (Batra, 2003:18).

Repayment Monitoring should be done to ensure that the borrower has settled the interest and principal as per repayment schedule, to ensure that the necessary steps has been taken to those borrowers who have failed to comply with the repayment term of the sanctioned letter and to ensure that the proper reporting has been done to the concerned officer in case of non-payment of interest and principal in time by the borrower (Batra, 2003:19).

When the borrower's account is overdrawn due to capitalization of interest, it is the instance of non-payment of interest. In case of non-payment of interest, monitoring shall be done to ensure that the interest due amount has been transferred to interest suspense account in accordance with the NRB directive to this effect, to ensure that the proper reporting has been done through internal memo to the Credit Department official immediately to those accounts, which have not paid interest on the due date. Default on payment of principal exists when the borrower fails to settle the outstanding principle on expiry date of the loan or on due date or as per the prearranged repayment schedule (Yadav, 2009:51).

Monitoring should be done in the case of non-payment of Principal to ensure that all the revolving credits are renewed timely, to ensure that necessary follow up with the borrower has been done for regularization, to ensure whether there is need for restructuring/ rescheduling of the facility, to ensure that non-payment is not wilful and to ensure that loan is classified and provision of loan is being done as implied by NRB directives (Yadav, 2009:53).

2.2.4 Loan Recovery

In principle, loans and advances extended by Bank are repayable on demand, but in practice all loans are recovered as per terms of sanction or within expiry of repayment period granted in normal cause. Recovery job starts in the bank by a recovery unit/personal of each branch after identification of following sequences. The Loan Recovery Department at Corporate Office should monitor the action of all the branches and shall issue necessary instruction on receiving reports from its branches. The main objectives of Loan Recovery effort are to contain NPA within the acceptable level, to recover the NPA without the litigation process as far as possible, to regularize the NPA with least additional exposure with low future risk in form of restructuring/re-scheduling, to undertake legally enforced settlement, if required, to manage Non-Banking Assets (NBA) and to develop modality of writing off the loans and advances to clean up the balance sheet (Batra, 2003:20).

The overall responsibility of loan recovery is obliged to branch manager of each branch and Head of Trade Finance Department at the Main Branch. However, the Branch Manager may designate any official to recovery action or create unit as required. Loan Recovery Department shall be set up in Corporate Office which will undertake the recovery action of Main Branch and monitor the recovery action of all the branches. The loan recovery unit in the Branch and Loan Recovery Department in the Corporate Office should be given responsibility of handling the recovery action and the performance of the officials involved in the recovery action should be evaluated based on their recovery performance. Accordingly, the system of reward and punishment should be introduced to motive the officials involved in recovery action by the management from tome to time. Because of various reasons (as listed above), the performing assets transforms into NPAs, for this purpose, the Bank officials need to discourage the situation and appropriate action needs to be taken on time (Batra, 2003:22).

2.2.5 Reasons for Assets Becoming NPA

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

i) Poor credit appraisal system
ii) Lack of proper monitoring

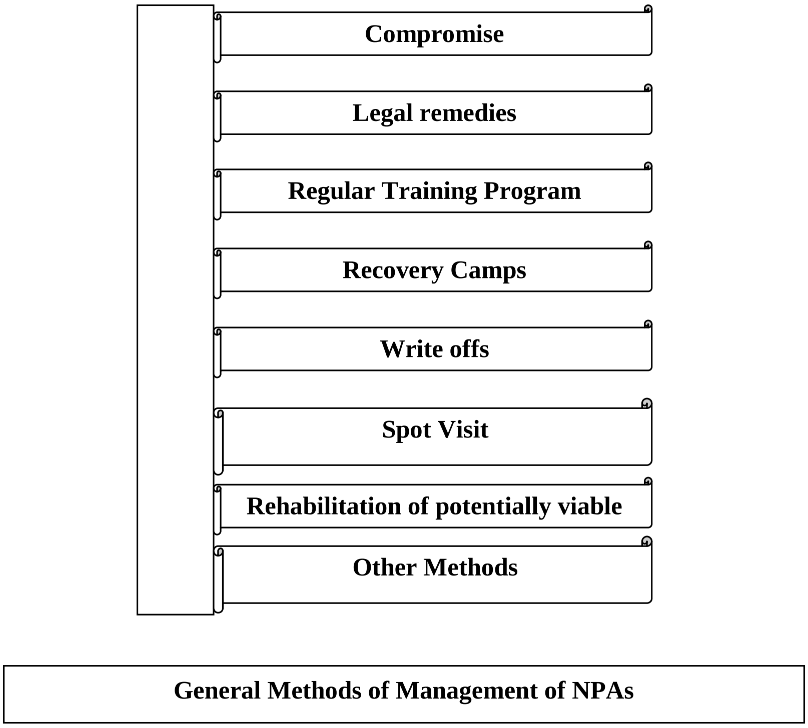
iii) Foreclosure and bankruptcy.
iv) Lack of coordination between banks.
v) Directed lending to certain sectors.
vi) Failure on the part of the promoters to bring their portion of equity from their own

2.2.6 Methods of Management of NPA

The management of NPA is serious issue in today's banking industry and is difficult task in practice. R Dhanuskodi in his research report "A study on No performing Assets" has mentioned about some general methods adopted by banks for management of NPAs which are as below:

Figure 2.1

General Methods of Management of NPAs



Source: R. Dhanuskodi, 2006

In simple it focuses on the methods of settlement of NPAs account. The methods are differs from bank to bank. The above paragraph explains some general methods of Management of NPAs by the banks (Dhanuskodi, 2006:10-13).

a) Compromise:

The dictionary meaning of the term compromise is “settlement of dispute reached by mutual concessions” (Dhanuskodi, 2006:13). The following are the detailed guidelines for compromise/negotiated settlements of NPAs.

- The compromise should be a negotiated settlement under which the bank should ensure recovery of its dues to the maximum extent possible of minimum expenses.
- Proper distinction should be made between willful defaulters and borrowers defaulting in repayments due to circumstances beyond their control.
- Where security is available for assessing the realizable value, proper weight age should be given to the location, condition and marketable title and possession of sub security.
- An advantage in settlement cases is that banks can promptly recycle the funds instead of resorting to expensive recovery proceedings spread over a long period.
- All compromise proposals approved by any functionary should be promptly reported to the next higher authority for post facto scrutiny.
- Proposal for write off/compromise should be first by a committee of senior executives of the bank.
- Special recovery cells should be set up at all regional levels.

b) Legal Remedies:

The legal remedies are one of the methods of management of NPAs. The banks observed that the borrower is making willful default; no more time should be lost instituting appropriate recovery proceedings. The legal remedies are filling of civil suits.

c) Regular Training Program:

The all levels of executives are compelling to undergrowth the regular training program on credit and NPA management. It is very useful and helpful to the executives for dealing the NPAs properly.

d) Recovery Camps:

The banks should conduct the regular or periodical recovery camps in the bank premises or some other common places; such type of recovery camps reduces the level of NPAs in the Banks.

e) Write Offs:

Write offs is also one of the common management techniques of NPAs. The assets are treated as loss assets, when the bank writes off the balances. The ultimate aim of the write off is to cleaning the Balance sheet.

f) Spot Visit:

The bank officials should visit to the borrowers' business place or borrowers field regularly or periodically. It is also help full to the bank to control or reduce the NPAs limit.

g) Rehabilitation of Potentially Viable Units:

The unit is sick due to technical obsolescence's of inefficient management or financial irregularities. When the Bank settles the dues, of such, companies through the compromise or through the legal actions the better is to be followed.

h) Other Methods:

i) Persistent phone calls.

ii) Media announcement

2.3 NRB Regulations towards Non-Performing Assets

NRB has issued new sets of regulations similar with international standards to address and minimize risks in financial business. These regulations include capital adequacy, loan classification and provisioning, single obligor limit, accounting policies and financial statements, liquidity risk, interest rate risk, foreign exchange risk, corporate governance, implementation of regulatory directives, regulation regarding investment in earnings assets etc. The new regulation addresses upon the classification of loan and advances and provisioning. Loans are classified as performing and non-performing loans. Regulation provides for "Overdue period of outstanding loans and advances' as minimum criteria for classification of loans and advances. Performing loans includes pass loans only, while non-performing loans includes substandard, doubtful and bad loans. Provisioning requirements are changed as under:

Table:2.1
Provisioning Percentage of loans

S. N.	Classification	Provision (percentage)
1	Pass	1%
2	Substandard	25%
3	Doubtful	50%
4	Bad	100%

Source: NRB Banking Regulations, 2010

Provision of 12.5 percent is to be made on all restructured and rescheduled loans. Repayment of principal and interest amount by overdrawing current accounts resulting in debit balances or by exceeding limit of overdraft facility is not allowed. Additional provision of 20 percent should be made for the loans, which are disbursed against personal guarantees only. The new regulation on single obligor limit reduces the fund-based limit to a single customer (or group) from 35 percent of capital fund to 25 percent of core capital and non-fund based limit from 50 percent of capital funds to 50 percent of core capital. The regulation also addresses the cases when bank will be over exposed on the single industry or single sector of economy. The new regulation also aims to disclose true and fair picture of the banks through their financial statements. Accounting policies and formats of the financial statements redefined and restructured to cope with best international practices. New disclosure requirements have enhanced quality of commercial bank's financial statements. The directives, regarding corporate governance, sets code of ethics for directors, chief executives, and employees of the banks. One of the provisions in the regulation is to form the internal audit committee under the chairmanship of non-executive board member to enhance the internal control system. The shareholders having more than one percent shares, the directors and employees of the banks are prohibited from availing credit facilities.

2.4 Review of Related Books

Peter Rose (1999) in her book "Commercial Bank Management" states achieving superior profitability for a bank depends upon several crucial factors:

1. Careful use of financial leverage or the proportion of bank assets financed by debts as opposed by the shareholders equity capital.

2. Careful use of operating leverage from fixed assets or the proportions of fixed cost input the bank used to boost its operating earnings before taxes as bank output grows.

3. Careful control of operating expenses so that more dollars of sales revenue become net income.

4. Careful management of assets portfolio to meet liquidity needs while seeking the highest returns from any assets acquired.

5. Careful control of the bank's exposure to risks so that the losses don't overwhelm its income and equity capital".

Michael R. Baye and Dennis W. Jensen (1996) through their book 'Money, banking and financial market: an economic approach' have tried to analyse the bank's profitability under an economic approach. They state "to maximize profits, banks should attract deposits unto the point where the value of marginal producer of deposits equals the interest rate paid on deposits."

Rose Kolari & Fraser (2002) in the book, 'Financial Institutions: Understanding and managing financial services' says that "Banks earn interest on loans and investments; they pay interest to the depositors. When interest rates changes, there may be an effect on income if a bank holds rate sensitive assets and liabilities. If, for example, a bank holds more rate sensitive assets than liabilities when interest rate rise, profits will be improved because the bank will receive more in increased interest revenue than it will pay out in rising costs. The reverse would be true during a period of falling interest rates.

Meir Kohn (1999) writes in his book, 'Financial institutions and markets': "Banks now have steadily expanded their activities in payment related services, in delegation and trust services, in credit substitution and services, and in forward transactions. In doing so, they have pursued economies of scope, relatively unconstrained by regulations" (Kohn; 1999:15).

2.5 Review of Related Articles

Batra (2003), Senior Partner of Kesar Dass & Associates, India, studied about developments of NPA in India along with the Asian markets. He found that Indian banks had disturbing amount of NPAs during the last twenty years. As on 31st March of 2003, total approximate NPAs was worth 1, 10,000 crore while it was around 63,883 crore as on 31st March of 2001.

This study shows that the reduction of gross NPA from 14.4% to 11.4% has not given much comfort since this accomplishment is on account of credit growth , which was higher than the growth of Gross NPAs . The NPA level hasn't either reduced or contaminated during these years.

The gross and net NPA's for Public Sector Banks (PSBs) as on 31.03.2001 were 12.39% and 6.74% respectively where as it was 11.4% and 6.2% for

Scheduled Commercial Banks (SCBs.) Batra also analyzed the factors resulting to NPA in the early nineties and came out with these points.

- Public Sector Banks performed commendably even though there were limitations set for them. But during early nineties, PSB's were suffering from severe capital inadequacy representing negative profitability. This situation occurred as the restrictions which were set for their functioning were incomplete which did not project the dominant needs of corporate targets. Incorrect target perception and identification lead them to the wrong way resulting NPAs.
- PSBs were functioning under control and as per the direction of Finance Ministry during Pre-reform era. Along with Reserve Bank of India (RBI), it directed all aspects of working of the working of the banks. Banks were not free to price their products in competition with each other. They could not provide loans to division of their choice disallowing them invest their funds in their best interest.
- Finance Ministry and RBI used to take major policy decisions. Even if directors were appointed from the specific sectors to make decision, there was political invasion in either the decision making itself or on the appointment of directors.
- Audit and inspection was done only for formality and it was unable to correct the effect of serious errors in policies and directions.
- Banks could not build up itself in terms of skills and expertise to regulate the credit growth which increased by 160 times (i.e. from 3,000 crore in 1970 to 475113 crore on 2000)
- Need for credit information was not felt and not made which disabled banks to publish names of the defaulters to other banks in the financial system.

The impacts of NPAs on the working of commercial banks are:

- Impact on Profitability
- Impact on the outlook of Bankers towards credit delivery.

- Excessive focus on credit risk management.
- High cost of fund
- Impact on Bank’s screenplay on Stock Exchange.

Sapkota (2004) in his article published on 19 May, 2004 in Rajdhani National Daily entitled "Portion of NPA in commercial banks-high in public, low in private" has highlighted the fact of NPA as being less in private banks in comparison to public banks. He has mentioned that the NPA of two big nationalized banks (NBL and RBB) was about 60% and the loans were in very serious situation. He further added that in order to improve this situation and to make healthy banking environment, financial reform program had been brought, as its consequences, the management of these two big banks were handed to foreign company on a contract but the ration of NPL was not reduced (Sapkota, 2004).

The supervisory authorities impose strict regulations for the income recognition of NPLs. Loans which are classified as substandard, doubtful or loss requires suspension of interest payment and if the interest is not collected it would be considered as non-accrued interest which is erased from the income. Normally, uncollected interests are put on memorandum accounts where NPLs are restored on accrual basis after the full settlement on all uncovered principal and interest. So it would be useful if footnotes are kept which explains the accounting policies followed with observance of recognition of income from NPAs. The interest income of the bank should replicate only interest income which are realized and should exclude accrued interest in order to avoid overstatement of interest (Sapkota, 2004).

When bad loans are to be written off, the decision is done by the BODs relying on the established legal systems and the repayment culture. It is hard to advise to the authority to regulate guidelines as to when a loan could be considered as unrecoverable.

The banks should report NPAs under the three categories and it would be preferable to categorize NPA in accordance with the industrial sector. It is to be noted that the total amount of NPAs should not include non- accrued interest.

Kundu (2005) in his article Non-performance of Non-Performing Assets analyzed certain difficulties with NPAs which were:

- Market return on capital cannot be received by the owners. Owners may even lose their assets if the bank fails which would affect the large number of shareholders.
- Market return on savings cannot be received by depositors. If the bank fails, depositors would lose their savings or uninsured balance. Banks will also redistribute other borrowers by charging higher rates of interest resulting in lower deposit rates and higher lending rates which would hamper the economic growth of the nation.
- NPAs symbolize bad loans which misallocate credit from good projects, which do not receive funding, to failed projects. Bad investment ends up in misallocation of capital, labor and natural resources resulting in the economy to perform below its production level.
- NPAs may pour out the banking system and catch the money stock, leading to economic reduction.

The writer also writes about the affect of politics on lending by banks. Loans are given to various industries not for commercial purpose and on the viability of project but on the basis of political power. Some politician would ask the bank to extend the loan to a particular corporate and the bank would be required to do so. In normal situation, bank should make a review of the actual need of the party concerned, the business prospect of the firm, its financial statements, the management etc. But since it is not done; many of these loans become NPAs.

In the same context, Kundu also made a comparative study with some other countries stating the causes of NPA and measures adopted for its reduction which are as below:

- **China**

a. Causes:

(i) The State Owned Enterprises (SOE's) believes that the government will take them out from trouble and they continue to take high risk and not really strive to achieve profitability and operational efficiency.

(ii) Political and social implications of restructuring SOE's force the government to keep them upbeat.

(iii) Banks are disinclined to lend to private sectors as NPA of private sectors are both politically and financially undesired.

(iv) Lack of courts capacity to enforce.

b. Measures:

(i) Reducing risk by strengthening banks, raising disclosure standards and spearheading reforms of the SOE's by reducing their debt level.

(ii) Passing the law allowing the creation of assets management companies, foreign equity participation in securitization and assets based securitization.

(iii) Incentive like tax breaks, exemption from administration fees and clear cut asset evaluation norms should be implemented. Leases, transfers, restructuring, debt to equity swaps and assets securitization methods should be used to dispose non-performing loans.

- **Korea**

a. Causes

(i) Extended periods of interest rate control and selective credit allocation resulting in inefficient distribution of funds.

(ii) Lack of monitoring where banks depended only on collaterals and guarantees in the allotment of loans. Banks did not pay enough attention on cash flows and earning performance.

b. Measures

(i) Corporate Restructuring Vehicles (CVR) and debt/equity Swaps was used to facilitate the resolution of bad loans.

(ii) Korea Asset Management Corporation (KAMC) and NPA fund was created to finance the purchase of NPAs.

(iii) Strengthening of Provision norms and loan classification standards based on future like estimated cash flows were implemented.

(iv) Financial Supervisory Commission (FSC) was created on 1998 to ensure an effective supervisory system by the central bank.

- **Japan**

a. Causes

(i) High price investment on real estate during boom. The recession caused prices to crash and turned lot of the loans as bad loans

(ii) Time consuming and expensive legal mechanism to dispose bad loans which resulted in NPAs to remain on the balance sheet.

(iii) Expansionary fiscal policy measures administered to rouse the financial system propped up construction and real estate industrial segment which may further worsen the NPA problem.

(iv) Inadequate accounting systems.

(v) Weak corporate governance combined with a no-bankruptcy policy.

b. Measures

(i) In 1997 foreign exchange control law was amended and threat of suspension of banking business with regards to capital adequacy ratio was prescribed.

(ii) Japanese accounting standards was established on 2001 in lieu with international accounting standards.

(iii) The government committed public funds to deal with banking sector weakness.

- **Pakistan**

a. Causes.

(i) "Zero equity" project culture where there was minimal due thoroughness performed by banks in giving loans along with collusive lending and poor corporate governance.
(ii) Poor entrepreneurship.
(iii) Unceasing over capital and lack of competitive advantages.
(iv) Loan given due to political influence.

b. Measures

(i) Independent board of directors (BOD) was appointed in the bank and the top level management of the banks was changed.
(ii) Aggressive settlements of debt with the default borrowers at a less value (well below the actual debt.)
(iii) Corporate and Industrial Restructuring Corporation (CIRC) was set up in order to take over the Non-performing loan portfolios of national banks on certain agreed terms and conditions and issue government bonds which earned market rate of return.
(iv) Banking Companies Act was introduced in 1997 and special banking courts was established under the act to facilitate the recovery of non-performing loans and advances from the defaulter (Dhanuskodi, 2006:25).

From the study of causes and measures of NPAs in these countries, the methods of resolving NPAs could be:

(i) Recapitalization of banks with Government aid.
(ii) Disposal and write off NPAs.
(iii) Increase the regulation of banks to avoid NPAs.

In the article by Chhetri (2005) entitled "Non performing assets: A need for rationalization" the writer has attempted to provide connation of the term NPA and its potential sources, implication of NPA in financial sector in the South East Asian Region. He had also given possible measures to manage NPA. Since the date became past dues, the loan became NPA. The book of account with lending institution should be effectively operative by means of real transaction effected on the part of the debtor in order to maintain loan performing. As per Chhetri failure of business for which loan was used, defective and below standard credit appraisal system, credit programme sponsored by government, slowdown in economy recession, diversion of fund are some of the factors leading to accumulation of NPAs. Chhetri concluded that financial institutions are best with the burden of mounting level of NPA in developing countries. Such assets debar the income flow of the financial institution while claiming additional resources in the form of provisioning there by hindering gainful investment. Rising level of NPAs cannot be taken as stimulus but the vigilance demanded to solve the problem like this eventually will generate vigor to gear up the banking and financial activities in more active way contributing to energizing growth (Chhetri, 2005:17).

Dhanuskodi (2006) in his article about NPAs with special reference to Commercial Bank of Ethiopia (CBE) and defined NPA as an asset which ceases to generate income of the bank. The past due amount remaining uncovered for the two quarter consequently the amount would be classified as NPA for the whole year. It includes borrowers' defaults or delays in interest or principal repayment. In the study he found that NPA affects the internal & external positions of the bank which are:

A. Internal Factors:

- NPAs Increase the total expenditure: If NPA occurs, expense for provision for doubtful debts should be made which causes relevant increase in the expenses
- NPAs reduce earning capacity: The NPA affects earning capacity of the bank. In general various causes reduce the profitability performance of the bank. The provision for doubtful debts is one among the most important cause for reducing the profitability of the bank
- NPA reduce ROA and ROE.

- NPA affect Capital Adequacy Ratio.

B. External Factors:

- The high level of NPA is not preferred by Regulatory and credit rating agencies.
- Indifferent attitude developed in the mind of Bank's Customers.
- Image of the bank in the eyes of general public will go down.

The author concludes as NPA is a double-edged weapon, which affects bank profitability due to interest income not being recognized on NPA accounts and loan loss previously to be created from profit earned. The bank must adopt structured NPAs management policy for elimination or reducing the NPAs in the Bank. In general the trend of NPAs in CBE are increasing trend, on the same time the CBE has been adopted a very good techniques to control over the NPAs.

Uprety (2008) wrote a column on a web page and criticized the NRB directive to blacklist the big loan defaulters. He claimed as even this step is appreciative; there is no transparency and inclusiveness in the law- making process in Nepal which has been its weakness as it fails to withstand three main tests so that the provision would be as effective as law. The three factors are:

- **Legality**: Even the directive has been imposed by NRB; legally the bank has not been given the authority to impose a directive of this nature under the NRB Act 2058. Even if we assume that the directive has a legal basis, it will require the approval of NRB board which is not done yet.

- **Constitutionality**: As per this directive, banks and financial institutions are prohibited to extend the credit not only to the blacklisted businessmen but also to their relatives. For example: if a father is blacklisted, his son or daughter is not allowed to take loans from banks. Similarly if a private company is blacklisted, the stakeholders of the company are automatically blacklisted. A shareholder who holds more than 10 percent share in a public company which has a default bank loan is also blacklisted even the shareholder is not involved in the management of the company. So this directive seems like it is above the Constitution of Nepal which guarantees the right to do business, profession and occupation as fundamental rights of all citizens.

- **Rationality**: this directive fails to be rational as it can blacklist businesses even if one of its projects fails out of five successful projects. If the rationale was to force the businessmen to divert their cash flows from successful ventures to give financial security to unsuccessful ventures, then it ignores other investors and parties involved of the successful projects.

Despite all these weakness the system of Credit Information Bureau (CIB) included by the directive should be encouraged and it should be strengthened. The role of CIB should be clear and should be restricted only for the information of credit-worthiness of individuals or companies. Banks should compulsorily consult for the information kept by the CIB before granting any credit facility not only for the huge amount but for every transaction.

Nepalese Banking System is puzzled by NPA of considerable amount which was up to NRs. 22.18 billion as of Mid July 2007. The NPA was 9.56% of total loans and advances. NPA was declined by NRs. 2.30 billion in 2005/06 and further by NRs. 3.40 Billion in 2006/07. So, from this analysis we can clearly see that although loans and advances are increasing, NPA. Even though NPA is decreasing the NPA ratio has not still yet reached the satisfactory level (Uprety, 2008).

The volume of NPA is largely on account of the portfolio if public banks so it need to be broken down into the public and private banks category to magnify the reasons for the existing levels of NPA. The NPA ratio of the public banks is still 19.58% even though it has shown signs of improvement in the past two years. The reform started in the public banks has significantly lowered the volume of NPA in these banks by write offs. The NPA ration in the private banks as on Mid July 2007 was just 4.93%.This ratio has almost been within the range of 10 % and has been shown as improvement in the last six years (Uprety, 2008).

NRB requires provision on all the loans given by the banks, which goes higher as the loan quality deteriorates. The banks must create loan loss provision on the gross value of outstanding loans, rather than on the net loans and they are not allowed the respite in the value of collaterals. The banks thus must create provisions according to the quality of the loan portfolio. Similarly, public banks with large amount of NPAs have large provision in their balance sheets while the provision of the private banks is lower. It shows that the Nepalese banking sector has somewhat protected itself from the large volume of NPA through creation of loan loss provisions. Even though the gross NPA ratio is still high, the net NPA ratio is minimal which implies that the banking sector doesn't stand to lose any more on account of NPA.

Since the large volume of NPA has been a major problem in the public banks of Nepal along with some private banks, reform program started helped to lower the amount of both Gross and Net NPA. In the chart presented below, a wide gap between NPA and provision can be observed during mid July 2002 and has narrowed down since. As on mid July 2007, total provisions had covered the total loans of the industry.

2.6 Review of Related Thesis

Lila Prasad Ojha (2003) conducted a study on "*Lending Practice: A Study on NABIL Bank Limited, SCB Nepal Limited, and Himalayan Bank Limited*." With the objective of:

- To determine the liquidity position, the impact of deposit in liquidity and its effect on lending practices.

- To measure the bank's lending strength.
- To analyze the profit behavior of lending and measuring the ratio and volume of loans & advances made in agriculture, priority and productive sector.
- To measure the lending performance in quality, efficiency and its contribution in total income.

The study was conducted on the basis secondary data. The research finding of the study is:

The measurement of liquidity has revealed that the mean current ratio of all the three banks is not widely varied. All of them are capable in discharging their current liability by current assets. The measurement of lending strength in relative term has revealed that the total liability to total assets of SCNBL has the highest ratio. The high ratio is the result of high volume of shareholders equity in the liability mix. Himalayan Bank Limited has high volume of saving and fixed deposit as compared to current deposit resulting into low ratio of non-interest bearing deposits to total deposits ratio compared to the combined mean. SCBNL's tendency to invest in government securities has resulted with the lowest ratio of loan & advances to total assets whereas. NABIL Bank Limited. Has the highest due to steady and high volume of loan & advances throughout the years. The ratio of investment on loan & advances has measured the total portion of investment in total of investment and loan Advances. The mean ratio among the bank does not have deviated significantly. The loan & advances and investment to deposits ratio has shown that NABIL Bank Limited has deployed the highest proportion of its total deposits in earning activities. This is indicative of that in fund mobilizing activities NABIL Bank Limited is significantly better.

The absolute measures of lending strength have revealed that the mean volume of net assets and deposits is higher in SCBNL with moderate variation. The volume of net assets of Himalayan Bank Limited is the least to the low share of capital, reserves & surplus in its capital mix. But the volume contributed by Himalayan Bank Limited. In case of loan & advances is highly appreciable compared to its net assets. The volume of loan & advances contribution by NABIL Bank Limited is the greatest in five years of study period. The mean investment of NABIL Bank Limited is the highest but the investment on government securities of SCBNL is the highest. The portfolio analysis has revealed that the flow of loan & advances in agriculture sector is the lowest priority sector among these commercial banks. The contribution of the entire bank in industrial sector is appreciable. The contribution made by Himalayan Bank Limited. In industrial sector is the greatest that of SCBNL is the least. The lending in commercial purpose is the highest in case of NABIL Bank Limited and least in case of SCBNL has highest contribution in service sector lending. It has contributed 34. 86 % of its total credit in general use and social purpose. The measurement of efficiency in lending has revealed that the loan loss provision to loan & advances analysis shows NABIL Bank Limited has the highest mean ratio. According to Nepal Rastra Bank directives, the loan loss provision indicates the provision made against the performing loan (pass loan and sun-standard loan) only. It indicates that the volume of sub-standard loan in the loan mix on NABIL Bank Limited. Is higher and the volume of non-performing loan in the mix of NABIL Bank Limited is likely to increases in coming future. The mean ratio of interest income to total income has concluded that the contribution of interest income in total income is higher in case of Himalayan Bank Limited. And lower in case of SCBNL. The interest expanses to total deposits ratio indicate that the cost of fund in Himalayan Bank Limited. Is the highest and that of SCBNL is the least. The total income to total assets ratio measures the earning power of each rupee employed by the bank. NABIL‘s ratio in this case is the best. The ratio of total income to total reflects the capacity of a rupee of expanses. The productivity of expanses in SCBNL is the best. The performance of SCBNL is significantly better than two banks in case of profitability. EPS is the highest in the case of SCBNL.

Samiksha Thapa (2004) conducted a study on "*Investment Policy of Nepal Bangladesh Bank Limited and other Joint Venture Banks (NABIL and Grindlays Bank Limited.)*" with the objective of:

- To examine the liquidity, assets management efficiency, profitability and risk position of NB Bank in comparisons NABIL and NGBL.
- To analyze the relationship between loan & advances and total investment with other financial variables of NB Bank Limited and compare them with NGBL.
- To examine the fund mobilization of investment policy of NB Bank through off-balance sheet activities in comparison to the other two banks.
- To study the various risks in investments of NB Bank in comparison with NABIL and NGBL.
- To analyze the deposit utilization trend and its projection for next five years of NB Bank and compare them with NABIL and NGBL.

The study was conducted through secondary data. The research findings of the study are as follows:

The liquidity position of NB Bank is comparatively better than that of NABIL and NGBL. NB Bank is not better position regarding its on balance sheet as well as off balance sheet activities in compare to NABIL and NGBL. NB Bank dose not seem to follow any definite policy regarding the management of its assets. Profitability position of NB Bank is comparatively worse than that of NABIL and NGBL. NB Bank has maintained high growth rates comparison to other banks through it is not successful to make enough investment. The position of NB Bank in regard to utilization of the fund to earn profit is not better to compare to NABIL and NGBL.

Shrijana Shrestha (2006) conducted a study on "*Nepal Rastara Bank Guidelines on Investment Policy of Commercial Banks in Nepal (A Case Study of Nepal Investment Bank limited.)*" With objective of

- To highlight the NRB directives regarding investment policy (Loan, advances and investment)
- To analyze the liquidity of NIBL.
- To find out relationship between total deposit total and loan and advances, total deposit and total investment.
- To make the trend value analysis of deposit utilization and its projection for next five years.
- To find out whether NRB guidelines are actually being implemented.

The study was conducted on the basis on secondary data.

The main finding of the study is:

Bank in good position to meet the daily cash requirement as bank maintain the average cash and bank balance in respect to total deposit. The performance of NIBL regarding deposit collection, granting loan and advances and investment is quite satisfactory but does not seem to follow a definite policy. NIBL has not efficiently utilized its equity capital hence return on equity is not satisfactory because of lack of sound investment policy for mobilization of its equity capital. Interest earned to total operating income of NIBL is high. However, bank failed to maintain net profit on the study. From the analysis of coefficient of correlation, there is positive and significant relation between total deposit and loan and advances and current assets and current liabilities and loan loss provision and loan advances but there is negative and no significant relationship between outside assets and net profit. Trend analysis and projection for next year of total deposits, loan and advances, investment and net profits are in increasing trend.

Kafle (2006) in his study entitled "*Non-performing Loans of Nepalese commercial banks*."

The researcher's mean objectives of the study are:

i) To know the problems of the non-performing loans and its effect in the ROA and ROE of the Nepalese commercial banks

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

The major findings of the study are:

Through the research he has found that the no banks have been following NRB's directives regarding the loan loss provision. He also conclude that the return on assets (ROA) and return on equity (ROE) of the bank deposed upon the NPLs. The high degree of negative correlation between NPL and ROA and the NPL and ROE clearly indicates that there is inverse relation between them. He has recommended that for the smooth operation of the commercial banks, the NPLs should be controlled for this bank should provide necessary training regarding loan management to the manpower's. In order to remove, the NPLs, banks should take enough collateral so that banks can recover its loan amount. For the loan loss provision as per the NRB directive and to reduce the NPL, the bank management should be effective and the NRB's monitoring and regulation is necessary.

Thapa (2008) entitled "*A Study of Non-performance Assets of Nepalese Commercial Banks in Nepal*" of the period from FY 2001 to FY 2007.

The objectives of the study are as below:

a) To highlight Loans and Advances trend in commercial banks.
b) To point out the amount of NPAs in Nepalese commercial banks

The major findings of his study are as follow:

- The status of non-performing loan of commercial banks shows that, they are making positive improvement over it. By the end of mid July 2007, the ratio of non-performing loans to total loan and advances declined to 9.65 percent. Total amount of non-performing loan remained to Rs. 22182.9 million in the same year. In the last year the percent and amount of non-performing loan were 14.22 percent and Rs. 26770.42 million respectively.

- Loans and advances, the major component of assets, constituted the 46.66 percent of total assets in mid July 2006. Similarly, investment and liquid funds, another component of assets, registered the 19.06 percent and 8.98 percent of total assets in the same year. In the preceding year the respective share of loan and advances, investment and liquid funds were 40.44 percent, 19.15 percent and 9.06 percent. In the current year the loan and advances increased by higher rate of 32.05 percent compare to 8.61 percent in the last year. By the end of mid July 2006 the total outstanding amount of loan and advances of commercial bank reached to Rs.228951.9 million. It was Rs. 173383.4 million in mid-July 2005.
- In the current fiscal year deposit mobilization of commercial bank marginally increased by 15.88 percent compare to 15.39 percent growth in the previous year. By the end of mid July 2006 it reached to Rs. 337497.2 million from Rs. 291245.6 in the last year. Of the component of deposit, current deposit celebrated by higher rate of 20.45 percent compared to 7.91 percent in last year. Fixed deposit increased slightly higher of 13.89 percent compared to 13.75 percent in the previous year. However, saving and call deposit growth rate slipped to 15.23 percent and 18.62 percent compare to 16.65 percent and 28.51 percent respectively.
- Liquid funds increased by 14.45 percent and reached to Rs.44089.7 million in mid-July 2006 from Rs. 38842.1 million in mid-July 2005.
- In the current fiscal year the net profit of the banking system grew by slower rate of 10.20 percent compared to 53.38 percent in the last year. By the end of mid July 2007 the net profit amounted to Rs. 8797.9 million from Rs 7983.5 in mid July 2006.

Shrestha (2008) conducted a study on "*SWOT Analysis of Nepal Bank Limited* "with the objective of:

a) To Review strength & weakness of Nepal Bank Limited in it's major areas of operation.
b) To explore areas of opportunities and threats to Nepal Bank Limited prevailing in the changing context.
c) To show a suggestive package based on the findings of the study for the improvement of the financial performance of Nepal Bank Limited.

On the basis of the various studies and analysis major findings of this study are presented below:

i) Liquidity Position of sample bank seems quite near or an average. It is obvious that in the present situation of the country, investment potentiality is not favourable so the liquidity in the commercial banks is sufficient.

ii) The sample commercial bank has high volume of non - performing assets with respect to the total assets i.e. 0.30.

iii) There was a situation of continuously negative profit in Nepal Bank Limited till the FY 2059/60. Therefore, all the indicating factors to represent the profitability are in negative in Nepal Bank Limited. NBL was generating interest income from its credit on average of 7.0%. If we take the volume of net profit in NBL, It was 1323 million in the FY 2061/62.

iv) Because of the negative profit up to 2059/60, NBL has negative earning per share. But from the FY 2060/61, it can earn profit and its earning per share is positive. But average EPS of NBL was Rs 307 in the study period.

v) Credit and Investment to total deposit ratios of Nepal Bank Limited was 78% on an average for the study period. Similarly correlation between deposit and loan and advance was negative correlation in Nepal Bank Limited for the study period. This indicates that trend of deposit utilization in RBB was poor.

vi) Nepal Bank Limited was not being able to maintain the preferred provision apart from for pass loan. Similarly NBL was high provision for non - performing loan. As far as directive credit is concern NBL could not provide any kind of figure for directive credits.

Devekota (2009) conducted a study on "*Comparative SWOT Analysis of Nepalese Commercial Joint Venture Banks (Standard Chartered Bank Nepal Ltd., Nepal Arab Bank Ltd. and Himalayan Bank Ltd.)* "with the objective of:

a) To study and analyze the growth, objectives, functions, and role of the commercial Joint Venture Banks
b) To evaluate the comparative financial strengths & weakness of three competitive JVBs.
c) To provide package of suggestions and possible guidelines to improve the banking operation in order to maximize the values of their shareholders based on the findings of the study.

The major findings of the study are:

a) Banks are primarily profit making organizations that provide a range of financial services to their customers. On the basis of the profitability, the selected JVBs are among the top five commercial Banks operating in the country, Standard Chartered Bank Nepal Ltd., being the top one. The profitability position of SCBNL & NABIL is better than that of HBL in terms of Return on total assets and total deposits.
b) Interest incomes form the major portion of the total income in all these selected JVBs during this study period. Likewise, interest expenses cover the major portion of total expenses in these banks.
c) During the study period, HBL is found to be the highest Deposit holding bank. In other words, Total deposits of HBL exceeded the other two banks under study, SCBNL & NABIL, in all of the years taken for this analysis. *In*

the trend analysis section, it is noticeable that the Total Deposits for NABIL is in the decreasing trend. The Total deposits trend of NABIL explains that its deposit is declining by NRs. 389.22 million each year. The Total deposits trend of HBL shows that the trend line almost fits with the actual Total deposits which have been increasing by NRs. 1795.42 million each year.

d) HBL has been seen to adopt the aggressive lending policy during the period of this analysis. It has been mobilizing a large portion of its Total deposits on Loans & Advances. The Loans & Advances of HBL has always been greater as compared to SCBNL & NABIL during this whole period under analysis.

e) In case of all three JVBs, debt financing has always almost exceeded 90 % of the Total Assets over the review period, which indicates the excessively geared capital structure of these banks, which signifies the excessive use of debt to finance Total Assets. The high 'Total Outsiders' Fund to Total Assets' ratio implies bank's success in exploiting debts to the more profitable assets. Since all the JVBs had been extensively using debt financing to the total assets, it can be concluded that these banks are highly levered.

f) The analysis reveals that all the JVBs have limited their Net Fixed Assets to Net worth Ratio at adequate level. Banks being the non-manufacturing enterprises have the minimal investment of owners' equity in the fixed assets in order to maximize the return on shareholders' fund.

g) The investments of all these JVBs are found to be more or less volatile. In some years, they are in the increasing trend whereas in other years, they are in the decreasing trend. This might be due to the instability in the political & economic situation of the country, which created an environment of chaos in the overall economy including the banking industry.

h) Other financial indicators like Earning per share (EPS), Dividend per share (DPS) and Book Value per share of SCBNL is found in the better position as compared to that of NABIL & HBL. The DPS of SCBNL & NABIL is in the increasing trend as compared to that of HBL, which is rather volatile.

i) The comparative strength of SCBNL is better as compared to NABIL & HBL as per data and as per the analysis done in the various sections. One the primary objective of the commercial bank is to maximize the profit. The SCBNL has dominated in this regard during almost the whole period of study except for one or two cases where NABIL took off. However, the profit before tax of all three banks is in the increasing trend.

j) The loan loss provision of SCBNL has always been least (during the whole period under analysis) among these three selected Joint Venture Banks signifying that it has less amount of bad loans, which is obviously good for any bank. This also proves the greater strength of SCBNL in mobilizing its deposits in the more beneficial manner.

Since all the three Banks selected for study are among the top banks operating in Nepal, their relative financial strength is better in the economy as compared to the other banks. But while comparing these selected banks alone, SCBNL, NABIL & HBL can be ranked chronologically as banks with higher strengths and lower weaknesses. Opportunities & Threats are present in the external environment. It is very probable that the bank with higher strength can grasp excellent opportunities and avoid redundant treats present in the economy.

Yadav (2009) in his thesis entitled "*A Study on Non-performing Assets- with Special Reference to Nepal Bank Limited and Rastriya Banijya Bank Limited*"

The objectives are specified as below:

a) To study the general reasons for assets become NPA in RBB and NBL
b) To point out the level of NPAs in NBL and RBB banks after financial sector reform program
c) To find out the problems of banks due to NPAs

The major findings are as follows:

- The share of RBB and NBL in the assets and liabilities of the banking sector is around 50%. Although international financial experts have been managing these banks, the performance especially for reducing NPA is not satisfactory.
- The management teams were supposed to bring NPA level to 5% level. The NPA total credit ratios of RBB increased from 20.17% in FY 1997/98 to 60.15% in FY 2002/03. It increased by 5% points in FY 2002/03 than the previous year. Like wise, the NPA / total credit ratio of NBL also increased from 27.46% to 60.47% in FY 2002/03, which shows the rising trend.
- Both of them has negative net worth since FY 1998/99 and the net worth figures continuously increased in the last five years. Although financial performance of both the management teams is totally unsatisfactory, they have improved in other areas. People are questioning the returns of such a huge expense. Is it going to be a futile exercise, suppose they brought down the NPA level to a satisfactory level? But what will happen after the management teams leave the banks? Questions are still remaining unanswered.
- The net profit trend of NBL and RBB is highly negative in first three fiscal year because more than 60% non performing asset. But now, NBL and RBB is earning profit from last two years.
- Total deposit is not correlated with this two banks' loan and advance. This is very serious matter and the main cause of over liquidity.
- Situation of deposit mobilization is poor in NBL and RBB. NBL and RBB was not focusing on the quality of loan rather focusing on the volume of loan.
- After the implementation of financial sector reform NBL and RBB is able to earn profit from 2060/61 and also able to decreasing volume of non - performing assets. But NBL and RBB have to more focus to improve the credit management because NBL and RBB are not able to maintain NPA as the specified standard of NRB i.e. 5 %.

- Credit related financial indicators in NBL and RBB seem irrelevant in comparison with the specified standard of NRB.
- Various acts and regulations are enacted for the financial sector reform but implementation of policies and directives like directed sector credit, sufficient provision for loan loss, volume of NPA is vital because of the increasing trend of NPA in commercial banks.

2.7 Research Gap

The researcher has found various studies conducted in the field of financial performance and loan management of joint venture banks. But there is very few studies regarding non-performing assets. However, different pilot studies have been reviewed so that the chances of duplication will be avoided from the present study and some newness can be created for serving the objective set. Similarly, different previous researchers have confined their study to the examination and evaluation of financial operation, financial position and loan management of Standard Chartered Bank Nepal Ltd., Nepal Arab Bank Ltd., Himalayan Bank Ltd. and Nepal Bank Limited. They have assessed their strengths, weaknesses and opportunities and attempted to find out reasons of changes on profitability and liquidity trends of the both.

In conclusion, the researcher is trying to clear that whether it is focused to the deposit mobilization, generating more profitability, giving more loan and advances to customers or not and collection of loan disburse. So, it is trying to evaluate the effectiveness of monitoring and collective policies of non-performing assets of the banks especially of Nepal Credit & Commerce Bank Ltd. (NCCBL) and Nepal Bank Limited (NBL). There is no confusion that Non-performing assets (NPA) affects the profitability of commercial banks. But without a systematic research or study, it cannot be said that how much these two are affected by NPA. On the surface, NPA might appear to be largely unrelated, because operations personnel typically do not participate in screening and monitoring loan customers, and at the same time loan officers and review personnel typically do not participate in overseeing operations costs. Despite this separation between NPA and profitability, it cannot be reached to a conclusion that there is no any relationship between problem loans (NPA) and profitability of commercial banks. Therefore, to reveal the secret, it is necessary to conduct a systematic study. That is why this research will try to find out the relationship between NPA and profitability. Likewise, this study will also highlight on the effect of NPA on banks profitability. The main research problem is to analyze whether the sample banks have right level of NPA and liquidity as well as is able to utilize its resources effectively or not. To achieve this main objective, various financial and statistical tools are used. Therefore, this study is useful to the concern bank as well as different persons: such as shareholders, investors, policy makers, stockbrokers, state of government etc.

CHAPTER-III
RESEARCH METHODOLOGY

The research methodology is followed to achieve the basis objectives and goals of this research work. The basic objective of this study is to highlight the NPA level in NBL and NCCBL. For systematic analysis of related data and information proper research methodology is necessary. Research methods helps to analyze, examine and interpretation of data and information in research work. The sole objective of this study is to examine and to analyze the NPA management of NBL and NCCBL and to provide recommendation for their financial improvement. Research design, nature and source of data, period covered, research variables, sample and method of data analysis are incorporated under this chapter.

3.1 Research Design

The bottom line of this research is to analyze the soundness of NBL and NCCBL in relation to loan disbursement and NPA. The research design of this study is descriptive as well as analytical. This available information from primary and secondary source are used to examine, explain and evaluate the disbursement and collection situation of NBL and NCCBL. Descriptive research design has been adopted in fulfilling the objectives of this study. It is tough to study the principle causes arising from borrowers' side and quantify them in relation to weak repayment performance of NBL and NCCBL. The statistical analysis is done to assess the trend of loan disbursement and NPA from F.Y. 2004 to 2009. Average, Percentage, graph, chart and diagrams are included.

3.2 Nature and Sources of Data

For this study, mostly secondary data are used. These secondary data are collected mainly from published source like annual report, prospectus, balance sheet, newspaper, jouranal , Internet and other sources.

Secondary data like sources & uses of fund, NPA Staus of banks are obtained from Banking and Financial Statistics published by Nepal Rastra Bank and through personal visit of respective organization as well as from their web sites. Similarly other secondary data like loan classification of respective bank has been obtained from annual report of the concerned banks.

3.3 Population and Sample

The sample size has been drawn in such a manner that it gives most of the information with maximum accuracy and relevancy with the research objective. Out of 28 commercial banks, NBL and NCCBL have been chosen as sample. NBL represents the public banks of Nepal whereas NCCBL represents the private sector banks of Nepal. The sample size has been chosen in size a manner that it would be enough to provide all necessary information.

The population of this study comprised all the 28 commercial banks of Nepal. Interview was taken to staffs of NBL and NCCBL who has been working or already worked for credit department of respective banks.

3.4 Sampling Method

The sampling method used for the study is the judgmental sampling. It entails that the selection of the sample is deliberate and not random. The rationale behind taking samples of NBL and NCCBL is that these are the banks which have a higher level of NPA than the other banks and both public as well as private sector of banks have been covered in this thesis.

3.5 Data Collection Procedure

The data was collected through the annual reports of NBL and NCCBL. It was difficult to get the data of NBL as the Annual General Meeting of the bank was not held for years. So, the data of NBL was gathered through personal visit and with the help of the staffs at the Credit Department of Head Office. Other required information regarding reason for accumulation of NPA and measures that the banks has been adopting for reduction of the same has been collected via in depth interview with credit officers at both the banks at mutually convenience time.

3.6 Data Analysis

Any statistical tools can be used in solving the problem of the study. For the purpose of the study, all collected primary as well as secondary data are arranged, scanned, tabulated, under various heads and then after descriptive cum statistical analysis have been carried out to enlighten the study. Mean and trend analysis are being calculated under statistical analysis.

3.6.1 Financial Tools

Financial analysis is the process of identifying the financial strength and weakness of the firm by properly establishing relationship between the item of balance sheet and profit & loss account, while adopting 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 to analyze a company's financial position and performance and to assess future financial performance (Sharpe, 2000)

Ratio Analysis: Ratio analysis is the numerical relationship between any two given variables of financial statement, which serve meaningful purpose for study. Ratios are expressions of coherent relationship between items in the financial statements of a fiscal year.

Non-performing Loan to Total Gross Loan

This ratio is used to identify the share of bad debts or useless credits in the total credit & advances of banks. In other words, this is the share of credits, which are failed to generate regular earnings. It is always expressed in percentage. Lower and lower ratio is desirable for banks. It is calculated by using the following formula.

Non-performing Loan to Total Gross Loan = $\frac{\text{Non - performing Loan}}{\text{Total Gross Loan}}$

Loan and Advances to Non-performing Assets

This ratio indicates the proportion of non-performing assets in relation to the loan and advance. The ratio is very important ratio for every bank. Nowadays, non-performing assets affect lots of banks. Higher ratio indicates increasing in the bad quality of loan (assets) in the total volume of loan and advance. Higher ratio indicates the poor and ineffective credit policy and poor performance of the economy. It is calculated by using the following formula.

Loan and Advances to Non-performing Assets = $\frac{\text{Non - performing Assets}}{\text{Loan and Advances}}$

The financial tools used for analyzing the data were profitability and asset management ratios under ratio analysis. The formulas of key indictors used in this study were as follows:

~~e.~~a. **Net profit to loan and advances =** $\frac{\text{Net profit}}{\text{Loan and advance}}$

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~~f.~~b. **Total credit to total deposit ratio =** $\frac{\text{Total credit (loans \& advances)}}{\text{Total deposit}}$

~~g.~~c. **Income from loan and advances to total loans ratio**

$$= \frac{\text{Income from loan and advances}}{\text{Total loans}}$$

d. **Credit & Advances to Total Assets =** $\frac{\text{Credit \& Advances}}{\text{Total Assets}}$

e. **Non-performing credit to credit & advances =** $\frac{\text{Non - performing credit}}{\text{Total credit \& advances}}$

f. **Market price per share (MPS) =** $\frac{\text{Market price of share}}{\text{No. of common shares outstanding}}$

Arithmetic Average (Mean)

For the purpose of study as regards to interpretation and comparison arithmetic average was used for the individual data. The arithmetic average is calculated by summing up the ratios and by dividing this figure by the number of observations.

Arithmetic mean (Average) = $\frac{X}{n}$

Standard deviation (S.D.)

It was calculated as an absolute measure of dispersion or variability in the given data with regard to the average variable. Standard deviation for the ratios has been calculated as follows:

S. D. (σ) = $\frac{\int X - \bar{X} Å}{n}$

Coefficient of Variation

According to Prof. Karl Pearson, coefficient of variation is the percentage variation in mean, standard deviation being considered as the total variation in the mean. It is one of the relative measures of dispersion that is useful in comparing the amount of variation in data groups with different mean.

Coefficient of variation, denoted by C.V. is given by;

$$C.V. = \frac{\pm}{X} \times 100$$

Where, ∃ = Standard Deviation C.V.= Coefficient of variation, $\overset{z}{X}$ =mean

∃ = Standard deviation

i.e. $∃ = \sqrt{\frac{X^2}{n} - \frac{X}{n}}\ 2$

For comparing the variability of two distributions, we compute the coefficient of variation for each distribution. A distribution with smaller CV is said to be more homogeneous or uniform or less variable than other. Conversely, a series with greater CV is said to be more variable or heterogeneous than the other.

Trend Analysis: The easiest way to evaluate the performance of a firm is to compare its current ratios with past ratios. When financial ratios over a period of time are compared it is known as the trend analysis. It gives an indication of the direction of change and reflects whether the firm's financial performance has improved, deteriorated or remain constant over time. In this analysis the past trend is analyzed of any data and future movement is predicted.

A widely and most commonly used method to describe the trend is the method of least square.

The straight-line trend is given by the following formula:

$$Y = a + bx$$

Where,

Y =Values of dependent variables

a = y intercept

b= slope of the trend line

x = values of independent variable (Time)

$$a = \frac{\phi y}{n} \qquad b = \frac{\phi xy}{\phi x^2}$$

Where,

y = Sum of the observation in series Y

xy = Sum of the observation in series X & Y

x^2 = Sum of square of the observation in series X

The straight line trend implies that irrespective of the seasonal and cyclical swings and irregular fluctuations, the trend value increase or decrease by a constant absolute amount 'b' per unit of time. Hence, the liner trend values from a series in arithmetic progression, the common difference being 'b' the slope of the trend line

CHAPTER-IV
PRESENTATION AND ANALYSIS OF DATA

This chapter consists of presentation and analysis of data using both statistical and financial tools as referred in the third chapter. The main focus of this chapter is to analyze the sources & uses and NPA of NBL and NCCBL and make a concluding remark on the basis of the analysis conducted. Data gathered from various sources are presented, compared and analyzed with the help of different tools. Therefore, it is the crucial part of this study, which helps to analyze the NPA in banks of Nepal with taking a special reference to NBL and NCCBL. The data are analyzed on the basis of representation of principal indicators.

4.1 Representation of Principal Indicators

Principal Indicators had been accepted to calculate the financial condition of the organizations. Results of operations of the sampled banks are analyzed and interpreted on the basis of the required indicators needed for this thesis. The main motto of the study is to analyze the impact of NPA on the financial ratios of the sampled banks.

4.1.1 Current Ratio

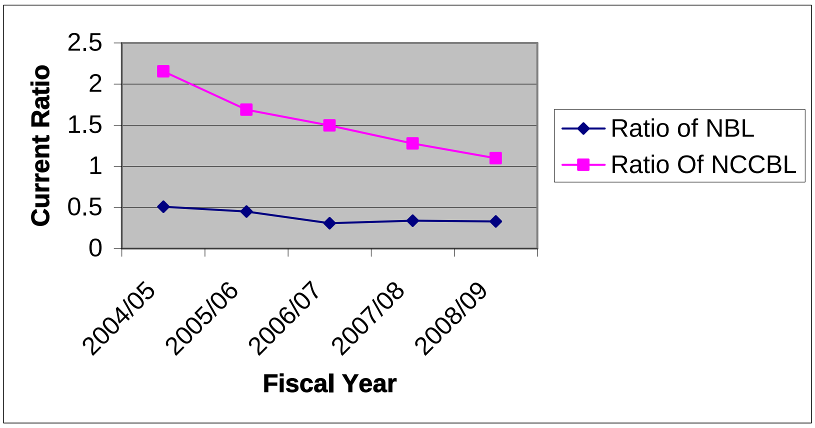
Table: 4.1
Current Ratios of Sample Banks

Year	Current Ratio of NBL	Current Ratio of NCCBL
2004/05	0.51	2.153
2005/06	0.45	1.689
2006/07	0.31	1.497
2007/08	0.34	1.278
2008/09	0.33	1.098
Mean	0.33	1.543
SD	0.388	0.407
C.V	0.087	0.264

Source: Annual Report of Banks

Figure: 4.1

Diagrammatic Representation of Current Ratio



Source: Table 4.1

Table 4.1 shows the current ratios of Nepal Bank Limited for the study period of 2004/05 to 2008/09. The ratios were 0.51, 0.45, 0.31, 0.34 and 0.33 respectively. Comparing to five year mean, only in the fiscal year 2004/05 the ratio is more than the average i.e. 0.51. The higher the ratio, the better is the liquid position of the bank. The trend of current liabilities is of increasing one, where as current assets is in increasing trend up to the fiscal year 2005/06. In the fiscal year 2005/06 the current asset has increased to Rs 6627.11 million from Rs.6266.79 million in the previous fiscal year. The average current ratio, standard deviation and C.V. of NBL are 0.33, 0.388, and 0.087 respectively

The above analysis helps to conclude that the current ratio position is not better in recent fiscal years in case of NCCBL. The figure shows the bank is holding more liquid cash balance in earlier fiscal year i.e. more liquid cash balance in FY 2004/05 than in FY 2006/07, FY 2007/08, and FY 2008/09 respectively. Having a glance at the nature of assets and liabilities of the NCCBL bank has the poor liquidity position. The bank may face the problem of working capital if they need to pay the current liabilities at demand. Delay in payment of the liabilities may lead the banks to lose their goodwill. They will have the problem in winning the confidence of current depositors and short-term lenders. Therefore too much liquidity as well as too low liquidity both is not desired and both have negative impacts. Thus maintaining a proper liquidity position is must.

The Table 4.1 clearly shows that the current ratio of the bank has different ratios showing different liquidity positions. The current ratio of NCCBL, under the study period, it has ranged between 2.153 in the fiscal year 2004/05 to 1.098 in fiscal year 2008/09. The ratio of the bank showed in decreasing trend. The average current ratio, standard deviation and C.V. of NCCBL are 1.543, 0.407, and 0.264 respectively. It shows that there is more fluctuation on current ratio in NCCBL than in NBL.

4.1.2 Income from Loan and Advances to Total Loans Ratio

Ratio of Income from loan and advances to total loans

$$= \frac{\text{Income from loan and advances}}{\text{Total loans}}$$

Table: 4.2

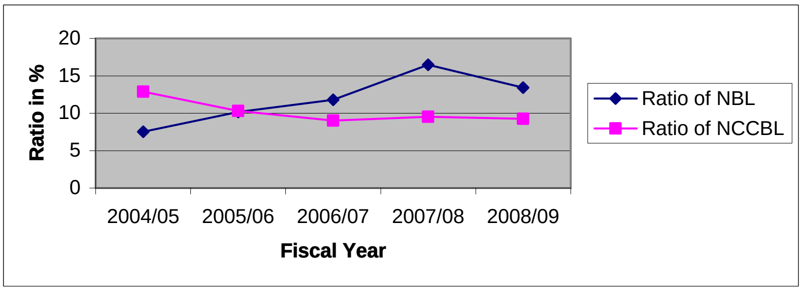
Ratio of Income from Loan and Advances to Total Loans

Year	Ratio of NBL	Ratio of NCCBL
2004/05	7.52	12.87
2005/06	10.17	10.32
2006/07	11.78	9.01
2007/08	16.47	9.54
2008/09	13.44	9.26
Mean	11.87	10.2
SD	3.37	1.57
C.V	0.28	0.15

Source: Annual Report of Banks

Figure: 4.2

Ratio of Income from Loan and Advances to Total Loans



Source: Table 4.2

The above table and the graph represent the ratio of income from loan and advances to total loans of NBL and NCCBL. The income from loan and advances to total loans of NBL is in increasing trend from fiscal year 2004/05 till 2006/07 but it declined in fiscal year 2008/09 even though the NPA level was comparatively low. This shows that NPA has no effect on the income from loan and advances to total loans for NBL. On the other hand, the income generated from total loans of NCCBL was high at 12.87% on fiscal year 2004/05 and low at 9.01% on fiscal year 2006/07. The standard deviation and C.V. of income from loans for NBL is 3.37 and 28% while it is 1.57 and 15% for NCCBL which shows there is more fluctuation on income trend in NBL than in NCCBL.

4.1.3 Net Profit to Loans and Advances Ratio

Table: 4.3

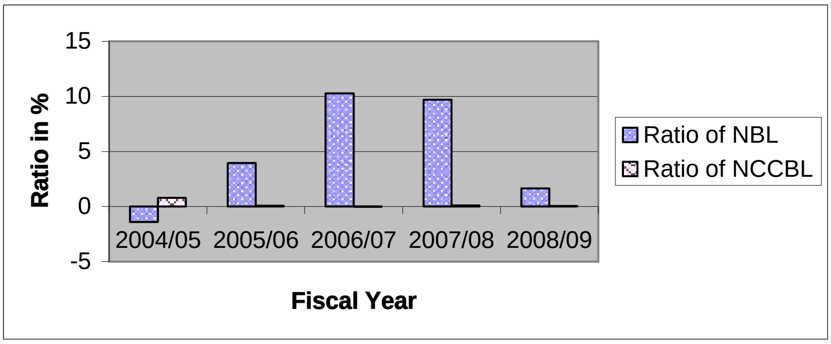
Ratio of Net Profit to Loans and Advances

Year	Ratio of NBL	Ratio of NCCBL
2004/05	(1.39)	0.80
2005/06	3.96	0.07
2006/07	10.26	(0.02)
2007/08	9.70	0.098
2008/09	1.65	0.058
Mean	4.86	0.20
SD	5.06	0.33
C.V	1.04	1.67

Source: Annual Reports of Banks

Figure: 4.3

Ratio of Net Profit to Total Loans and Advances



Source: Table 4.3

The above table shows the ratio of net profit to total loans and advances for both sampled banks. The mean, standard deviation and C.V. ratio of net profit to total loans and advances of NBL is 4.86, 5.06 and 104% while it is at 0.20, 0.33 and 167% for NCCBL respectively. It shows that NCCBL is not earning much of its profit from the total loans and advances and the NPA has caused a serious impact on the bank's profitability. It shows that there is more fluctuation on net profit to loan and advances ratio in NCCBL than in NBL.

4.1.4 Non-Performing Credit to Total Credit Ratio

Table: 4.4

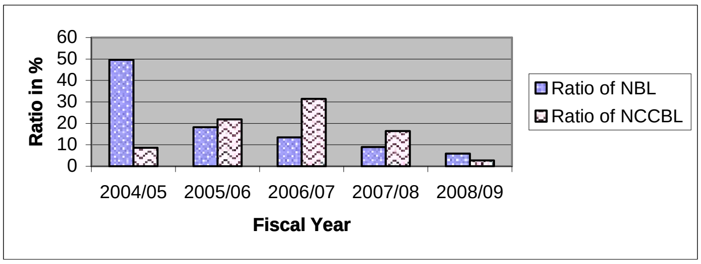
Ratio of Non-Performing Credit to Total Credit

Year	Ratio of NBL	Ratio of NCCBL
2004/05	49.64	8.64
2005/06	18.18	21.87
2006/07	13.49	31.37
2007/08	8.95	16.36
2008/09	5.91	2.74
Mean	19.23	16.19
SD	17.62	11.18
C.V	0.91	0.69

Source: Financial Report of NCCBL and NBL

Figure: 4.4

Ratio of Non-performing Credit to Total Credit



Source: Table 4.4

The above table shows the ratio of non-performing credit to total credit for both sampled banks. The mean, standard deviation, C.V. of non-performing credit to total credit of NBL is 19.23%, 17.62 and 91% respectively while it is at 16.19%, 11.18 and 69% for NCCBL. It shows that NBL is not earning much of its profit from the total credit and the NPA has caused a serious impact on the bank's loan collection. It shows that there is more fluctuation on non-performing credit to total credit ratio in NBL than in NCCBL

4.2 Sources and Uses of Funds

In this portion major principal indicators of both sources and uses of fund had been tabulated to calculate the financial condition of both the selected banks and also of commercial banks in aggregate. Results of operations of the sampled banks are analyzed and interpreted on the basis of the required indicators needed for this thesis. The main motto of the study is to analyze sources & uses of funds and the impact of NPA on the financial ratios of the sampled banks.

4.2.1. Analysis of Sources and Uses of Funds of Commercial Banks (Aggregate)

Management of funds is the important part of the banking business. The problem of managing funds is great for banks than it is for almost any other enterprise. The sources and uses analysis took out proportion of each source and each use to the total funds of the bank and it were expressed in percentage. The percentage was compared with the standard percentage of a typical bank. This analysis also concerned behaviors of the sources of funds. The uses were analyzed in terms of their supporting ability to the sources of funds to which they represent. In order to make study easier, the sources and uses of funds of banks were categorized and presented in following table. Analysis of sources and uses of funds of commercial banks (Aggregate) is given in table 4.5 and 4.6.

The sources and uses analysis took out proportion of each source and each use to the total funds of the banks and it were expressed in million. This analysis also concerned behaviors of the sources of funds. The uses were analyzed in terms of their supporting ability to the sources of funds to which they represent in table 4.5 and 4.6.

Table: 4.5

Sources of Funds of Commercial Banks

(Rs. in million)

Particulars	2004	2005	2006	2007	2008	2009
1. Capital Fund	11,814.6	(10,201.7)	(19,129.5)	(17,742.1)	(4,149.5)	9,960.7
2. Borrowings	3,170.4	3,023.6	6,842.9	9,519.6	12,750.4	14,408.2
3. Deposit	203,879.3	233,811.2	252,409.8	291,245.6	337,497.2	426,080.3
4. Bills Payable	-	-	480.2	599.6	698.7	975.6
5. Other Liabilities	86,697.4	113,183.6	92,900.7	86,580.7	79,854.6	81,303.1
6. Reconciliation A/C	-	-	65,319.8	47,230.1	60,737.6	19,151.2
7. Profit & Loss A/C	-	-	10,104.8	11,272.7	3,249.1	14,856.8
Sources of Fund	305,561.7	339,816.7	408,928.8	428,706.2	490,638.1	566,736.0

Source: Banking and Financial Statistics, Mid – January 2010, NRB

From the above table 4.5 contribution of capital fund in total sources is 38.65% in 2004 and decreased to 1.75% in 2009. The capital fund has negative value from 2005 to 2008. The deposit has the highest contribution in sources of fund. The Major sources of capital funds are: Share capital, general reserves, other reserves and retained earnings. Likewise, deposits contribute more funds out of total sources of funds i.e. the contribution of deposit has 66.72% in 2004 and increased to 75.18% in 2009. Major sources of deposits are, saving, fixed and current a/c. considering the contribution of borrowings to total sources, it is approximately 1%, which is the lowest among other sources of funds. Major sources of borrowing of commercial banks are NRB, Inter Bank and Financial institution. Other sources of funds are 25%. Deposit is only one reliable source of funds of commercial banks.

Table: 4.6

Uses of Funds of Commercial Banks

(Rs. in million)

Particulars	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
1. Liquid fund	38,163.6	46,252.8	38,369.4	38,842.1	44,089.7	66,875.4
2. Investment	3,9045.5	42,384.3	50,821.9	57,539.1	64,443	71,495.5
3. Share & Other Investment	6,340.8	7,284.3	9,359.1	24,634.7	29,087.8	37,459.3
4. Loans & Advances	123,211.1	138,922.9	157,198.9	173,383.4	228,951.9	302,913.4
5. Bill Purchased	1,143.8	1,050.4	3,909.2	3,353.8	2,824.1	3,694.9
6.Loans Against Collected Bills	167.5	58.2	168.2	83.0	53.5	29.7
7.Fixed Assets	-	-	3,809.6	4,026.7	6,077.7	8,101.2
8.Other Assets	97,489.4	103,863.8	50,728.6	52,632.7	59,146.6	55,347.5
9. Others	-	-	92,121.3	74,210.7	55,964.7	20,819.1
Uses of Fund	305,561.7	339,816.7	408,928.8	428,706.2	490,638.1	566,736.0

Source: Banking and Financial Statistics, Mid – January 2010, NRB

From the above table 4.6, contribution of liquid fund in total uses is 12.48% in 2004 and decreased to 11.80% in 2009. Loans and advances contribute more funds out of total uses of funds i.e. the contribution of loans and advances has 40.32% in 2004 and increased to 53.44% in 2009. The uses of funds are used for different purposes. The commercial banks have maintained liquid funds of 11.80% in 2009. Major uses of liquid funds are in call money, cash in hand and balance in hand. They have maintained sufficient liquid funds. They make average investment of 12.0% on government securities and share and debentures. They provide loan and advances of 40.0 % to 55.0% for its customers. Major uses of fund as loan and advances in private sectors and financial and non-financial sector of government enterprises, interest accrued and other uses cover 1.5% and 8.0% respectively.

4.2.2 Analysis of Sources and Uses of Funds of Nepal Bank Limited

The sources and uses of fund of Nepal Bank Limited is presented in table 4.7 and 4.8.

Table: 4.7

Sources of Funds of Nepal Bank Limited

(Rs. in million)

Particulars	2004	2005	2006	2007	2008	2009
1. Capital Fund	1449.1	1064.3	(10,347.5)	(10,066.5)	1,820.6	1,906.5
2. Borrowings	52.4	-	1,124.9	1,717.4	1,604.9	1,820.1
3. Deposit	34,737.4	36,288.5	34,744.2	35,444.9	38,715.2	41,451.7
4. Bills Payable	-	-	169.2	76.1	92.4	35.9
5. Other Liabilities	30,090.6	26,711.0	36,401.0	23,575.4	10,265.5	9,718.7
6. Reconciliation A/C	-	-	1,768.0	1056.0	3085.8	2033.4
7. Profit & Loss A/C	-	-	1,399.5	2,329.7	(7,877.3)	-
Sources of Fund	66,329.5	64,063.8	65,259.2	54,133.0	47,707.1	56,966.3

Source: Banking and Financial Statistics, Mid – January 2010, NRB

From the above table 4.7 contribution of capital fund in total sources is 2.0% in 2004 and increased to 3.3% in 2009. The deposit has the highest contribution in sources of fund. The major sources of capital funds are: Share capital, general reserves, other reserves and retained earnings. Likewise, deposits contribute more funds out of total sources of funds i.e. the contribution of deposit has 52.37% in 2004 and increased to 72.76% in 2009. Whereas contribution of overall commercial bank is 66.72% to 75.18%, which is higher than Nepal

Bank Limited. Major sources of deposits are, saving, fixed and current a/c. considering the contribution of borrowings to total sources. Major sources of borrowing of Nepal Bank Limited are NRB, Inter Bank and Financial institution. Deposit is only one reliable source of funds of NBL similar to other commercial banks.

Table: 4.8

Uses of Funds of Nepal Bank Limited

(Rs. in million)

Particulars	2004	2005	2006	2007	2008	2009
1. Liquid fund	4,770.6	6,444.0	5,886.2	5,517.4	7,003.6	5,055.2
2. Investment	11,722.8	10,593.8	13,838.6	11,776.9	13,226.3	12,918.4
3. Share & Other Investment	59.8	429.9	51.2	2,644.5	3,057.0	3,733.5
4. Loans & Advances	19,078.1	19,108.0	17,456.0	12,180.4	13,377.5	15,480.6
5. Bill Purchased	88.4	33.7	1,073.3	610.7	373.1	290.1
6.Loans Against Collected Bills	99.6	-	1.3	-	-	-
7.Fixed Assets	-	-	-	-	-	-
8.Other Assets	30,510.2	27,454.4	15,731.5	10,504.9	8,933.9	9,382.5
9. Others	-	-	11,012.2	10,787.6	1,546	9,876.6
Uses of Fund	66,329.5	64,063.8	65,259.2	54,133.0	47,707.1	56,966.3

Source: Banking and Financial Statistics, Mid – January 2010, NRB

From the above table 4.8, contribution of liquid fund in total uses is 7.19% in 2004 and increased to 8.87% in 2009. Loans and advances contribute more funds out of total uses of funds in NBL i.e. the contribution of loans and advances has 28.76% in 2004 and decreased to 27.17% in 2009. But contribution of loans and advances in overall commercial banking has 40.32% to 53.44%. The NBL has maintained liquid funds of 8.87% in 2009 which is lesser than overall banking scenario. Major uses of liquid funds are in call money, cash in hand and balance in hand. The NBL has not maintained sufficient liquid funds. NBL makes average investment of 16.0% on government securities and share and debentures. NBL provides loan and advances of 28.76 % to 27.17% for its customers which are lesser than overall banking scenario.

4.2.3 Analysis of Sources and Uses of Funds of Nepal Credit and Commerce Bank Limited

The sources and uses of fund of Nepal Credit and Commerce Bank Limited is presented in table 4.9 and 4.10. This analysis also concerned behaviors of the sources of funds. The uses were analyzed in terms of its supporting ability to the sources of funds to which it represent.

Table: 4.9

Sources of Funds of Nepal Credit and Commerce Bank Limited

(Rs. in million)

Particulars	2004	2005	2006	2007	2008	2009
1. Capital Fund	510.7	941.3	725.5	260.7	(308.3)	200.7
2. Borrowings	19.7	-	-	-	-	-
3. Deposit	4,294.1	5,959.6	6,630.1	6,619.5	6,500.3	7,320.2
4. Bills Payable	-	-	5.8	63.6	14.5	110.2
5. Other Liabilities	811.8	715.3	1220.5	1651	2,568.4	1988.6
6. Reconciliation A/C	-	-	0.1	14.8	41.8	60.6
7. Profit & Loss A/C	-	-	98.3	31.2	-	495.6
Sources of Fund	5636.3	7616.2	8,680.3	8,640.8	8,816.7	10,175.9

Source: Banking and Financial Statistics, Mid – January 2010, NRB

From the above table 4.9 contribution of capital fund in total sources of NCCBL is 9.0% in 2004 and decreased to 1.9% in 2009. The deposit has the highest contribution in sources of fund in case of NCCBL too. The major sources of capital funds are: Share capital, general reserves, other reserves and retained earnings. Likewise, deposits contribute more funds out of total sources of funds i.e. the contribution of deposit has 76.18% in 2004 and decreased to 71.93% in 2008. Whereas contribution of overall commercial bank is 66.72% to 75.18%, which is higher than Nepal Credit and Commerce Bank Limited. Major sources of deposits are, saving, fixed and current a/c. considering the contribution of borrowings to total sources. Major sources of borrowing of Nepal credit and Commerce Bank Limited are NRB, Inter Bank and Financial institution. Deposit is only one reliable source of funds of NCCBL similar to commercial banks.

Table: 4.10

Uses of Funds of Nepal Credit and Commerce Bank Limited

(Rs. in million)

Particulars	2004	2005	2006	2007	2008	2009
1. Liquid fund	793.3	1,024.9	710.6	805.1	832.4	1,632.2
2. Investment	315.2	511.9	324.7	521.6	1155.3	1,835.6
3. Share & Other Investment	91.8	96.6	68.1	75.6	70.0	64.4
4. Loans & Advances	3321.8	4417.6	5934.3	5836.6	5083.9	5,084.5
5. Bill Purchased	0.5	19.3	104.0	78.1	38.3	196.5
6.Loans Against Collected Bills	-	-	-	-	-	-
7.Fixed Assets	-	-	197.0	201.0	203.2	228.8
8.Other Assets	1113.7	1545.9	829.3	1,024.4	1,273.9	1,071.1
9. Others	-	-	512.3	98.4	159.7	62.8
Uses of Fund	5,636.3	7,616.2	8,680.3	8,640.8	8,816.7	10,175.9

Source: Banking and Financial Statistics, Mid – January 2010, NRB

From the above table 4.10, contribution of liquid fund in total uses is 14.07% in 2004 and increased to 16.03% in 2009. Loans and advances contribute more funds out of total uses of funds in NCCBL i.e. the contribution of loans and advances has 58.93% in 2004 and decreased to 49.96% in 2009. But contribution of loans and advances in overall commercial banking has 40.32% to 53.44%. The NCCBL has maintained liquid funds of 16.03% in 2009 which is higher than overall banking scenario. Major uses of liquid funds are in call money, cash in hand and balance in hand. The NCCBL has not maintained sufficient liquid funds. NCCBL makes average investment of 8.0% on government securities and share and debentures. NCCBL provides loan and advances of 58.93 % to 49.96% for its customers which are higher than overall banking scenario.

4.3 Total Loan & Advances & NPA of NBL and NCCBL

Table: 4.11

Loan & Advances & NPA of NBL and NCCBL

(Rs. in million)

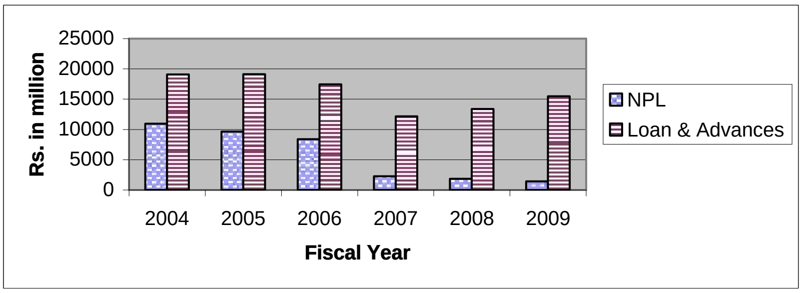
Year	2004	2005	2006	2007	2008	2009
NBL						
Loan & Advances	19,108.0	17,456.0	12,180.4	13,377.5	15,480.6	19261.0
NPA	9,640.08	8,372.0	2,262.18	1,856.0	1,410.80	1955.0
NPA/ L& A (%)	**50.45**	**47.96**	**18.57**	**13.87**	**9.11**	**10.15**
NCCBL						
Loan & Advances	4,417.6	5,934.3	5,836.6	5,083.9	5,084.5	7141.6
NPA	600.05	519.26	1,289.90	1,606.87	864.0	1168.36
NPA/ L& A (%)	**13.58**	**8.75**	**22.10**	**31.60**	**16.99**	**16.36**

Source: Banking and Financial Statistics, Mid – January 2010, NRB

NBL has fluctuating trend in the loan & advances. It is one of the largest lenders in Nepal. Where as, its non performing assets to loan & advances ratio is in decreasing trend. It has improved a lot in the quality of the loan & advances. The NPL ratio to loan & advances has dropped to 9.11% in the 2008 from 50.45% in the 2004. It is due to strict recovery actions taken during Foreign management and write off of loans from books. Similarly NCCBL has shown increasing trend in the loan & advances till 2006. After that it has also decreased. It is because of new management of NCCBL which started concentrating more on recovery than lending. Its non-performing assets to loan & advances ratio is in fluctuating trend. Actually it seems to decrease till fiscal year 2005/06 whereas increased substantially during 2006 and 2007. Similarly, the NPA ratio again declines in the year of 2008. The NPL ratio to loan & advances has dropped to 16.99% in the 2008 from 13.59% in the 2004. NBL being the supreme commercial bank of Nepal has a high amount of loans in comparison to NCCBL. The figure depicts the level of loan & advances and the level of non performing assets and trend.

Figure: 4.5

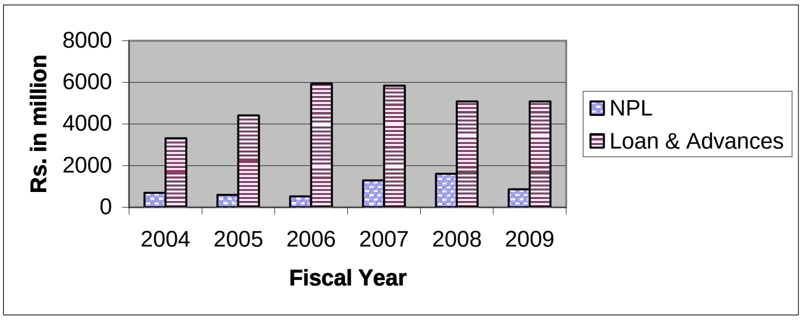
Loan & Advances and NPA of NBL



Source: Table 4.11

Figure: 4.6

Loan & Advances and NPA of NCCBL

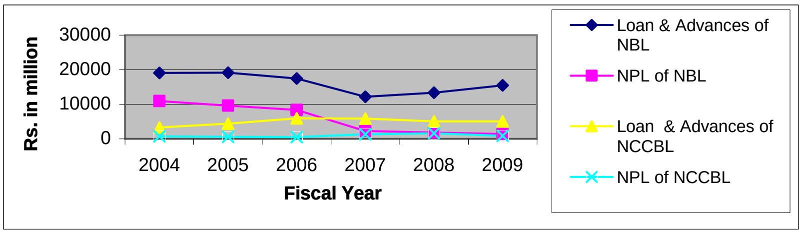


Source: Table 4.11

From above figure it shows that the loan and advances is in increasing trend till 2006 and slightly decreased afterwards in case of NCCBL and decreasing trend in case of NBL. Similarly, NPA is in decreasing trend in both banks. Actually in both banks new management teams concentrate more on recovery ultimately resulting reduction in NPA. The same is also presented in the trend form which is as below:

Figure: 4.7

Loan & Advances and NPA of NBL and NCCBL



Source: Table 4.11

4.4 Trend Value of Loan & Advances and NPA of NBL and NCCBL

Trend analysis enables to compare two or more time series over different periods of time and draw important conclusions about them. If the values of a phenomenon are observed at different periods of time, the values so obtained will show considerable varieties or changes. Among various devices for measuring changes in financial statement of the firm, trend analysis is one of the effective tools, which minimizes the weaknesses of the ratio analysis to some extent. The changes in the financial statements may be measured in terms of absolute changes or in terms of relative changes or the percentage changes between the dates taken as a base year. To avoid misinterpretation of changes measurement of absolute as well as relative terms must be expressed. In this study, trend analysis shows the trend of loan & advances and non performing assets (NPA) of NBL and NCCBL for the period of ten years. The trend of NPL and loans and advances are presented in table 4.12.

Table: 4.12

Trend value of Loan and Advances and Non Performing Assets of NBL and NCCBL

(Amount in millions)

	NBL		**NCCBL**	
Year	**Trend value of Loan & Advances a =16,113.43 b= (1,155.85)**	**Trend value of NPA a = 5,751 b= (2,206.65)**	**Trend value of Loan & Advances a = 4,946.45 b= 306.13**	**Trend value of NPA a = 930.15 b= 131.63**
2004	19,003.05	11,267.61	4,181.11	601.08
2005	17,847.20	9,060.96	4,487.25	732.71
2006	16,691.36	6,854.32	4,793.38	864.34
2007	15,535.51	4,647.67	5,099.52	995.97
2008	14,379.66	2,441.03	5,405.65	1,127.59
2009	13,223.82	234.38	5,711.79	1,259.22
2010	12,067.97	-1,972.27	6,017.92	1,390.85
2011	10,912.13	-4,178.91	6,324.05	1,522.47
2012	9,756.28	-6,385.56	6,630.19	1,654.10
2013	8,600.44	-8,592.20	6,936.32	1,785.73
2014	7444.555	-10798.9	7242.425	1917.375

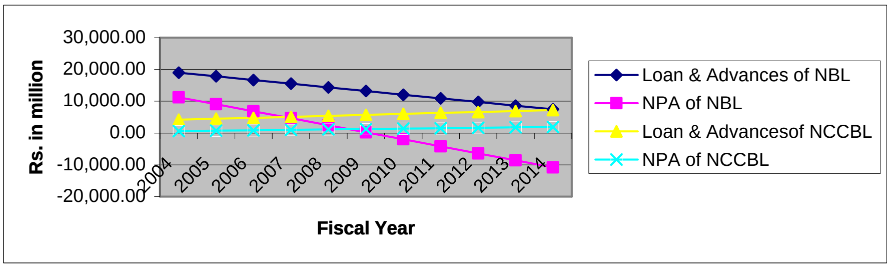
Source: Appendix-I.
Data has been taken from Banking and Financial Statistics, NRB, 2010

The above table 4.12 shows that the total loan and advances of NBL is in decreasing trend. The average loan and advances of NBL is NRs. 16,113.43, which is decreasing at the rate of NRs. 1,155.85 per year. Loans and advances are expected to decrease from NRs. 19,003.05 in 2004 to 8,600.44 in 2013. On the contrary, loans and advances of NCCBL seem to be in increasing trend. NCCBL's average loans and advances is NRs. 4,946.45 and is increasing at the rate of NRs. 306.13 every year. As NBL is suffering more from the problems of bad debt, they seem to be concentrated more on recovery rather than lending. As a result of which both loan and NPA seems to be in decreasing trend.

Similarly, if we look at the trend of non-performing assets of NBL, it is in decreasing trend which is a positive sign. Lesser the NPA, sounder will be the health of financial institution. The average NPA of NBL is NRs. 5,751, which is decreasing at the rate of NRs. 2,206.65 per year. However, with the increase in loans and advances, NPA of NCCBL also seems to be increased at the rate of NRs. 131.63 per year. Following figure no: 4.4 represent the trend line of loan and advances of NBL and NCCBL for 10 consecutive years.

Figure: 4.8

Loan and Advances and NPA of NBL and NCCBL (Trend value)



4.5 Year Wise loan classification of NBL and NCCBL

Table: 4.13

Year Wise Loan Classification of NBL

Category	(Rs. in millions)					
	2004	**2005**	**2006**	**2007**	**2008**	**2009**
Pass Loan	7,167	8,298	8,270	9,547	11,180	13,698
Restructured Loan	-	-	225	632	720	-
Substandard Loan	1,291	233	130	47	17	64
Doubtful Loan	2,644	1,280	64	88	30	21
Loss Loan	7,030	8,127	8,178	2,127	1,809	1,983
Total	**18,132**	**17,938**	**16,867**	**12,442**	**13,757**	**15,765**

Source: Annual report of NBL of respective years

In above table 4.13, total loans and advances has been classified into various categories depending upon the nature of the loan such as pass, restructured, substandard, doubtful and loss. In NBL performing loan i.e. pass loan is in increasing trend and other categories are in decreasing trend. Due to concentration of bank management more on recovery, non-performing loan has also reduced substantially ultimately decreasing total loans and advances in 2009 in comparison to previous years. Increment in pass loan is positive sign and is important factor for long term sustainability of the bank

Table: 4.14

Year Wise Loan Classification of NCCBL

Category						**(Rs. in millions)**
	2004	**2005**	**2006**	**2007**	**2008**	**2009**
Pass Loan	2,696	4,117	5,493	4,167	3,183	4,223
Restructured Loan	379	139	47	443	332	191
Substandard Loan	227	279	65	90	86	25
Doubtful Loan	95	182	407	147	388	110
Loss Loan	-	-	-	1,053	1,133	732
Total	**3,396**	**4,717**	**6,012**	**5,899**	**5,122**	**5,281**

Source: Annual report of NCCBL of respective years

In above table 4.14, year wise classification of total loans and advances of NCCBL has been shown. Total loans and advances have been categorized into various categories depending upon the nature of the loan. In this table also we can see that i.e. pass loan is in increasing trend and other categories are in decreasing trend. Actually till 2007 loan under the loss category is in increasing trend ultimately increasing the total loans and advances as well. However after the introduction of new management loss loan has declined remarkably. Due to concentration of bank management more on recovery, non-performing loan has also reduced ultimately decreasing total loans and advances of the bank.

4.6 Non-Performing Assets of Commercial Banking Industry

The volume of Non-performing Assets (NPA) is largely on account of the portfolio if public banks so it need to be broken down into the public and private banks category to magnify the reasons for the existing levels of NPA. The NPA ratio of the public banks is still 11.08% even though it has shown signs of improvement in the past two years. The reform started in the public banks has significantly lowered the volume of NPA in these banks by write offs. The NPA ratio in the private banks as on Mid July 2009 was just 6.3%.This ratio has almost been within the range of 10 % and has been shown as improvement in the last six years.

Table: 4.15

Non-Performing Loans in Banks

(In percent)

Banks	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Non-government	5.04	4.82	5.82	8.42	9.3	6.3
Government	26.97	24.11	22.06	17.74	14.92	11.08
Overall	**32.09**	**28.93**	**27.87**	**25.58**	**24.21**	**18.64**

Source: Banking and Financial Statistics, Mid – January 2010, NRB

NRB requires provision on all the loans given by the banks, which goes higher as the loan quality deteriorates. The banks must create loan loss provision on the gross value of outstanding loans, rather than on the net loans and they are not allowed the respite in the value of collaterals. The banks thus must create provisions according to the quality of the loan portfolio. Similarly, public banks with large amount of NPAs have large provision in their balance sheets while the provision of the private banks is lower. It shows that the Nepalese banking sector has somewhat protected itself from the large volume of NPA through creation of loan loss provisions. Even though the gross NPA ratio is still high, the net NPA ratio is minimal which implies that the banking sector doesn't stand to lose any more on account of NPA.

Since the large volume of NPA has been a major problem in the public banks of Nepal along with some private banks, reform program started helped to lower the amount of both Gross and Net NPA. In the chart presented below, a wide gap between NPA and provision can be observed during mid July 2004 and has narrowed down since. As on mid July 2009, total provisions had covered the total loans of the industry. At the same time the NPA of the whole industry is also in decreasing slowly but steadily. It is also very encouraging for the industry.

4.7 Non-performing Loan Status of NBL and NCCBL

This ratio is used to identify the share of bad debts or useless credits in the total credit & advances of banks. In other words, this is the share of credits, which are failed to generate regular earnings. It is always expressed in percentage. Lower and lower ratio is desirable for banks. It is calculated by using the following formula.

$$\text{Non-performing Loan to Total Gross Loan} = \frac{\text{Non - performing Loan}}{\text{Total Gross Loan}}$$

Table: 4.16

Non-Performing Loan to Total Gross Loan

(Rs. In million)

Bank	**2004**			**2005**			**2006**			**2007**			**2008**			**2009**		
	Total Gross Loan	NPL	NPL to Total Gross Loan (%)	Total Gross Loan	NPL	NPL to Total Gross Loan (%)	Total Gross Loan	NPL	NPL to Total Gross Loan (%)	Total Gross Loan	NPL	NPL to Total Gross Loan (%)	Total Gross Loan	NPL	NPL to Total Gross Loan (%)	Total Gross Loan	NPL	NPL to Total Gross Loan (%)
NBL	18132.33	10964.91	**60.47**	17937.66	9640.08	**53.74**	16866.5	8372.0	**49.64**	12441.59	2262.18	**18.18**	13756.60	1856.0	**13.49**	15770.70	1410.80	**8.95**
NCCBL	3396.41	700.83	**20.63**	4717.30	600.05	**12.72**	6011.90	519.26	**8.64**	5899.16	1289.90	**21.87**	5122.2	1606.87	**31.37**	5281.0	864.0	**16.36**
Total Banks	111904.4	32095.69	**28.68**	127065.4	28933.41	**22.77**	148366.43	27877.7	**18.79**	194360.82	25580.5	**13.16**	229363.91	24215.85	**10.56**	306638.36	18648.50	**6.08**

Source: Banking and Financial Statistics, Mid – January 2009, NRB

Table 4.16 showed that the non-performing loan to total gross loan ratios of NBL in the fiscal years 2004, 2005, 2006, 2007, 2008 and 2009 were 60.47%, 53.74%, 49.64%, 18.18%, 13.49% and 8.95% respectively. The data shows that NPL of Nepal Bank Limited is in decreasing trend. The level of NPA in 2007 has decreased substantially. The main reason behind this is management being serious about recovery of loan and also writes off of NPA from financial books. Initially it was more than 50%, now it is only single digit. The average ratio of the bank for the immediate past six-year period was 34.07%. Similarly the non-performing loan to total gross loan ratios of NCCBL in the fiscal years 2004, 2005, 2006, 2007, 2008 and 2009 were 20.63%, 12.72%, 8.64%, 21.87%, 31.37% and 16.36% respectively. The data shows that NPL of Nepal Credit and Commerce Bank Limited is in fluctuating trend. The value is in decreasing trend up to 2006 and then substantially increased during fiscal year 2007 and same thing continues till 2008. It further slightly decreased in fiscal year 2009. The average ratio of the bank for the immediate past six-year period was 18.60%.

The non-performing credits to total credit ratios of overall banking industry in the fiscal years 2004, 2005, 2006, 2007, 2008 and 2009 were 28.68%, 22.77%, 18.79%, 13.16%, 10.56% and 6.08% respectively. The average ratio of the overall banking industry for the immediate past six-year period was 16.67%.

The comparison of non performing loan to total gross loan showed that NBL had the highest average non-performing loans to total gross loan ratio between the two banks. NCCBL had also the highest ratios than overall banking industry. NCCBL had the lower average non-performing loan to total gross loan ratio over the period than NBL. But both banks have higher non-performing loan than total banking industry. From the above observation, it is found that the total NPA as of percentage to total loan is very high at NBL in comparison to that of NCCBL. But it is to be noted that the figure is significantly decreasing in NBL but in NCCBL the figure has increased dramatically during 2007 and 2008. However after the new management took over the bank’s management the NPA figure has become almost half than that of previous year. It shows the efficiency of the management.

4.8 Reasons for NPA and Initiatives Taken to Reduce the NPA Level in Selected Banks

In order to further know about the NPA, its impact on both the banks and measures adopted by the banks for its management, an in depth interview was taken with the concerned personnel of both the banks. Mr. Angir Man Singh, Manager Credit Control Department of NCCBL Corporate office Baghbazar and Mr. Indra Pahadi, Asst. Manager of Risk Management Division of NBL was the respondent to the interview conducted. Questions were raised regarding what is the reason behind high level of NPA in respective banks, roots of a loan to become NPA, what strategies are imposed to reduce the NPA, NRB regulations, the impact of regulations on loan recovery and influence of external factors in the work environment.

According to Mr. Angir Man Singh, the current level of NPA in NCCBL is high because of:

- **Lack of risk analysis skills**.

The main reason of the current level of NPA is due to failure in risk prediction of the bank. According to Mr. Singh, the bank provided loan to such sectors which carried heavy risk. For example, even when the garment industy was falling, the bank continued to entertain those industries with loans without knowing the risk on that kind of business. So, the loans beacame NPA as these businesses failed to perform.

- **External factors which affected the cashflow of the client's business.**

Cashflow is the main source of any business. If cashflow of any business is affected, it cannot pay to the bank accordingly. Even the bank calculates the cashflow of a business and approves loan to it, the external factors makes an impact on the business and these business fail to perform. Harrisiddhi Brick Factory and Nepal Drugs are the major example of the business whose loan became NPA due to external factors which affected the cashflow of these businesses.

- **Loan granted on external pressure**

In one way or other external pressure exists during loan disbursement process of the bank. Even if some projects are weak and not worthy to get approved, due to pressure from promoters, seniors and other extenal sources loan gets approved which later became non perfomring.

- **Weak monitoring and follow up process of loans.**

After a loan is approved, it should be monitored regulalry and follow up actions must be taken if there is any chance of a loan to become bad. NCCBL failed to monitor most of their loans during the past five fiscal years.

- **Political instability in the country**

Another reason for turning performing loan into NPA is poor political situation of the country. Since last couple of year's political situation of the country is not stable and thus we are continuously facing problems like labor strikes, blockades of roads, bandhs etc. Due to these factors, business of client could not flourish ultimately resulting loan into NPA. For example, NCCBL was providing vechile loans especially in Terai regions of Nepal. Every now and then Terai remained closed for indefinite period due to which the vehicles could not run and thus failed to generate cash flow.

According to Mr. Pahadi, the root causes of default in NBL are mainly due to:

- **Willful Defaults**

Borrowers indulging in frauds and malfeasance are willful defaulters and they will continue to remain ineligible for restructuring of loan under the Debt Restructuring Mechanism.

Causes of willful default:

- Funds are siphoned by borrowers.
- Mal intention of borrowers (firms are registerd in the name of servant or low societal profile person).
- Client became out of contact of the bank
- Obstacles created by borrowers to sell the saleable collaterals.
- Weak collateral and overvalued at the time of disbursement.
- Insufficient pledge goods for entire loan.
- Unwillingness showed by defaulter at the time of demand of personal guarantee and additional collaterals.
- Creating legal obstacles to hamper bank's recovery actions.
- Absconding.
- Irregularity of staffs at the time of loan disbursement.

- **Non-Willful Defaults**

Borrowers who cannot serve interest together with principal as per the terms and conditions of CFP due to unavoidable cirucmstance and may or may not be eligible for restructuring under the Debt Restructuring Mechanism.

Causes of Non-Willful Default:

- Due to Unavoidable circumstances, customer with good intention also could not serve the debt on time (i.e. internal as well as external political situtation, business environment etc.)

- Customers who has commited for repayment through the restructuring and rescheduling.
- Natural disasters.
- Customers whose project were captured by government.
- Time frame given by Sick Industry Rehabilitation Committee to those firms that has been proved as Sick Industry.

- **Relating to NRB regulations:**

According to Mr. Singh, NRB regulations have helped the bank in the recovery process along with the efforts of the bank. Due to the black listing and passport seizing procedure, defaulters are forced to communicate with the bank and pay back loans on amciable settlement. Due to prevailing NRB regulations, various big defaulters are willing to payback the loans to the bank. Some of them have already settled the loan whereas negotiation process is going on for some other clients.

According to Mr. Pahadi, NRB regulations have not made such an impact on the recovery process of the bank. The current recovery success of the bank is all due to the efforts of the staff and the new foreign management of the bank which gave them fair working environment.

- **Strategy of Bank to reduce the level of NPA.**

NCCBL is implementing “Carrot and Stick” approach to reduce the level of NPA prevailing in the bank. The bank now is constantly communicating with the defaulters and urging them to payback their loans. The bank is even applying external pressures to the defaulters for the settlement of loans. The bank is also providing waiver in interest in case to case basis to some bad loans whose cashflow got affected. If the defaulter is not willing to come to the bank for settlement purpose, then such NPAs are reported to Debt Recovery Tribunal (DRT) and legal actions are taken against such clients. Due to this, NCCBL has been able to recover 80% of the targeted recovery in the last four fiscal years.

However, Mr. Pahadi was not willing to disclose the strategy of NBL to reduce the level of NPA, but has agreed that the bank had provided waiver of interest facility to some defaulters.

According to Mr. Pahadi, NBL was able to recover 90% of their targeted recovery during last three fiscal years under the efficient foreign management. Even today in absence of foreign management also NBL is following the same path and is emphasizing in loan recovery.

Some major recovery actions of NBL to reduce the volume of NPA are:

- Issue the Standard Demand Letter (SDL) of different ways.
- Publication of Defaulter Notice.
- Blacklisting the Defaulters.
- Auction and Seal Tender of Mortgaged Properties.
- Restrained other collaterals of borowers (if possible).
- Asumption of collaterals into bank’s name.
- Recommend to NRB to take the action as per the BAFIA’s Section 57 like Passport Seizure.
- NPAs refer to DRT.

- **Effect on goodwill and MPS of the bank due to NPA.**

According to Mr. Singh, the goodwill of the bank is affected by the current level of NPA existing in the bank. According to him, most of the people who have knowledge about annual report of the bank and can interpret it used to blame and make the management of the bank responsible for the current position of NPA. Mr. Singh believes that there is no such mechanism in Nepal

Stock Market which affects the MPS of the bank due to NPA level but agrees that the EPS has been affected due to NPA.

In accordance with Mr. Pahadi, the goodwill of the bank is not at all harmed by the current level of NPA but aggreed upon the fact that it is due to NPA the EPS of NBL is negative and the price of the share of NBL is not listed on Nepal Stock Exchange.

4.9 Analysis of Responses by Credit Customer of Banks

70% of sample customer of the NBL bank told that they were satisfied with the bank and the remaining percentage said no. 80% of the sample customer said bank officer visited their project site at the time of granting credit.1 customer said 'no' and the remaining customer was unknown about the bank officer visit, he said he was the representative of the credit taking group. Only the 50% of the customer said they were up to date with the banking polices. Eight customers out of ten customers were unsatisfied with the bank interest rate. Only two customers said," We are more or less satisfied". 7 out of 10 customers responded that they would take credit from the same bank in the near future, 1 said 'no ', and the remaining 2 customers did not responded clearly. 70% of the customer of the bank received information of repaying credit from the bank, 20% customer were uncooperative with the researcher, and remaining 10% said 'no', he said he would need credit no more. 5 out of 10 customers were satisfied with the bank officers' cooperation, 4 customers were unsatisfied.

Services charge taken at the time of issuing credit is high from the view point of 50% customers. 40% customers said they were more or less satisfied with the service charges. One customer was unaware of that service charge. 90% of the sample customers said they utilized the credit for the same sector as specified at the time of taking loan. One customer did not response clearly. Nobody said 'no'. Only one out of ten responded clearly that he would change the bank next time. Two customers did not want to response the question. Seven customers said they would attach with the bank.

Table: 4.17

Frequencies of Responses of Credit Customers of NBL Bank

Particulars:	Yes		No		No clear responses		Total
	No.	%	No.	%	No.	%	No.
1. Are you satisfied with the bank?	7	70	3	30	-	-	10
2. Does any bank officer visit your project site at the time of granting credit?	8	80	1	10	1	10	10
3. Do you know all information about bank policies?	5	50	5	50	-	-	10
4. Are you satisfied with the bank interest rate?	2	60	8	40	-	-	10
5. Do you want to take further credit from the bank?	7	70	1	10	2	20	10
6. Have you received any notice before credit expiration date?	7	90	1	10	2	20	10
7. Do you feel that you have got full cooperation from the bank officer?	6	60	4	40	-	-	10
8 Is the services charge taken by the bank satisfactory?	5	50	4	40	1	10	10
9. Have you utilized the entire credit to the same sector as specified at the time of taking credit?	9	90	-	-	1	10	10
10.Are you thinking to switch the bank in the future?	1	70	7	10	2	20	10

Source: Opinion Survey, 2010

50% of sample customer of the NCCBL bank told that they were satisfied with the bank and the remaining 50 %percentage said 'no'. 70% of the sample customer said bank officer visited their project site at the time of granting credit.1 customer said 'no' and the remaining 2 customers were unknown about the bank officer visit. 7 out of 10 customers said they were up to date with the banking polices.

Six customers out of ten customers were unsatisfied with the bank interest rate. Four customers were not satisfied with the bank interest rate. 8 out of 10 customers responded that they would take credit from the same bank in the near future, 1 said 'no ', and the remaining 1 customer did not responded clearly. 70% of the customers of the bank received notice of repaying credit from the bank, 20% customers said, "This is our first time." 7 out of 10 customers were satisfied with the bank officers' cooperation, 3 customers were unsatisfied.

Services charge taken at the time of issuing credit is high from the view point of 50% customers.30% customers said they were more or less satisfied with the service charges. 20% customers were unaware of that service charge. 80% of the sample customers said they utilized the credit for the same sector as specified at the time of taking credit. One customer did not response clearly. One customer (10%) said he had not utilized all the credits as purpose. Only one out of ten responded clearly that he would change the bank next time. Nine customers said they would attach with the bank.

Table: 4.18

Frequencies of Responses of Credit Customers of NCCBL

Particulars:	Yes		No		No clear responses		Total
	No.	%	No.	%	No.	%	No.
1. Are you satisfied with the bank?	5	50	5	50	-	-	10
2. Does any bank officer visit your project site at the time of granting credit?	7	70	1	10	2	20	10
3. Do you know all information about bank policies?	7	70	3	30	-	-	10
4. Are you satisfied with the bank interest rate?	4	40	6	60	-	-	10
5. Do you want to take further credit from the bank?	8	80	1	10	1	10	10
6. Have you received any notice before credit expiration date?	7	70	1	10	2	20	10
7. Do you feel that you have got full cooperation from the bank officer?	7	70	3	30	-	-	10
8 Is the services charge taken by the bank satisfactory?	5	50	3	30	2	20	10
9. Have you utilized the entire loan to the same sector as specified at the time of taking loan?	8	80	1	10	1	10	10
10. Are you thinking to switch the bank in the future?	1	10	9	90	-	-	10

Source: Opinion Survey, 2010

4.10 Major Findings of the Study

This study covers one public bank and one private bank and the study is based on secondary and primary data. In order to analyze the situation, in-depth interview conducted with the respected staffs of the banks and the facts has been analyzed under the different needs. Both descriptive and analytical tools have been used to draw conclusions.

a) The ratio of non-performing loan to total gross loan was very high in NBL in comparison to NCCBL which exhibits that the total credit provided by NBL is not performing well due to various external or internal factors of the bank.
b) The percentage of total NPA to total gross loans is higher in NBL than in NCCBL. However, it is to be noted that the ratio is constantly decreasing in NBL while in NCCBL the ratio decreased for two fiscal years and again started to increase from 2006 and same trend continues till 2007. However after the new management took over the bank's management the NPA figure has become almost half than that of previous year. It shows the efficiency of the management. Despite of this the figure shows that NBL has overcome the problems of NPA but NCCBL has still not completely overcome the problems related with NPA.
c) The occurrence of NPA in both the banks is not only due to the clients but due to bank's management as well. There is neither such strong loan disbursement policy nor efficient loan monitoring process in both the banks.
d) Loans become NPA not only due to willful defaults of the client but also due to non-willful defaults of the clients which occurs when the cash flow of the client's business is affected due to various internal as well as external factors.
e) NRB regulations have played a helping hand role for the recovery of NPA in NCCBL whereas in NBL the loans are recovered due to the fair working environment and efforts of the staffs.
f) Goodwill of NCCBL has been affected by the existing level of NPA in the bank and EPS has been affected by the level of NPA in the bank.

g) With introduction of new management team level of non-performing loan has been reduced substantially in both selected banks. Although the tenure of foreign management has been completed in NBL, the current management is following the same path as shown by previous team.

h) 70% of sample customer of the NBL bank told that they were satisfied with the bank and the remaining percentage said no. 80% of the NBL sample customer said bank officer visited their project site at the time of granting credit.1 customer said 'no' and the remaining customer was unknown about the bank officer visit.

i) Services charge taken at the time of issuing credit is high from the view point of 50% customers in NBL. 40% customers said they were more or less satisfied with the service charges. One customer was unaware of that service charge. 90% of the sample customers said they utilized the credit for the same sector as specified at the time of taking loan.

j) 50% of sample customer of the NCCBL bank told that they were satisfied with the bank and the remaining 50 %percentage said 'no'. 70% of the sample customer of NCCBL said bank officer visited their project site at the time of granting credit.

k) Six customers out of ten customers of NCCBL were unsatisfied with the bank interest rate. Four customers were not satisfied with the bank interest rate. 8 out of 10 customers responded that they would take credit from the same bank in the near future, 1 said 'no ', and the remaining 1 customer did not responded clearly. 70% of the customers of the NCCBL bank received notice of repaying credit from the bank, 20% customers said, "This is our first time." 7 out of 10 customers were satisfied with the bank officers' cooperation, 3 customers were unsatisfied.

l) Services charge taken at the time of issuing credit is high from the view point of 50% customers of NCCBL.30% customers said they were more or less satisfied with the service charges.

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Banks in Nepal are judged by its level of NPA and provisions made for losses. It is generally known that banks which have low level of NPA and provisions for losses makes better profit than the other. However, analysts are not uniform about the impact of NPA in banks. This study titled "A study of NPA in banks in Nepal with reference to Nepal Bank Limited and Nepal Credit And Commerce Bank Limited" is aimed to assess different causes and level of NPA in the banks. The functional objectives of the study are as follows:

- To study the level of NPA in the selected banks.
- To know how a loan becomes NPA.
- To know what plans and strategy are implemented by the banks to minimize the NPA level.
- To know what are the effects that the banks are facing due to NPA.

From the study of sources of fund it is observed that the contribution of capital fund in total sources of NBL was 2.0% in 2003 which increased and reached to 3.3% in 2008. The deposit has the highest contribution in sources of fund. The major sources of capital funds are: Share capital, general reserves, other reserves and retained earnings. Likewise, deposits contribute more funds out of total sources of funds i.e. the contribution of deposit was 52.37% in 2003 which has been increased to 72.76% in 2008 in NBL. In case of entire commercial banking industry, contribution of deposit is overall commercial bank is 66.72% to 75.18%, which is higher than Nepal Bank Limited.

From the study of uses of fund it is observed that contribution of liquid fund in total uses of NBL was 7.19% in 2003 which increased and reached to 8.87% in

2008. Loans and advances contribute more funds out of total uses of funds in NBL i.e. the contribution of loans and advances has occupied 28.76% of total uses of fund in 2003 which decreased and reached to 27.17 % in 2008. But contribution of loans and advances in overall commercial banking industry is in the range of 40.32 % to 53.44 %. The NBL has maintained liquid funds of 8.87 % in 2008 which is lesser than overall banking industry. The NBL has not maintained sufficient liquid funds. NBL makes average investment of 16.0% on government securities and share and debentures.

From the study contribution of capital fund in total sources of NCCBL is 9.0% in 2003 and decreased to 1.9% in 2008. The deposit has the highest contribution in sources of fund in case of NCCBL too. Likewise, deposits contribute more funds out of total sources of funds i.e. the contribution of deposit has 76.18% in 2003 and decreased to 71.93% in 2008. Whereas contribution of overall commercial banking industry is 66.72% to 75.18%, which is higher than Nepal Credit and Commerce Bank Limited. Deposit is only one reliable source of funds of NCCBL similar to commercial banks.

From the study, contribution of liquid fund of NCCBL in total uses is 14.07% in 2003 and increased to 16.03% in 2008. Loans and advances contribute more funds out of total uses of funds in NCCBL i.e. the contribution of loans and advances has 58.93% in 2003 and decreased to 49.96% in 2008. But contribution of loans and advances in overall commercial banking industry has 40.32% to 53.44%. The NCCBL has maintained liquid funds of 16.03% in 2008 which is higher than overall banking industry. The NCCBL has not maintained sufficient liquid funds. NCCBL makes average investment of 8.0% on government securities and share and debentures.

The comparison of non performing loan to total gross loan showed that NBL had the highest average non-performing loans to total gross loan ratio between the two banks. NCCBL had also the highest ratios than overall banking industry. NCCBL had the lower average non-performing loan to total gross loan ratio over the period than NBL. But both banks have higher non-performing loan than total banking industry.

5.2 Conclusion

This study covers one semi government bank and one private bank and the study is based mostly on secondary data. In order to analyze the situation, in depth interview is conducted with the respected staffs of the banks and the facts have been analyzed under the different needs. It is concluded that the ratio of non-performing loan to total gross loan was very high in NBL in comparison to NCCBL. However, throughout the years the scenario has changed. Non-performing loan of NBL has substantially decreased from 60.47 % in 2003 to 8.95 % in 2008. It is all because of foreign management which handled the management of bank from July 2002 till July 2007. They concentrated mainly on recovery of loan rather than lending. Further certain portion of loan has been write off from books because of which also NPA level has gone down. Though write off has been done, recovery process of such loans is still taking place. The credit provided by NBL was not performing well due to various external or internal factors of the bank. Thus, the percentage of total NPA to total loans was higher in NBL than in NCCBL. Similarly, in case of NCCBL the loan & advances seems to be in increasing trend till 2006. After that it has also decreased. It is because of new management of NCCBL which started concentrating more on recovery than lending. Its non-performing assets to loan & advances ratio is in fluctuating trend. Actually it seems to decrease till fiscal year 2004/05 whereas increased substantially during 2006 and 2007. Similarly, the NPA ratio again declines in the year of 2008. The NPA ratio to loan & advances has dropped to 16.99% in the 2008 from 21.09% in the 2003.

Although the NPA ratio in NCCBL has decreased it is still more than that of NBL. It means that NBL has overcome the problems of NPA but NCCBL has still not overcome the problems related with NPA.

It is concluded that the occurrence of NPA in both the banks is not only due to the clients but due to bank's management as well. There is neither such strong loan disbursement policy nor efficient loan monitoring process in both the banks. Loans become NPA not only due to willful defaults of the client but also due to non-willful defaults of the clients which occurs when the cash flow of the client's business is affected. NRB regulations have played a helping hand role or the recovery of NPA in NCCBL whereas in NBL the loans are recovered due to the fair working environment and efforts of the staffs.

NPA is considered a major problem for any commercial banks. There are varieties of factors due to which a loan becomes NPA. Some of these factors include proper loan sanction procedure, regular loan monitoring process, external factors which affect the client's business, bad intention of the client etc.

It is a noted fact that the publicly owned banks have a high level of NPA than the private joint venture banks. The publicly owned banks are obliged to give loans to all the sectors of the economy where as the private banks disburses loan to the willful sectors only. In Nepal, there is a high chance of corruption in public banks than in the private banks. In the interview conducted at NBL, Mr. Pahadi claimed that 90% of the bad loans of the past were willful and it was done in the partnership of both the staffs and the parties.

If there is existence of proper loan management and a perfect working environment, there would be a less possibility of a loan to become NPA due to non-willful defaults. A loan can always be NPA due to willful default. The higher the amount of NPA, the higher the amount of provisions for losses, it makes an impact on the profitability in any banks.

Although the management of the bank and the staffs are making best of their efforts to reduce the level of NPA, they are being arbitrated by several external and internal factors. There are many businessmen who have not paid the defaults to the bank but are living a high standard life. No such remedial measures are introduced to capture the personal property of the client if they fail to pay back to the bank.

A lower NPA level not only plays a vital role in making bank’s profit higher but it also makes goodwill of the organization. Organization having higher NPA should find out whether the goodwill of the organization is being affected or not. The organization which has higher NPA should be willing to change the credit strategy to reduce its NPA level. A higher level of NPA also affects the EPS. So, any organization which has higher level of NPA should eliminate its NPA level to entertain its shareholders with positive EPS.

70% of sample customer of the NBL bank told that they were satisfied with the bank and the remaining percentage said no. 80% of the NBL sample customer said bank officer visited their project site at the time of granting credit.1 customer said 'no' and the remaining customer was unknown about the bank officer visit. Services charge taken at the time of issuing credit is high from the view point of 50% customers in NBL. 40% customers said they were more or less satisfied with the service charges. One customer was unaware of that service charge. 90% of the sample customers said they utilized the credit for the same sector as specified at the time of taking loan.

50% of sample customer of the NCCBL bank told that they were satisfied with the bank and the remaining 50 %percentage said 'no'. 70% of the sample customer of NCCBL said bank officer visited their project site at the time of granting credit. Six customers out of ten customers of NCCBL were unsatisfied with the bank interest rate. Four customers were not satisfied with the bank interest rate. 8 out of 10 customers responded that they would take credit from the same bank in the near future, 1 said 'no ', and the remaining 1 customer did not responded clearly. 70% of the customers of the NCCBL bank received notice of repaying credit from the bank, 20% customers said, "This is our first time." 7 out of 10 customers were satisfied with the bank officers' cooperation, 3 customers were unsatisfied. Services charge taken at the time of issuing credit is high from the view point of 50% customers of NCCBL.30% customers said they were more or less satisfied with the service charges.

5.3 Recommendations

In order to improve the NPA level in banks of Nepal, the following suggestions and recommendations have portrayed here on the basis of findings of the study.

- Both the banks should realize the current plight of economy and risk management. It is rational to minimize risk through short-term lending instead of long term lending. Therefore preference should be given to short-term loan over long term loan.
- The problem to resolve NPA should be a serious issue not only to the concerned bank and NRB but it should be a national issue. Government should take proper action against willful defaulters and give proper assistance to sick industries practically.
- The defaulters of a loan are walking freely in the street and living a high standard of life. These defaulters should be socially refused. People should know that they are defaulters of a loan.
- Unfair competition among the banks should be intervened. Since the number of banks is increasing, aggressive marketing approach is being applied by most of the banks. They are providing loans to the clients without proper investigation or allowing overdrafts to clients even if they do not need. Such mechanism should be stopped by the bank to eliminate future risk.
- Staffs should be trained properly to analyze the risk of a business. If a business is analyzed effectively, there is a low chance of a loan to become NPA.
- A proper and strict credit manual should be developed by banks. Strict action should be taken to those who do not follow the rules and regulations of the credit manual. Trainings should be given if necessary.

- Bank should be given authority to classify assets straightly as doubtful or loss without benchmarking the delinquency period if they feel that the assets would be hard to collect.
- Loan recovery department should be effective and proper working environment should be provided to the staffs working in the recovery department. There should not be existence of pressure from senior staffs and other external factors to the staffs working in this department.

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Appendix 1

Calculation of Trend values of Loans & Advances of NBL

Year	Loans & Advances (Y)	Deviation from Mid July 2006.5 (X)	X^2	XY	Y= a+bx
2004	19,078	-2.5	6.25	(47,695.25)	19,003.05
2005	19,108	-1.5	2.25	(28,662.00)	17,847.20
2006	17,456	-0.5	0.25	(8,728.00)	16,691.36
2007	12,180	0.5	0.25	6,090.20	15,535.51
2008	13,378	1.5	2.25	20,066.25	14,379.66
2009	15,481	2.5	6.25	38,701.50	13,223.82
N=6	**∑Y=96,681**	**∑X=0**	**$\sum X^2 =$ 17.50**	**∑XY=(20,227.30)**	

Here,
When ∑X=0 from two normal equations,

$$\mathbf{a} = \frac{\sum Y}{N} = \frac{96,681}{6} = 16,113.43$$

$$\mathbf{b} = \frac{\sum XY}{\sum X^2} = (1,155.85)$$

Hence, the equation of straight line trend is

Y= a+bx

Expected Trend Values of Loans & Advances

Year	Loans & Advances (Y)	Deviation from Mid July 2006.5 (X)	Y= a+bx
2010		3.5	12,067.97
2011		4.5	10,912.13
2012		5.5	9,756.28
2013		6.5	8,600.44
2014		7.5	7242.425

Calculation of Trend values of NPA of NBL

Year	NPA (Y)	Deviation from Mid July 2006.5 (X)	X^2	XY	Y= a+bx
2004	10,965	-2.5	6.25	(27,412.28)	11,267.61
2005	9,640	-1.5	2.25	(14,460.12)	9,060.96
2006	8,372	-0.5	0.25	(4,186.00)	6,854.32
2007	2,262	0.5	0.25	1,131.09	4,647.67
2008	1,856	1.5	2.25	2,784.00	2,441.03
2009	1,411	2.5	6.25	3,527.00	234.38
N=6	**∑Y=34,506**	**∑X=0**	**$\sum X^2 =$ 17.50**	**∑XY=(38,616.31)**	

Here,
When ∑X=0 from two normal equations,

$$a = \frac{\sum Y}{N} = \frac{34{,}506}{6} = 5751$$

$$b = \frac{\sum XY}{\sum X^2} = (2206.65)$$

Hence, the equation of straight line trend is
Y= a+bx

Expected Trend Values of NPA

Year	NPA (Y)	Deviation from Mid July 2006.5 (X)	Y= a+bx
2010		3.5	(1,972.27)
2011		4.5	(4,178.91)
2012		5.5	(6,385.56)
2013		6.5	(8,592.20)
2014		7.5	(10798.9)

Calculation of Trend values of Loans & Advances of NCCBL

Year	Loans & Advances (Y)	Deviation from Mid July 2006.5 (X)	X^2	XY	Y= a+bx
2004	3,321.8	-2.5	6.25	-8304.5	4,181.11
2005	4,417.6	-1.5	2.25	-6626.4	4,487.25
2006	5,934.3	-0.5	0.25	-2967.15	4,793.38
2007	5,836.6	0.5	0.25	2918.3	5,099.52
2008	5,083.9	1.5	2.25	7625.85	5,405.65
2009	5,084.5	2.5	6.25	12711.25	5,711.79
N=6	**∑Y=29678.70**	**∑X=0**	**$\sum X^2 =$ 17.50**	**∑XY=5357.35**	

Here,
When ∑X=0 from two normal equations,

$$a = \frac{\sum Y}{N} = \frac{29678.70}{6} = 4946.45$$

$$b = \frac{\sum XY}{\sum X^2} = 306.13$$

Hence, the equation of straight line trend is

Y= a+bx

Expected Trend Values of Loans & Advances

Year	Loans & Advances (Y)	Deviation from Mid July 2006.5 (X)	Y= a+bx
2010		3.5	6,017.92
2011		4.5	6,324.05
2012		5.5	6,630.19
2013		6.5	6,936.32
2014		7.5	7,444.55

Calculation of Trend values of NPA of NCCBL

Year	NPA (Y)	Deviation from Mid July 2006.5 (X)	X^2	XY	Y= a+bx
2004	700.83	-2.5	6.25	-1752.08	601.08
2005	600.05	-1.5	2.25	-900.075	732.71
2006	519.26	-0.5	0.25	-259.63	864.34
2007	1,289.90	0.5	0.25	644.95	995.97
2008	1,606.87	1.5	2.25	2410.305	1,127.59
2009	864.0	2.5	6.25	2160	1,259.22
N=6	**∑Y=5580.91**	**∑X=0**	**$\sum X^{2} =$ 17.50**	**∑XY=2303.47**	

Here,
When ∑X=0 from two normal equations,

$$a = \frac{\sum Y}{N} = \frac{5580.91}{6} = 930.15$$

$$b = \frac{\sum XY}{\sum X^2} = 131.63$$

Hence, the equation of straight line trend is

Y= a+bx

Expected Trend Values of NPA

Year	NPA(Y)	Deviation from Mid July 2006.5 (X)	Y= a+bx
2010		3.5	1,390.85
2011		4.5	1,522.47
2012		5.5	1,654.10
2013		6.5	1,785.73
2014		7.5	1917.37

Appendix 2
Calculation of Ratio Calculation
Calculation of Current Ratio

Year	NBL Current Assets	Current Liabilities	Ratio	NCCBL Current Assets	Current Liabilities	Ratios
2004/05	6266.79	12327.7	0.51	4587.9	2130.79	2.153
2005/06	6627.11	14682.5	0.45	6440.19	3812.02	1.689
2006/07	4595.17	14633.6	0.31	6918.08	4619.81	1.497
2007/08	5861.07	17441.4	0.34	6427.7	5030.94	1.278
2008/09	6159.33	18536.5	0.33	6036.67	5500.34	1.098
		Mean	0.388		Mean	1.543
		SD	0.08729		SD	0.40736
		C.V	0.22498		C.V	0.26401

Ratio of Income from Loan And Advances to total Loan						
	NBL			NCCBL		
	Income from loan and advances	Total Loan		Income from loan and advances	Total Loan	
2004/05	126836.1	16866.5	7.52	77373.15	6011.9	12.87
2005/06	126531	12441.59	10.17	60879.33	5899.16	10.32
2006/07	162052.7	13756.6	11.78	46151.02	5122.2	9.01
2007/08	259743.4	15770.7	16.47	50380.74	5281	9.54
2008/09	261841.4	19482.25	13.44	66520.88	7183.68	9.26
Mean			11.87			10.2
SD			3.370			1.5715
CV			28.38			15.406

Ratio of Non-performing Loan to total loan						
	NBL			NCCBL		
Year	Non performing loan	Total Loan		Non performing loan	Total Loan	
2004/05	8372	16866.5	49.64	519.26	6011.9	8.64
2005/06	2262.18	12441.59	18.18	1289.9	5899.16	21.87
2006/07	1856	13756.6	13.49	1606.87	5122.2	31.37
2007/08	1410.8	15770.7	8.95	864	5281	16.36

2008/09	1151.4	19482.25	5.91	196.83	7183.68	2.74
Mean			19.234			16.196
SD			17.62044			11.1873
CV			91.61087			69.0748

Ratio of Net Profit to Loans and Advances

Year	NBL			NCCBL		
	Loan and advances	Net Profit	Ratio	Loan and advances	Net Profit	Ratio
2004/05	17456	-24263.8	-1.39	5934.3	4747.44	0.8
2005/06	12180.4	48234.38	3.96	5836.6	408.562	0.07
2006/07	13377.5	137253.2	10.26	5883.9	-115.9	-0.0196
2007/08	15480.6	150161.8	9.7	5084.5	498.75	0.09809
2008/09	19261	31780.65	1.65	7141.6	415.46	0.05817
Mean			4.836			0.20131
SD			5.068514			0.337512
CV			104.808			167.6547

Appendix 3

List of Commercial Banks Licensed from Nepal Rastra Bank

The name and the year of establishment of the commercial banks operating in Nepal have been listed in below:

Name of the bank	**Year of establishment (A.D.)**
1. Nepal Bank Limited	1937
2. Rastriya Banijya Bank	1965
3. NABIL Bank Limited	1984
4. Nepal Investment Bank Limited	1985
5. Standard Chartered Bank Limited	1986
6. Himalayan Bank Limited	1993
7. Nepal SBI Bank Limited	1993
8. Nepal Bangladesh Bank Limited	1994
9. Everest Bank Limited	1994
10. Bank of Kathmandu Limited	1995
11. Nepal Credit & Commerce Bank Limited	1996
12. Nepal Industrial and Commercial Bank Limited	1998
13. Lumbini Bank Limited	1998
14. Machhapuchchhree Bank Limited	1999
15. Kumari Bank Limited	2001
16. Laxmi Bank Limited	2002
17. Siddhartha Bank Limited	2003
18. Agriculture Development Bank Limited (ADB)	1965
19. Global Bank Limited	2007
20. Citizen Bank Limited	2007
21. Prime Bank Limited	2007
22. Bank of Asia Limited	2007
23. Sunrise Bank Limited	2007
24. NMB Bank Ltd.	2008
25. Development Credit Bank Ltd	2008
26. Kist Merchant Bank Limited	2009
27. Janta Bank Limited	2010
28. Mega Commercial Bank Limited	2010