CHAPTER – I

INTRUDUCTION

1.1 Background of the Study

The Nepalese financial system comprises of commercial banks, development banks, finance companies, co-operative societies, non-government organization, insurance companies, Nepal stock exchange, citizen investment trust, employees provident fund and postal saving service.

Financial institution like commercial banks, development banks and finance companies play a central role in mobilizing all allocating resources in a national economy. This stands in fundamental contrast to planed economy, where financial institutions play a largely incidental role in resource allocation. Financial institutions are the heart of financial system which plays the role of intermediaries between surplus units (lenders) and deficit (borrowers) units in an economy. It holds the deposit of millions of persons, government and business and other profit and non-profit oriented organization. Therefore, such institutions accept deposits and in turn lend it to people who are in need of financial resources. Financial institutions make the flow of investment easier, so no one can deny the role of it. It makes the funds available through their lending and investing activities to borrowers like individuals, business firm and government. They provide technical and administrative assistance to industries, trades and business.

Bank is the important partner of business and promoter of economic activities. It is institutions, which deal with money in those persons who have spare money if they have no urgent need for money at that time people like to save money, deposit it in bank and other who money need borrow it from bank. Commercial bank act 1974 defines a commercial bank, A commercial bank means bank which deals in exchanging currency accepting deposit giving loan and doing commercial transactions commercial banks are the largest source of finance and its business is largely confined to business institution. The commercial bank were established with the concept of supplying short term loans for the enforcement of lend in priority and deprived sector these banks initiated to provide credit to small and cottage industries, agriculture and service etc.

In modern time most of the developing countries trying to centralize their policies towards the rapid economic development through the liberalization and privatization. Commercial banks are successful to bring about the healthy competition among banks. After beginning of Nepal Bank limited various bank and financial institutions was established. Due to initiation of various bank and financial institution tough competition is also being arises. Due to tough competition, every commercial bank are ready to provide loans in productive as well as unproductive sector in Nepal, specially huge numbers of financial institution provides loans on unproductive sector and ultimately customer or debtors are unable to repay the loan on time so this can be happened due to lack of honesty and integrity of the consumer. Right now financial institution faces huge losses on their lending money and treats it as a non-performing loan (assets).

"A man without money is like a bird without wings," the Rumanian proverb insists the importance of the money. A bank is an establishment, which deals with money. The basis functions of commercial bank are the accepting of all kinds of deposits and lending of money. In general there are several challenges confronting the commercial bank in its day today operations. The main challenge facing the commercial banks is the disbursement of funds in quality assets (loans and Advances) or otherwise it leads to non-performing assets.

Bank plays a vital role in developing the economy of any country. The level of over all development of a country i.e. social, cultural, political, technological or economical is characterized by the level of economic growth and the crux of the economic growth lies in the development of well managed and structured banking system. Hence, banks can be considered as the backbone of a country's overall development or banks can be regarded as the pioneer to create and mobilize the capital, rendering various financial services. Banks have been contributing commendable efforts to establish and develop the industries, trade and commerce in the country. Though bank refers to create and mobilize the capital / funds: modern banking has specific purpose, it provides an effective payment and credit system, which facilitates the challenging funds economy. Moreover banks also encourage industrial innovations and business expansion through the funds provided by them to the entrepreneurs. Beside this they encounter various functions on behalf of their customer and in turn they are paid for their services. Commercial banks undertake the payment of subscriptions, insurance, premium, rent etc. and collection of cheque, bills, salaries, pension, dividend, interest etc. Further more commercial banks also arrange to remit money from one place to another on behalf of beneficiary. They issue Bank Gurantee, letter of credit, which easier to overcome the problems regarding national and international trade. In fact the economic deployment of a country is not possible without a sound banking intermediation.

Nepal Bank limited is the first and oldest commercial bank of Nepal which was inaugurated by the late king Tribhuvan in 30th Kartik 1994 B.S. It was established as semi-government financial institution. Its authorized capital is 10 million. It is joint venture. It is joint venture of Nepal Government and private shareholders. Till now its authorized capital is 1 billion. The establishment of this commercial bank has solved to a greater extent the problem of commercial banking system in the economy. It has made available various facilities for depositing and borrowing money for commercial and priority sector. It is used to manage all the business transaction of the government including entire business of currency exchange due to the absence of a central bank, central bank of Nepal was established with ten million of authorized capital. It has 100 branches that spread all parts of the country. It was established with the purpose of developing banking system in the country to promote industry, trade and agriculture as well as to circulate Nepalese currency all over the country.

Rastriya Banijya Bank is fully government owned and is the largest commercial bank in Nepal. Rastriya Banijya Bank was established on 23 January, 1996 (2022-10-10). It provides the various kinds of banking services to a wide range of customer including bank, insurance companies, industrial trading houses, airlines, hotels and many other sectors. Its head office is in Kathmandu and operation has been done throughout the different parts of the country where it established its branches. In total, RBB has 117 branches that span across 68 districts.

Rastriya Banijya Bank provides various products and services in the form of deposits, remittances, loans, Merchant banking and bank guarantees. It has also been lending and investing in rural areas, targeting low-income people under the deprived sector lending requirements. In doing so, it has participated in several government rural credit initiatives including the intensive Banking program. RBB has adopted a methodology of providing financial services thought self-help groups with the Banking with the poor program, which focuses on combining its lending practices with the social mobilizations of self-help group (SHGS) undertaken by NGOs. The program targets poor women, formed into SHGS, who are encouraged to save first and then determine the interest on loans provided to their members unfortunately, the program has faced serious difficulties, due to weak institutional support and insufficient dedication of program. This has resulted in poor implementation and incapacity to transform the pilot project into a viable program. However, some positive aspects of the banking with the poor program include the relative low cost of financial intermediation, in comparison to usual practices and the good overall participation of the population in the program.

RBB faced major difficulties in operating its social financial intermediation in a profitable manner. With pilots such as Banking with the poor program, the bank failed to test standardize and replicated a program in an appropriate pace and lacked a planning process including vision, outcomes, goals and clear measurable outcomes. Along with this, no clear review and knowledge management was carried out with regards to its financing of the priority sector.

The best indictor of the health of the banking industry is the level of non-performing loan. Given this fact, Nepalese bankers and institutions seem to be placed in vulnerable to high credit risk than they were in past. Credit from major source of income and its share of gross credit in total earning assets of all commercial bank is above 54 percent. However, average NPL level of banking industry to internationally accepted from of 5 percent. Such higher level of NPL required bank to provide for such provisions which consumed earnings and deteriorated the capital in case of few commercial banks.

Rapid credit growth and loan losses have caused banking crisis in many countries and recent banking crisis in USA is an instance for this. As the competition for credit growth is high in Nepalese banking industry, it is possible that banking crisis may creep into Nepal also. This is the stage, where comprehensive credit risk management guideline should be issued by Nepal Rastra Bank to improve credit risk management Practices in banking industry and to prevent deterioration in quality of credit. The less opportunity for getting avenues for loan flotation has compelled the banks to finance without being choosy. Quality of loans and advances could not be maintained to the desire level if there is no choice whether to finance or not. Once the loan is given it is supposed that the repayment of interest or principal shall have to be served without any hindrance. The resources behind the loan that turns irregular from regular one. The main reason may be economic situation of the country. Which has global and for reaching impact. The smooth operation of the commercial banks is possible only when the economy of the country function well. Other factor that helps to turn the bad loan, types of loan, types and quality of the securities taken and legal hurdle created by the borrower when the recovery action is started. NPA has always been significant problem for every commercial bank and proper attention for the management of the NPA under top priority. Due to increasing NPA now bank losing priority. Non - performing assets is that assets which is created unable to pay by borrower on time.

Generally, loan and advance are considered to be non - performing when principle or interest is due and NPL is for 90 days or more as classified by Nepal Rastra Bank. The classification of loan may vary from country to country as per the requirement of their banking system. Most of the countries have classified loans into four categories: good, sub - standard, doubtful and loss. This is the best international Practice. Under this classification, the entire loans except good are considered as non - performing loan. Nepalese financial system has adopted the same. Dividing the total amount of non - performing loans (assets) by total loans (assets) derives the ratio of non - performing loan (assets).

Later some developed bank and financial institution were established to provide medium and long term credit facilities to the industry and agriculture. In this context, Nepal industrial development corporation was established in 2016 B.S. to provide the financial and managerial assistance in the field of industry and to help the private sector in the field of industry. For mobilizing the saving and credit Nepal Bank Limited arranged sound banking system. Treatment on bad debt of credit and restricting of new policy develop. NBL has initiated the financial sector reform project on July 22, 2002 under the World Bank Administered by the NRB. Since then, management of the bank is handed over to international chamber of commerce management (ICCM) team group of France of 5 years. The bank had shown the significant operating results under the foreign management team after the completion of the forgoing management team. The bank is still being managed by NRB management team from July 22, 2007. (www. nepal bank. com. np)

1.2 Focus of the Study

This study focuses on analyzing "Non-performing assets of NBL and RBB". These banks can bring unique financial value and service to all customers. It will be a sound institution where depositor continue to have faith in the security of their funds are receive reasonable returns; borrowers are assured of appropriate credit facilities at reasonable price; other service-seekers receive prompt and attentive service at reasonable cost; employees are paid adequate compensation with professional career growth opportunities and stock holders receive satisfactory return for their investment. Although established with the initial vision of supporting trade it has with the passage of time contributed remarkably to the development of all spheres of economic activity in the country (Rana, 2062, P.5). Reducing the high level of non-performing assets has been the main challenges. However; these institutions are not ready to reduce their volume of lending but they are offering new and attractive loan schemes among the customers as their services. Therefore it has to be financially competent and professionally strong to survive and prosper in the competitive environment. For this; it should transform itself by increasing cost effectiveness, enhancing service quality and improving efficiency therefore; the study is focused on the current situation, variability, trends and factor affecting non-performing assets of NBL and RBB.

1.3 Statement of the Problem

Almost all the government banks in Nepal were running in loss in past.. Though almost all the private sector banks are earning profit, it is very difficult to call them sound. Some banks have very low capital adequacy ratio while some have piled of non-performing assets. Similarly, it appears that bank do not have proper system in managing and predicting the market risk. Nepal Bank limited and Rastriya Banijya Bank are also facing a big challenge due to the poor analysis of loan and non-performing assets however; failure of management of both government owned banks leads higher non-engineering the management or increasing supervision over the bank management by central bank of nations. So, the Nepalese banking sector has been becoming a victim of huge NPLs. The major questions regarding this study work could be addressed as follows:

1. What is the assets composition in NBL and RBB?
2. What is the trend of NPA in banks?
3. What is the profitability of banks?
4. What is the improvement?

1.4 Objective of the Study

Now the financial market is very complex and facing huge competition. For winning in the competition they must be aware about the non-performing assets. The basic objectives of the study are to examine the non-performing assets in terms of loan recovery of Nepal Bank Limited and Rastriya Banijya Bank. The other specific objectives include;

1. To find out the assets composition of banks.
2. To predict the trends of NPA.
3. To find out the profitability of banks in terms of assets.
4. To suggest and recommend on the basis of major findings.

1.5 Significance of the Study

This study will exist in carrying out the decisions for further studies. Loan and advances are the most profitable of all the assets of a bank. These assets constitute primary sources of income to the bank. It means interest earned from such loan and advances occupy major space in income statement of the bank. As a business institution, a bank aims at making huge profit. Since loan and advances are more profitable than any other assets. So it is very important to be reminded that must of the banks failure in the world due to the shrinkage in the value of loan and advances. Hence loan is known, as risky assets. Risk of non-repayment of assets (loan) is known as credit risk or default risk. Performing assets has multiple benefits while non-performing assets erodes even existing capital.

Therefore, success of any bank doesn't depend upon how much money a bank able to lend? But it depends upon the quality of loan. So success of any bank depends upon the amount of performing assets loan. Performing assets are those assets loan that repay principal and interest to the bank from cash flow it generates. Unfortunately, nowadays banks have been becoming victims of high level of NPL. Non-performing assets are those loans/assets, which neither pay interest not repay principle from the cash flow it generated. This study will help in better improvement for further evaluation and regulation body to know existing recovery problem. It also hopes that they will formulate new modified law and other proceedings. The study equally importance for the many groups such as management of bank, potential investor, policies maker and researcher too.

1.6 Limitation of the Study

This study will conduct within the following limitation and constraints.

- The study is concerned with Non-Performing assets (loan) of Nepal Bank limited and Rastriya Banijya Bank. It doesn't consider the other aspects of the banking business.
- The study is carried out secondary data and based on published financial documents such banks AGM reports, NRB published articles etc.
- The sample banks cannot represent total number of banking sector.
- This study is based on the limited application of analytical tools and descriptive approach.
- The study concerns only five years period.

1.7 Organization of the Study

This study is organized into five chapters. They are;

i) Introduction
ii) Review of Literature
iii) Research Methodology
iv) Presentation and Analysis of Data
v) Summary, Conclusion and Recommendation.

Chapter I. Introduction

This chapter deals with the general background focus of the study, statement of the problem, objective of the study, significance of the study, limitation of the study and organization of the study.

Chapter II. Review of Literature

Many writers and researchers have been given their idea about the related topic. These opinion and views are reviewed in this chapter. It includes theoretical review and research review.

Chapter III. Research Methodology

This chapter explains about the research methodology used to evaluate and analysis. This includes research design, source of data, Population and sample, Data gathering procedure, Data Processing procedure, Research variable and statistical Procedure.

Chapter IV. Presentation and Analysis of Data

This chapter deals with analysis and interpretation of data using the financial and statistical tool described. In this chapter efforts have been made to present and analyze the data in required form.

Chapter V. Summary, Conclusion and Recommendation.

This chapter deals with summary and conclusion of the study and recommendation is given to the concerned company (banks).

CHAPTER – II

REVIEW OF LITERATURE

This Chapter provides knowledge about the development and progress made by the earlier scholar on the concerned field of the study, review existing books, published and unpublished articles, review of policy documents to provide readers background, familiarity in order to fill the gap of research. Review of literature is the process of learning and understanding the concept of related area thoroughly. It assures readers that they are familiar with important research that has been carried out in similar areas. Similarly, it also establishes that the study as a link in a chain of research that is developing and emerging knowledge about the concerned field. In addition it also summarizes the findings of previous literature to provide knowledge about the background of the work done by earlier research work and to stop duplicate of the previous work. Thus, this work may be valuable component of research work.

2.1 Conceptual/Theoretical Review

The effectiveness with which an entity is managed is usually recognized as the single most important factor in its long term success. The success is measured in terms of accomplishment of the entity's goals. Management can be define as the process of defining entity goals and implementing activities to attain those goals by efficient use of human (manpower), material and capital resources. The management process is as set of independent activities use by the management of an organization to perform the function of planning, organizing, staffing, directing and controlling.

This section attempts to review the theoretical aspect of the study. They are historical development of banking system in Nepal, concept of commercial banks, functions of commercial banks, portfolio management in commercial bank, directives, policy and regulation of NRB, concept of Performing and non-Performing assets as well as non-performing loan management.

2.1.1 Development of Modern Banking System

The origin of commercial banking can be traceable in the ancient era of Greeks and Mesopotamians as well as Romans, when the practice of storing precious metals and coins at safe places and loaning out money to the people on interest was prevalent. The traces of rudimentary banking are found in the chaldeanc Egyptian and Phoenician history. The history of banking development, we cannot forget the bank of casa De san Giorgio in Genoa, was established in 1148; Bank of Venice 1401, the Bank of Barcelona was established in Barcelona. In fact modern bank started to take rapid speed in forming and functioning from 17th century. During this period, Bank of Milan, Bank of Florence and Bank of st, George was established in Genoa. In 1609, the Bank of Amsterdam was established in Holland, Likewise in 1610, Bank of Hamburg was established in Germany and Bank of England was established in England.

In spite of establishment of Bank of England in 1694, the development of modern commercial banking institution has to wait for another century and four decades until the passage of banking act of 1833 which provided the freedom for establishment of joint stock banks. While banking arose far early and rapidly in some countries than in other, it was only 19th century than the modern joint stock commercial banking system developed in leading countries of the world.

In conclusion, we can say that banking is not static but a dynamic concept. Development of banking which has taken place is the product of a trial and error and experiences which were made and result that followed relating to the acceptance of money and values as deposits, lending then to different sectors, providing different direct and indirect services to the individual, institution, state and the world.

2.1.2 Historical Development of Banking System in Nepal

The word Bank is derived from the Italian word banco which means a bench on which the merchants of Italy put on different types of currencies to show that they transact their business (Pandey, 2004, p.1). So "Banco" word was used to denote the monetary transactions. Now days the World Bank refers to those institution which are established under law for dealing with monetary transactions Bank accepts deposits from the individuals and institutes, lend to the needy medium term person and organization in term of short term and long term loan.

This history of modern banking system in Nepal is very new one. This becomes explicit when one competes Nepalese banking system with the banking system of other countries of the world. But this does not mean that there was the complete absence of banking activities in Nepal. The banking in the form of money lending can be traced back in the period of Gunkam Dev toward the end of eight century. According to the historical evidence in 723 A.D. Gunkam Dev the king of Katmandu had borrowed money to rebuild (Dahal, 2037, p.31). Toward the end of fourteenth century at the period of Jayasthiti Malla, a special class of people named 'Tankadhare' used to deal lending activities of money. Another historical example as to the pre-modern banking system is found when Rana Priminister Randip singh was administering Nepal in 1880 A.D. During his regime one financial institution by name Tejarath was established to give loan facilities to the government staff and offered loan facilities tot the public in general in the term of 5% interest (Shakya, 2040, p.40). The bank of England was founded in 1694 by a number of merchants of the city of London for the purpose of lending money to King William 3rd who required financing his military activities on the sentiment of Europe. After 57 years, a merchant, Shankhandhar interpreted Nepali sambat by clearing the public debt. These instances reveal that money lending was prevalent even before 8th century (Jha and Rajbhak, 1990, p.69).

A bank provides a number of facilities and can provide important contribution to develop the different sector of the economy by accumulating the money scattered in small amount in the nook and corner to formulate capital for its circulation and distribute in needy sector to establish and run small, medium and large scale industries as well as to promote and develop the trade and commerce sector. Considering to the functions, rights and authorities of various banking institutions, they have been classified into various groups. Some of the common types of Bank which can be found in Nepal are commercial Bank, Central, Bank and Development Bank.

Nepal Bank Limited is the first commercial bank of Nepal which was established on 15, November, 1937. This marked the beginning of an era of formal banking in Nepal. The bank's 51% of share is held by government of Nepal an 49% of share is held by private sector.

Nepal Rastra Bank was established on 26 April 1956 under the Nepal Rastra Bank Act 1955. It marked another milestone history of the banking development in Nepal. NRB, the central Bank of kingdom of Nepal, was established to discharge the central banking responsibilities including guiding the development of the embryonic domestic financial sector. Since then, there has been a huge growth in both the number and the activities of the domestic financial institution. To reflect this dynamic environment, the functions and objectives of the bank have been recast by the new NRB Act of 2002, the preamble of which lays down the primary functions of bank as: to formulate necessary monitory and foreign exchange policies, to maintain the stability in price and consolidate the balance of payments for sustainable development of the economy of the kingdom of Nepal; to develop a secure, healthy and efficient system of payments; to make appropriate supervision of the banking and financial system in order to maintain its stability and foster its healthy development; and to further enhance the public confidence in Nepal's entire banking and financial system (NRB. htm, 2006).

In a view of the various development programs launched after the beginning of planned development in the country, government established another commercial bank, Rastriya Banijya Bank in public sector on 23 January, 1966. Two commercial banks NBL and RBB were functioning under two different acts. So, it was felt necessary to introduce a new commercial banks under the same policy and rule. On 2031 B.S. commercial bank act 2031 and Rastriya Banijya Bank act 2021 B.S. were amended and introduced new commercial bank act 2031 B.S. After then NBL and RBB are functioning under the commercial bank act 2031.

In 1963 AD a co-operative bank was established that was converted into Agriculture Development Bank in 2024 B.S. to be the main financial institution for small rural, agro-industrial and co-operative sectors. For the purpose of the country, Nepal Industrial Development Corporation was established under the NIDC act 2016 B.S. It was set up with an objective of conducting feasibility study, market survey, financing for the development of the industry etc.

The tasks of banks are very dynamic, complex and riskier also. In this context only local commercial bank could not play their role in the development of modern banking. Realizing this fact that government introduced a new banking policy in 1980s. The policy allowed foreign banks to operate as joint venture bank provide autonomy to fix interest rate to certain limit and introduced auctioning of government securities. The first joint venture bank, Nepal Arab Bank limited was established in Ashadh 29, 2041 B.S. After that two joint venture banks; Nepal Indusuez Bank Limited 2042 and standard chartered Bank former Nepal Grindlays Bank Limited 2043 were established.

In order to encourage foreign investment, government introduced industrial and foreign investment policy in 1992. Foreign investment is expected to supplement in management, skill and productivity and providing access to international trade. In this context, government of Nepal has encouraged foreign investment in Nepal by providing attractive incentives and facilities within a liberal and open economic policy. The importance attached to foreign investment is clearly reflected in the new constitution.

When democratically elected government introduced liberalization and open economy policy the number of joint venture bank increase rapidly. Himalayan Bank Ltd. (2049 B.S.), Nepal SBI Bank Ltd. (2050 B.S.) and Nepal Bank of Ceylon (2053 B.S.) were established and are providing full fledge banking services. A number of other financial institutions also emerged in the country such as NIDC, citizens' investment trust, Insurance Company, co-operative organization etc. Newly established other commercial banks are Lumbini Bank, Kumari Bank, Machhapuchhre Bank, Laxmi Bank, Siddhartha Bank, Global Bank etc. which are also providing smooth and efficient banking service to meet the different needs of people, society and the nation.

2.1.3 Concept of Commercial Bank

Commercial banks perform all kinds of banking business and generally finance on trade, commerce and industries in country. They generally provide short-term loans. To accept the deposits of public and to grant loans for productive and profitable sectors are the basic objectives of commercial banks. They carryout agency function to promote the trade and commerce and help to exchange foreign currency. The role of banks in economic development is to remove the deficiency of capital by stimulating saving and investment. A sound banking system mobilizes the small and scattered of the community and makes them available for investment in Productive enterprise. In the connection, the banks perform two important functions.

a. They mobilizes deposits by offering attractive rates of interest, thus converting saving which otherwise would have remained inter (passive) into active capital.

b. They distribute saving through loan among enterprises which are connected with economic development. In this way, they promote the development of agriculture, trade and industry.

Commercial bank plays the most important role in the modern economic organization. Their business mainly consists of receiving deposits, giving loans and financing the trade of a country. They Provide short term credit i.e. lend money for short periods. This is their special feature. Ordinary banking business consists of changing cash for bank deposits and bank deposits for cash, transferring bank deposits from one person to another, giving bank deposits in exchange for bills, Government bonds, the secured and unsecured promises of businessmen to repay and so forth (sayrs, 1967,P.22). Commercial Banking Act 2020 define "A commercial bank is one which does commercial banking functions and which is not a bank meant for co-operative, Agriculture and industries or for such specific purpose." Commercial banks have multipurpose background of providing long term investment to build factory at its smooth running and upliftment of the industrial building. Most of the industries emerged on the country have been benefited through consortium loan (loan provided in a joint efforts of commercial banks). The emergence of industries and establishment of a factory have made the functioning of commercial bank much more important than it was before. It has numerous but valuable function of providing loan against pledged goods providing export import facilities through media, providing money and payment facilities to and from the country and so on.

Table 2.1

List of Commercial Banks

S.N.	Commercial Banks	Established	Head Office
1	Nepal Bank Limited	1994/7/30	Kathmandu
2	Rastriya Banijya Bank	2010/10/10	Kathmandu
3	NABIL Bank Limited	2041/03/29	Kathmandu
4	Agriculture Development	2024/10/07	Kathmandu
5	Nepal Investment Bank Limited	2042/11/26	Kathmandu
6	standard Chartered Bank Limited	2043/10/16	Kathmandu
7	Himalayan Bank Limited	2049/10/5	Kathmandu
8	Nepal SBI Bank Limited	2050/3/23	Kathmandu
9	Nepal Bangledesh Bank Limited	2051/2/23	Kathmandu
10	Everest Bank Limited	2051/7/1	Kathmandu
11	Bank of Kathmandu Limited	2051/11/28	Kathmandu
12	Nepal Credit and commerce Bank Limited	2053/6/28	Siddharthanagar
13	Lumbini Bank Limited	2055/4/1	Narayangadh
14	Nepal Industrial and commercial Bank Limited	2055/4/5	Biratnagar
15	Machhapuchhre Bank Limited	2057/6/17	Pokhara
16	Kumari Bank Limited	2057/12/21	Kathmandu
17	Laxmi Bank Limited	2058/12/21	Birjung
18	Siddhartha Bank Limited	2059/9/9	Kathmandu
19	Global Bank Limited	2063/9/18	Birjung
20	Citizen Bank Limited	2064/1/7	Kathmandu
21	Prime Commercial Bank Limited	2064/6/7	Kathmandu
22	Sunrise Bank Limited	2064/6/25	Kathmandu
23	Bank of Asia Nepal Limited	2064/6/25	Kathmandu
24	Development Credit Bank Limited	2057/10/10	Kathmandu
25	NMB Bank Limited	2053/9/11	Kathmandu
26	Kist Bank Limited	2059/11/9	Kathmandu

Source: Nepal Rastra Bank Publication 2066.

Among the 26 commercial banks, Nepal Bank Limited is the first and oldest in modern banking history of Nepal. His Majestry King Tribhuvan inaugurated Nepal Bank Limited on Kartik 30, 1994 B.S. This marked the beginning of an era of formal banking in Nepal. Until then all monetary transactions were carried out by private dealers and trading center. The Prime Minister Juddha Shumsher speaking on the occasion with the kind permission of His Majesty the king stated this work which is being done in the larger interest of the nation is a great moment for me. Therefore; this bank, which is established under the name of Nepal Bank Limited to fell that, need and to be inaugurated by his majesty the king, is a moment of great joy and happiness. The bank's objectives to render service to the nation's development will also need the support and best wishes for on. In that era, very few understood and had confidence in the new concept of formal banking. Rising equity shares were not easy mobilization of deposits even more difficult.

At Nepal Bank Limited and Rastriya Banijya Bank, banking should be based on Respect, Service and safely for the customer, serve Respect, reward and opportunity for the people with whom the bank work with respect, co-operation and support for the economic community of Nepal. Nepal Bank and Rastriya Banijya Bank was experiencing difficulty in terms of unpaid loan and falling profits. In their diagnostic review of the bank, concluded that the bank is in need of complete restructuring. Government of Nepal in consultation and agreement with the World Bank has come forward to restructure the bank and reform it to profitability. The bank (NBL) was put under the control of NRB and hired the services of the bank of Scotland (Ireland) for the management of the bank for an initial period of 2 years. These banks have been successful in providing leadership to return the bank to its former position of financial leadership within the country. Numerous systems in every functional area of bank management eg: Credit, Accounting, Human Resources, Auditing and Treasury have been modernized. Banks have spread their branches within the country and expanding close contact with many important banks of foreign countries and neighboring countries. In an under developing countries like Nepal, Commercial banks through varieties of services and functions have contributed to the even-growing economic upliftment of the country.

2.1.4 Functions of Commercial Banks

The commercial banks are the heart of financial system of the country as they held deposits of millions of people, government and business units in their different accounts make funds available through their lending and investing activities to borrowers, business firms and government. Commercial banks are established to earn project through the mobilization of cash. So, it performs various functions which are given as:

- Accepting Deposits
- Advancing loans
- Credit creation
- Financial support to foreign trade
- Agency service

2.1.4.1Accepting Deposits

Commercial bank accepts the deposit of public under fixed, Current and saving account. Bank provides security to the amount of client under current account but does not provide interest. There is no provision of interest to be paid and limitation of amount to be withdrawing any amount at any time. These account facilities to the traders and any organize institutions. It provides nominal rate of interest under saving deposit but there is limit to deposit and withdraw amount. The interest rate is lower than on the fixed deposits. Bank accepts deposit for a certain period of time under fixed deposit account and provides high rate of interest in the fixed deposit account and provides high rate of interest in the fixed deposit and interest depends upon the length of time. The money deposited in the fixed deposit can be withdrawn only after the expiry of the period for which the deposits was deposited.

2.1.4.2Advancing Loan

Commercial bank provides short term and medium term loan to the needy business organization and individuals against security deposits. The business of lending is performed in the form of advances, overdrafts, cash credit and discounting bill of exchange. It charges interest on loan which contributes to the profit of bank. Commercial banks accept the bill of reputed organization or businessmen. It discounts such bill and pays the cash immediately. Generally bank discounts such amount which can cover the amount of interest. When a person wants a loan from a bank he has to satisfy the manager about his ability to repay, the soundness of the venture and his honesty of purpose. In addition, the bank may require a tangible security or it may be satisfied with the borrower's personal security. Usually, such securities are accepted and can be easily disposed in the market, example, government securities or shares of approved concerns. Then details about time and rate of interest are settled and the loan is advanced. Banks makes the profit thus by giving loans.

2.1.4.3Credit Creation

Creation of credit is one of the most outstanding functions of a modern bank. A bank has sometimes been called a factory for the manufacture of credit. Generally, money received by the bank is meant to be advanced to others. A depositor has to be content simply with the bank's promise or undertaking to pay him back whenever he makes a demand. This bank is able to do with a very small reserve because all the depositors do not come to without money. Simultaneously some withdraw while others deposits at the same time. The bank is thus enabled to erect a vast superstructure of credit on the basis of a small cash reserve. The bank loan creates a deposit; it creates a credit for the borrower. Similarly, the bank buys securities and pays the seller with its own cheque which again is no cash; it is just a promise to pay cash. The cheque is deposited in some bank and a deposit is created or credit is created for the seller of the securities (Pandey, 2004, p.21).

2.1.4.4Financial Support to foreign Trade

Commercial bank purchases the currencies of various countries and sales to the industries and business at the competitive rate which is fixed by the market. Commercial bank needs to take consent of Nepal Rastra Bank for foreign currency exchange.

2.1.4.5Agency services

The bank works as on agent of their constituents They receive payment on their behalf. They collect rents, dividends on shares etc. They pay insurance premium and make other payments as instructed by their depositors. They accept bills of exchange on behalf of their customers. They also act as a trustee and executor of the property of its customers.

2.1.5 Directives, Policy and Regulation of NRB

Establishment of commercial Bank:

According to the revised policy, a commercial Bank with its headquarters outside the Kathmandu valley will be allowed to operate its office in Kathmandu and in other parts of the country provided that its functioning for 3 years is found satisfactory, its has other conditions as prescribed. Any regional level commercial bank, which is already in operation, will be given permission on request to open its offices in the Kathmandu valley before it completes its three year of operation provided that its paid-up capital is in the minimum of Rs. 1 billion. Other conditions to be meet by the banks operating outside Kathmandu for three years have been clearly laid down in the revised policy (Shrestha, 2005, p.312).

New Nepal Rastriya Bank Directives:

Review of its regulation and directives, clarification of ambiguous points and elimination and improvisation, therefore is a normal process of NRB. According a promoter of the bank holding more than 1 percent of the total share is not allowed to use loan facility from the same bank. For fiscal year 2002/03 only, banks were allowed to restrict those loans for which no interest is due. Loan Provision of 1 percent was allowed in such an instance only. Loan flow to small farmers development bank (SFDB) limited is deemed as loans to the deprived class.

Protective Provision

Provision of up to Rs 10 million has been made to protect small and medium industries through the deposit insurance and credit guarantee corporation.

Black Listing

Commercial banks and the finance companies have been issued directives an black listing and credit information for transparency and relevancy in their loan options and to regulate the process of black listing of loan defaulters. The directive wills also accessing information from one single source.

Adjustment and flexibility

Some of the revisions made to the directives cover bank paid-up capital increase, credit swamps, formation of auit committee, adjustment of loan loss provision, various aspects of institutional governed, loan rescheduling and restricting and so on. In addition, new directives were also issued on financial guarantee issuance, offering promotes is share as collateral and assumption of non-banking assets by the bank.

Imposition of Restriction:

Restriction on inter-bank transaction in Indian currency has been removed recognizing the fact that such a restriction has caused inter-bank market to

remain partially inactive. Commission charged to commercial banks for the purchase of Indian currency from NRB has also been waived which in turn is expected to help banks to reduce commission charged to the customers. Furthermore, individuals are also licensed to purchase Indian currency.
The Nepal Rastra Bank has also directed the commercial banks to provide some part of their priority sector loan to the deprived sector. On August 22, 1992, Nepal Rastra Bank issued some directives to commercial banks and financial institutions to clearly spell out the interest rate on deposits. Nepal Rastra Bank also instructed the bank and financial institutions to limit their interest rate spread on deposit and credit at 6 percent within the mid-December 1993. A further instruction to banks and financial institutions was issued in 2002 and now the interest rate spread required to be maintained by commercial bank and financial institutions has also been removed.

BASEL Committee on Banking Supervision (BCBS)

Internationally BASEL committee has been coordinating since many years in the banking regulation, policy and directives. In 1975 the BASEL committee was established by central bank governors of ten group (G-10) countries. In 1999 New BASEL Accord was developed and published. The BASEL Committee on banking supervision has also laid down certain minimum risk based capital standards that apply to internationally active commercial banks. That is bank's capital should at least 8 Percent of their risk weighted assets. This in fact helps bank to provide protection to the depositors and the creditors. Based on the BASEL norms under the BASEL capital Afford, 1998, the Indian Banks also issued similar capital adequacy norms. According to these guidelines, the banks will have to identity Tier-I and Tier-II capital and assign risk weight to the assets. Having done this they will have to assess the capital to Risk weighted assets Ratio (CRAR).

The minimum CRAR which the India banks are required to meet is set at 9 percent. It should be taken into consideration that the banks capital refer to the ability of bank to withstand losses due to risk exposures. In Nepal for the commercial banks, Nepal Rastra Bank adopted the BASEL Accord policies and directives. According to the Nepal Rastra Bank directives and policies under the 2060 provision to the development bank and commercial bank, at the end of the fiscal year Ashwin, Poush, Chaitra and Ashadh list of the classification of loan and advances should send with one week.

2.1.6 Concept of Performing Assets

Bank is an institution for keeping, lending and exchange of money. The bankers business is to take the debts of other people to offer exchange and there by create money. While investing the money by bank, the bank should be confirmed about the borrowers that the borrower will use them in productive sector or not. If the bank will be alert enough then no NPA will be caused only performing loan will be occurred.

Performing loan means that loan which recovers the installment amount in due time. So, Nepal Rastra Bank has issued guidelines of performing assets which is only the pass assets. Pass assets is classified as performing assets for a period of loan and advances which are not past due as well as past due for a period up to 3 months (Bhandari, 2005, P. 269). On the basis of the loan loss providing, the outstanding loan and advances and bills purchased of performing assets are classified as follows:

S.N.	Classified of Loan	Loan loss provision
1	Pass	1%

Sources: Nepal Rastra Bank Publication 2008.

Loan loss provision set for performing loans is defined as general loan loss provision.

2.1.7 Concept of Non-Performing Assets:

We all know that collection of deposits and making of loan and advances are core functions of bank and financial institutions. The money collected in the form of deposits by providing certain interest to depositors is translated into loan and advances and banks get interest income. On this transformation process bank have a small interest spread from which they have to meet the operating expenses, cost of bad debt and small profit margin. In order to pay the interest to the depositors and meet the withdrawal of depositors, there should be regular repayments of principle and interest of loan from the borrowers as per agreed schedule. In order to make this system interrupted bank should have all the loans as performing assets. i.e. good loans. Good loan and advances are called performing assets. Banks and financial institutions always try to have almost all the financial assets as performing assets to make them sound, sustainable, profitable and healthy with in the system. Sometimes unfavorable internal economic shocks and other factors affects the quality of loans and other assets give birth to non-performing loans and ultimately invite the financial crisis.

An asset is classified as NPA if the borrower does not pay dues in the form of principal and interest for a period of 90 days. NPA could wreck bank's profitability both through loss of interest income and write off the principal loan amount. It tackles the subject starting from the stage of their identification of non-performing loans vary from country to country as the country put in place norm as per requirements of their own banking system. Generally speaking, a loan is classified, as non performing loans only arrears at least 3 months. In Nepalese case too, the same rule has been adopted. So we can say that NPA is that portion of lending or loans which is irrecoverable by banks in the specific period as marked up by central bank (Nepal Rastra Bank Samachar, 2062, P.15).

From the total assets of bank if the assets of bank are not productive, is not able to earn the income, not been able to transform the fund under a certain period then that kind of assets is known as non-performing assets (NPA). Since the date the loan become past due, the loan becomes non-performing assets of the bank. Simply, non-performing assets means,

- Non-Performing loan (the part of the principle or the interest of the amount borrowed)
- Receivables

2.1.8 Classification of NPA

Nepal Rastra Bank has issued guidelines on provisioning requirement with respect to bank advances. In terms of these guidelines, NPA are mainly classified into three categories.

1) Sub-standard assets:

In this NPA the current net worth of the borrowed or the current market value of the security charged is not enough to ensure recovery of the dues to the bank in full. In other words, such assets have well defined credit weakness that jeopardize the liquidation of a debt and is characterized by the distinct possibility that the bank will sustain some loss if deficits are not corrected. However, in respect of accounts where there are potential threat of recovery an account of erosion in the value of security or non-availability of security and existence of other factors as frauds committed by borrowers. It will not be prudent for banks to classify them as sub-standard and then as doubtful after expiry of specified year's period from the date the account has become NPA. It is classified as non-performing assets for a period of 3 months to 6 months.

2) Doubtful assets :

A doubtful asset is one, which has remained NPA for a period exceeding 1 year. In the case of term loans, where installments of principle has remained overdue for a period exceeding 1 years should be treated as doubtful. A loan classified as doubtful has all the weakness inherent that has been classified as sub-standard with the added characteristics that the weakness makes collection or liquidation if full, on the basis of currently known facts, condition and value, highly questionable and improbable.

3) Loss assets:

A loss asset if one where loss has been identified by the bank or internal or external auditors or the central banks inspectors but the amount has not been written off, wholly or partly. It is classified as NPA for a period exceeding more then 1 year.

Thus, NPA depends according to the length of time. According to the provision of NRB, if the loan is performing but an obstacle is found then that loan will be classified as non-performing loan.

- If loanee is found in insolvency/ bankruptcy.
- If loanee is lost.
- If bill buying or discounting data is not received within 90 days.
- If loanee who have taken the loan for one purpose and invested that amount for other purpose or it they misuse the loan.

Table 2.2

Classification of Loan

Classification of loan	F.Y. 2061/062	F.Y. 2062/063	F.Y. 2063/064	F.Y. 2064/065	F.Y. 2065/066
Pass	Not past due and past due for a period up to 3 months loan and advances.	Not past due and past due for a period up to 3 months loan and advances.	Not past due and past due for a period up to 3 months loan and advances.	Not past due and past due for a period up to 3 months loan and advances.	Not past due and past due for a period up to 3 months loan and advances.
Substandard	Past due for a period of 3 months to 1 year loan and advances.	Past due for a period of 3 months to 1 year loan and advances.	Past due for a period of 3 months to 1 year loan and advances.	Past due for a period of 3 months to 1 year loan and advances.	Past due for a period of 3 months to 1 year loan and advances.
Doubtful	Past due for a period of 1 year to 3 years loan and advances	Past due for a period of 1 year to 3 years loan and advances	Past due for a period of 1 year to 3 years loan and advances	Past due for a period of 1 year to 3 years loan and advances	Past due for a period of 1 year to 3 years loan and advances
loss	Past due for a period of more than 3year loan and advances	Past due for a period of more than 3year loan and advances	Past due for a period of more than 3year loan and advances	Past due for a period of more than 3year loan and advances.	Past due for a period of more than 3year loan and advances.

Source: Nepal Bank Limited Publication 2008.

2.1.9 NPA in Nepalese financial System.

In June 2010 there were 26 commercial banks 63 development banks, 77 finance companies, 45 Non-Government organizations and 19 cooperatives societies authorized to do limited banking operations in the country. Besides, these organization regulated by NRB, there are other players with this growth in the number of banks and financial institutions, one could argue that the impact of domestic conflict and political instability in the country caused less impact in the financial sector compared to other sectors of the economy like tourism, industrial production and development.

First of all let us review the domestic problems and challenges of the financial system in Nepal. First, the capital fund of the banking sector shows negative balance of 5447.57 million in mid-July 2008. This is particularly the result of the poor performance of the Rastriya Banijya Bank and Nepal Bank limited.

Even some joint venture banks are not performing at a satisfactory level. Although some progress had been made in the areas of downsizing the staff, establishing system and procedures and reducing the operational costs in these banks, the main problems of overdue loans remain still crucial issues in both the banks.

In Nepalese case, the quality of loans has been deteriorated neither unfavorable economic condition of the nation nor bad intention of the borrower. This is because, if we study the defaulted loan of the bank we can find that most of the loan had been defaulted from the long back when the economic situation was favorable to the borrowers and also economy was achieving a higher level of economic growth. Their track record is not good and even in that time they have not paid to the bank as per agreement. It is business principle that entrepreneur has full right over profit and responsibility to bear losses of the business if any. If there will be a continuous loss in the business or any symptoms of losses are envisaged then borrower should either change the business or stop the operations to control further losses. This is because; borrower has to meet the obligation to loss from its own resources. In such cases, borrower needs to liquidate their assets for debt servicing. If we see the scenario to repay the loans, they would have been using available options such as liquidation of their personal assets and cut for luxurious life in order to repay the bank's debt.

The government of Nepal has been made a lot of efforts to make the Nepalese financial sector healthy and prudent through various reforms, the level of NPL in the Nepalese Banking system has not come down to an acceptable level. The efforts to date succeeded only to reduce the NPL to some extent but sufficient to maintain the sound health of the system to the desire level.

Table 2.3

Level of NPL in the Banking System

	July 2008	July 2009
Commercial Banks	14.22%	12.25%
Development Banks	4.91%	5.26%
Finance Companies	8.46%	8.96%

On the other hand, the level of NPL is still increasing in the Development Banks and Finance Companies. Therefore, we can see that the finance discipline and level of NPL is improving in banks, where as the problems in Development Banks and Finance Companies are deteriorating. The table provides above highlights the facts. In the healthy financial system the level of NPL should be contained within 5%. The financial sector reforms programs as focused its efforts at reducing the level of NPL to this minimum level. Therefore it has still been a challenging task for Nepalese authorities to data.
(Bhisma Raj Dhungana, NPL in the Nepalese financial system, souvenir, 2066, p.30).

2.2 Major Causes of NPL

NPL can not be considered as good symbol of banking system. The causes behind such higher NPL may vary. Some of major causes are as follows.

a) Lack of adequate analysis

Adequate analysis is the essence of every project before providing loan and advances. If management fails to analyze the expected performance, returns and market risk of the project than generally such credit will be converted into NPL future. So a major cause of NPL in case of Nepalese banking system is the banks are failed to conduct an appropriate and adequate analysis of every loan proposal.

b) Lack of effective credit policy

Every bank must have its own credit policy containing the details of different procedures and documents required for different types of credit. Due to lack of such effective policies the volume of NPL increases.

c) Concentration of corporate finance

Corporate finance includes credit to different industries and trades such as tourism, hotels, manufacturing industries, and import and air lines. These sectors are highly interrelated in some way with political and economic situation which may raise NPL.

d) Lack of good governance

In banking system good governance is a subject of crucial importance because banks deals with the other fund i.e. depositor's fund. If credit is provided to any person or organization with the motive of personal and financial benefits of either staff or management then recovery of such loan is unthinkable.

e) Moral hazard

A moral hazard is dishonest or character defects in an individual that increases the frequency of losses. It is the problem created by asymmetric information after the transaction occurs. Moral hazard in financial markets is the risk (hazard) that the borrower might engage in activities that are undesirable (immoral) for the lender's point of view because they make it less likely that the loan will be paid back. Because moral hazard lowers the probability that the loan will be repaid, lenders may decide that they would rather not make a loan.

f) Adverse selection

Adverse selection is the problem created by asymmetric information before the transaction occurs. Adverse selection in banking industry occurs when the potential borrowers who are the most likely to produce an undesirable (adverse) outcome-the bad credit risks are the one who most activity seek out a loan and are thus most likely to be selected. Because adverse selection makes it more likely that loans might be made to bad credit risks, lenders may decide not to make any loans even though there are good credit risks in the marketplace.

g) Lack of Screening and monitoring

Adverse selection in loan markets requires that financial institutions screen out the bad credit risks from the good ones so that loans will be profitable. Financial institutions must collect reliable information from prospective borrowers to minimize the non-performing loans. Selection of ultimate and ethical borrowers is a major challenge to the financial institutions and loan.

After the loan had been obtained the borrowers may have an incentive to take on risky activities that make it less likely that the loan will be paid off. To reduce moral hazard, financial institutions and loan manager must adhere to the principle for managing credit risk of writing provisions into the loan contracts that prevent borrowers for engaging in overly risky activities. There should be higher chances that the loan will be converting non-performing loans if the lenders or financial institutions should not monitor on borrowers activities.

h) Lack of ethical commitment

It should be occurs when borrows would not have any ethical commitment towards the repayment of loans. In some cases borrowers will not ready to repay the loan due ethical problems. So this should be increasing the non performing assets of financial institutions.

i) Worth of Collateral

Collateral is a property promised to the lender as compensation if the borrowers defaults. It reduces the lender's losses in the case of a loan default. If a borrowers defaults on a loan with collateral, the lenders can sell the collateral and use the proceeds to make up for its losses on the loan. But in some case of flexible wealth of collateral lender will not intentionally ready to repay the loan, if the wealth of collateral decreases than the borrowed amount.

j) Lack of credit culture in major financial institutions

The increase numbers of financial institutions creates huge problems and unfair competition to attract customers. So, more banks and financial institutions are ready to provide loans to customers because of greater competitions among to each others due to this, they are ready to provide loans without proper documentations and effective supervisions.

2.3 Effects of NPA on profitability of the Bank

Under the circumstances assets that do not earn any income to the bank affect the profits in a number of ways. Here are some example of the impact of NPA on profitability impact:

- ❖ The resources locked up in NPA are borrowed at a cost and have to earn a minimum return to service this cost.
- ❖ NPA on the one hand do not earn any income but on this other hand drain the profits earn by performing assets through the claim on provisioning requirements.
- ❖ Since they do not earn interest they bring down the field on advances and the net interest margin or the speed.
- ❖ NPA have a direct impact on return on assets and return on equity, the main two parameters for measuring profitability of the bank.
- ❖ Return on assets will be affected because while the total assets include the NPA they do not contribute to profits which are the numerator in the ratio.
- ❖ Return on equity is also affected as provisioning eats more and more into profit earned.
- ❖ The cost of maintaining these assets includes administrative costs, legal costs and cost of procuring the resources lucked in.

- NPA brings down the profits, affects the shareholder value and thus adversely affect the investor confidence.

As a whole the impact of NPA can be assessed with the following:

- Lower ROA and ROE.
- Lower image and rating of bank.
- Disclosure reduces investor's confidence.
- Increase cost/ difficulties in raising capital.
- NPA do not generate income.
- They require provisioning.
- Borrowing cost of resources locked in.
- Opportunity lost due to non- recycling of funds.
- Capital gets blocked in NPA.
- Utilize capital but does not generate income to sustain the capital that is locked.
- Recapitalization by government comes with string.
- Administration and recovery cost of NPA.
- Effect on employee morale and decision making.

(Athmanathan saraswati and venkatakrisha, management of NPA, 2001, p5).

2.4 Directives Regarding loan classification and Provisioning

Nepal Rastra Bank has issued unified directives to banks and financial institution for implementation effective from 2062/04/1 B.S. This also contains new directive concerning classification on loan portfolio and provisioning. Except a few important changes, this directive has retained most of the previous provisions. The classification criteria are as follows:

a) Pass category: All loans and advances the principal of which are not past due or past due for a period of up to 3 months only loans falling under pass category are termed as "Performing loan".
b) Sub-standard category: All loans and advances the principle of which are past due for a period of more than 3 months up to 6 months.

c) Loss category: All loans and advances the principles of which are past due for a period of more than 6 months and up to 1 year.

d) Loss category: All loans and advances the principle of which are past due for period of more than 1 year.

The loss providing on the outstanding loans and advances bills purchase shall be done on the basis of classification as follows:

Table 2.4Classification of Loan Loss Provision

Loan	**Loan loss provision**
Pass	1%
Sub-standard	25%
Doubtful	50%
loss	100%

2.5 Policies Initiated By NRB to Control The Level Of NPA

Various initiatives have been taken by the NRB to address the high risk assets such as: NPL, non-banking assets, monitoring of high risk exposures. These steps include strengthening of capital, monitoring risk, enhancing the capacity absorbing identified risk, strengthening credit management and implementation best credit policies.

Directive on good governance

NRB has issued a separate directive in order to enhance the level of corporate governance in the banks and financial institutions. This comprises of setting the minimum acceptable level of code of conducts of directors, CEO, employees. Similarly, provision of fair dealing with borrowers, prohibition to work in conflict with organization, maintaining of proper records and qualification of CEO and reporting of compliance of code of conduct, requirement of audit committee and responsibility of audit committee are also incorporated in it.

Adequate capital in relation to risk weighted assets

Generally, unidentified credit risk should be covered by the capital fund of the bank and financial institutions. Therefore, in order to absorb this type of risks, two types of measures have been prescribed by the NRB. The first is the minimum paid up capital which is Rs. 1 billion for the banks and it would vary for financial institutions as per their categories. The second is the risk based capital which is prescribed as 12% of total risk weighted assets. Out of the total capital fund the requirement of core capital is at least 6%.

Prudent loan classification and provisioning

For the identified risk, the loan loss provisions are 25% for sub-standard, 50% for doubtful and 100% for bad loan categories.

Requirement to monitor the concentration of asset

As per NRB guidelines loans should be at least classified under 14 categories and monitored whether any exposures in the sector are within the 100% of core capital or beyond the limit. Exposure up to 100% of core capital should be monitored by the management and beyond it should be monitored by the Board of Directors.

Maintaining of a good loan portfolio and establishing proper system for the collection of interest and principal

It has been a motivating task for the banks and financial institutions to recognize the interest in cash basis and classification of loans on the basis of overdue periods.

Compulsion for formulating and importance credit policy Guidelines (CPG)

NRB regulations require the bank and financial institutions to prepare and implement prudent credit management procedures. For this purpose CPG needs to be formulated and implemented by each bank and financial institutions.

Credit management aspects needs to be area that cover all the aspect on credit risk management policies and procedures.

Strengthening the credit information system and blacklisting procedures

In order to strengthen the discipline a system for obtaining credit information needs to be developed. For this purpose, the directives of blacklisting were issued by NRB almost one decade ago. This has been amended and strengthened in order to improve the credit information system and dealing with willful defaulters in a scientific way. This has facilitated to restore a good credit culture among banks and the borrowers.

Provisioning of loan write off

Each bank and financial institution should have its own loan write off policy. Generally, write offs are charged against reserves made for loan losses. Top management normally with the concurrence of legal and audit department makes decisions to write off the loan losses. It will be prudent to write off a loan when the amount of loan is less than that of the amount to be spent or recover the loan is less than that of the amount to be spent or recover the loan or while proceeding to the legal steps, there will be still an excess amount of outstanding amount than that of the liquidation value of the loan securities or if a loan is considered as uncollected under various possibilities and circumstances of recovery.

Refinance facility to sick industries

NRB has provided refinance facility for the rehabitation of sick industries since 2001/02. During the last five year a sum of Rs. 3 billion has been disbursed to 151 hotels and 41 industries. NRB still has allocated Rs. 2 billion in current fiscal year to facilitate them.

Other Measures:

Other measure focused for maintaining a good asset portfolio comprised various prudential norms. These measures are enhancing the eve if corporate governance, limitation to investment (such as unlisted shares and debentures) and deduction in capital for such activities, monitoring of liquidity gap through asset and liability mismatch, monitoring of foreign exchange exposure etc. (Source : NRB directives 2066).

2.6 Research Review

On way to conduct this research some books, articles journals and publications have been studied to formulate ideas about the subject matter. Although, the specific books regarding the NPA could not be found. However, some banking related book and some thesis have been consulted such as Tannan's Banking law and practice in India (1997).

2.6.1 Review of books and articles

Assessing the gravity of the problem Tannan found saying that banks and financial institutions at present face considerable difficulties in recovery of dues from the clients and a significant portion of the funds of banks and financial institutions is thus blocked in unproductive assets likewise for taking reference book on management of bank credit written by suneja (2001) has also been consulted .Suneja pointing out the cause of NPA says that the risk connected with lending to business depend on an enormous number of factors. Further, she suggests that if customers fail to make repayment on the due dare the bank has to consider what steps need to be taken to recover the debt.

Pradhan (2058) in his article "NPA: Some Suggestions to Tackle Them" found that unless the growth of NPA is kept in control, it has the potential to cause systematic crisis. He has maintained that a dream of globalization led to huge investment which unfortunately could not be utilized properly due to hesitant liberalization policies. Large corporate misused the credits and delayed payment and contributed indirectly for enhancing NPA ratio. He further argues that lack of vision in appraisal of proposal while loan sanctioning, reviewing or enhancing credit limits absence of risk management policy of financing, lack of initiatives to take timely action against willful defaulters etc. He further pointed out that most crucial reason for the increase in the NPA is the shabby and defaulter friendly legal system. Suggestion the remedy of NPA, he adds that administrative system should be strengthened, Legal reforms should be made and assets Reconstruction Company should be formed.

Dhungana (2063) in his article "Problem of NPL and the Need of financial discipline in the Nepalese Banking system" states that Nepalese financial system still has a high level of NPL. System's soundness cannot be restored without resolving the problem of NPL. He further says, the level of total loan is highest level in the Nepal in 2003 that of other south Asian countries. According to him, the main cause for NPL problem in the Nepalese banking system are internal and external factors consists poor system, procedures and credit culture in credit management, management oversight deficiencies in policy level and lack of competencies in the Board of Directors to monitor risk, limited supervision by the bank itself and fraud in lending and recovery, poorly manage few banks. External factors consists lack of financial discipline within borrowers and in financial system, poor legislative regime, deterioration in economic growth rates. He further suggests that for the management of NPL and a good banking there should be a proper risk management. Preventive and curative measures are acquired to be initiated in the system.

Basyal (2065) discussing about the financial sector reform in his article "Financial Sector Reform Program in Nepal Prospects and Challenges" state that the host of challenges and complexities that confront the financial system of Nepal could be categorized as the weak financial position of most of the government-owned financial institutions as reflected in their negative net worth and huge accumulated losses, higher portion of NPA, predominance of the informal financial system. It is estimated that the size of NPA in the commercial banking system is as high as 18% and 50% of this ratio we can found in the two largest banks (RBB and NBL). To tackle this problem, the financial system should be strengthened by improving its regulatory and supervisory systems. The central bank's capability for effective supervision of the financial institution should be enhanced. He gives an example of the Asian crisis of 1997-98 and suggests taking lesson from it. The crisis seriously affected the financial system and economics stability of the region. Large currency depreciation, capital market collapses, swollen NPA level of the finance system, negative economics growth rate were the immediate effects of the crisis. It is commonly believed that one of the critical factors behind the crisis was the absence of adequate central banking autonomy which substantially reduced the efficiency and effectiveness of the central banking functions and responsibilities. He suggests the concerned parties should review the measures they taken for solution of the crisis.

Poudel (2063) in his article "Financial System, Impaired Assets and their Resolution in Nepal" states that NPL/total loan ratio of Nepal is the highest among china, Japan, Korea, Malayasia and Thialand. NPL in Nepalese banking sector has been mounting since early 1990's and its main sources are two public sector banks, RBB and NBL, he adds. Moreover, NPL of these banks is as high as 60% of their total loan portfolio, poor government resulted from political inference and insider lending, Weak information system and weak legal framework and accounting practices in the main caused of NPA problem, he clarifies. He says the NRB should formulate and implement all the necessary rules, regulation, acts, policies and guidelines to address the NPA problem.

2.6.2 Review of Thesis

Dinesh kumar khadka (2004) studies on "Non-Performing Assets of Nepalese commercial Banks." He has taken the main objective to examine and study of level of non-performing assets in total assets deposit and total lending of Nepalese commercial banks. It is well known fact that the bank and finance institution in Nepal have been facing the problem of swelling NPA and the issue is becoming more and more unmanageable day by day, he adds. His study is especially focused in five Nepalese commercial banks i.e. Nepal SBI Bank, Nepal Investment Bank, Nepal Bangladeh Bank, Bank of Kathmandu and NABIL Bank Ltd. only among these five sampled commercial banks, he found the NPA of NBBL seems very worse than all other banks. He concludes that the level of NPA in sampled banks is not so alarming and the situation is quite satisfactory. We recommends to overcome the problem of NPA than being loan a risky assets, effort should be made to have proper control in the every step of loan management corporate structure of the banks play key role in the effective loan management. He has followed descriptive research design with analytical approach. His research is based on secondary data. He has used simple percentage tool like arithmetic tool, karlpearson co-efficient of correlation and regression analysis for data processing Procedures. His research based on research variables like NPL and the level of NPL in different parameter.

Dirgha Narayan Kafle (2006) aims to study the level of NPL is total assets, total deposits and total lending by Nepalese commercial banks and to find out whether the Nepalese commercial banks are following the NRB directives regarding loan loss provision for NPL on his thesis title "Non-Performing loans of Nepalese commercial Banks." He found the level of NPA in Nepalese banking sector is alarming and increasing. In his study lack of proper financial analysis, management inefficiency and lack of proper collateral are the causes of high-level NPA. Nepalese commercial banks should strongly think on these areas, he recommends. He has followed descriptive research design with analytical approach. He has used arithmetical tool, Karl Pearson co-efficient of correlation and regression analysis for data processing procedures.

Saroja (2007) says ineffective credit policy, political pressure to lead to uncreditworthy borrower; over valuation of collateral are the major causes of mounting non-performing assets of the banks in her thesis title "A study of the Non-performing assets of commercial Banks of Nepal". To identfy effects of NPA on ROA and ROE, to solve one of the case of the NPA i.e. analysis and interpretation of the case and to find out the factors behind the accumulation of NPA. She state present loan classification and provisioning directives seems more stringent than previous one. She further says adequate provisioning strengthens the financial health of the banks and makes them able to face any kind of future contingencies. She recommends that there should be regular supervision and follow up for proper utilization of loan. On the way of conducting her research, she follows analytical and descriptive research design in research methodology. Different kinds of appropriate mathematical, statistical and financial tools have been applied for analysis purpose. Correlation analysis, ratio analysis and different diagrams and graphs are used in her research as tools and techniques.

Panta (2004) has done a study on deposits and its utilization by commercial banks in Nepal. The objective of this study was to carry out the performance evaluation of commercial banks of the deposit mobilization. The study has covered the sophisticated statistical tools to analyze the data. He concludes that failure of commercial banks in resource utilization is due to the defective lending policy.

Poudel (2005) carried out a study on "comparatively Analysis of Financial performance between Nepal Bank and Rastriya Banijya Bank." The basic objective of that study was to provide comparative financial performance of NBL and RBB. In that study finance tools and statistical tools were used to evaluate the performance of banks. In financial tools liquidity, activity, profitability, Structure and income and expenditure rations. Further, the researcher used the method of least square to find out the trend of different financial indicator like earning per share, dividend per share and net profit, loans and market value per share. On the basis of different financial indicators he found that the performance of NBL better than that of RBB.

Though these studies are found to be quite useful in their own side but the questions of NPA and its cause as well as effect on various aspects empirically and qualitatively in Nepal Bank and Rastriya Banijya Bank is yet to be researched. These thesis are mainly on the condition of NPA in Nepalese banking sector and other policies and directives regarding this topic. The contribution of NPA of these two banks is more than 60% an overall NPA. Previous researchers have analyzed only other commercial bank's NPA problem. None of them could address the cause and effect of NPA in profitability of these two major commercial banks. NPA problem in these two commercial banks are. NPA problem in these two commercial banks are mounting regularly. The problems are needed to be solved promptly. The methodology adopted in this research are research design, Population and sample, type and nature of data, data gathering procedures, data processing procedure and technique of analysis and so on. Secondary data are used for the purpose of the study.

CHAPTER III

RESEARCH METHODOLOGY

This chapter includes the research design, sources of data, population and sample, data gathering procedures, data processing procedures and statistical procedures. This chapter presents the theoretical relationship between non-performing assets and other financial tools.

3.1 Research Design

The research study is based on descriptive and analytical research design. The study aims to portray accurately upon the non-performing assets of Nepal Bank Limited and Rastriya Banijya Bank. Hence descriptive and analytical research design is applied for the study.

3.2 Population and sample

Since the study is concerned with the cause and effect of NPA of commercial banks in Nepalese perspective, therefore all the commercial banks are the population of the study. The census of the population is neither feasible nor desirable for the study of this nature that is why a sample from the population has therefore selected for the purpose of this study. For the selection of the sample from the population, random sampling method is applied and accordingly the following commercial banks have been chosen for the sample.

a) Nepal Bank Limited
b) Rastriya Banijya Bank

3.3 Nature and source of data

Secondary data was used for the study. The sources of secondary data has been collected from published data as annual reports, bulletins, financial statistics, articles, journal and annual balance sheet of Nepal Bank Limited and Rastriya Banijya Bank as well as the website. In addition to above sources, qualitative information has been collected from the personnel of concerned bank.

3.4 Data Collection Procedure

The data has been collected on secondary sources from the related banks. To collect necessary data and information other concerned people was also consulted. Banking and financial statistics, NRB policies and directives are collected from the website of NRB. The annual reports, audited and unaudited financial statement of NBL and RBB were collected by frequent visit to the Head office and website of the bank.

3.5 Tools for Data Processing and Analysis

In this study, statistical tools like percentage changes, bar diagram, tabulation, trend line has been used as the data analysis tool. A different financial variable has been worked out with the help of computer programmers like Microsoft word, Excel. Similarly, some financial tools also used to analyze the data.

3.5.1 Financial Tools

Return on Assets (ROA): It is the ratio which is defines as net income after tax to total assets. Total assets include Long Term as well as short term assets. It can be expressed as;

$$\text{ROA} = \frac{NetIncomeafterTax}{TotalAssets} \times 100$$

Operating Ratio:- Operating ratio indicates an operating efficiency increased on total assets.

Operating Ratio = $\frac{OperatingIncome}{TotalAssets} \times 100$

Interest Income on loan and advance:- The interest income on loan and advance is calculated by using the following formula.

Interest Income on loan and advance= $\frac{InterestIncome}{TotalLoanandadvance} \times 100$

3.5.2 Statistical Tools

After data is collected and organized, statistical analyses are performed. Various inferential statistical tools are used in the study.

Simple Regression Model

The simple regression model has been used to describe the changes in non-performing assets for a given changes in total assets.

The regression equation of Y on X is expressed as;

Y = a+bX

Where, a = Y-intercept

b = slope of the line

X = Total Assets

Y = Non-performing assets.

In the above model,

$$b = \frac{N \quad XY \, \mathrm{Z} \quad X . \quad Y}{N \quad Y^2 \, \mathrm{Z}(\quad Y)^2}$$

Correlation co-efficient (r)

Correlation analysis is the statistical tool, used to describe the degree to which one variable is linearly related to another. It has been used in the study to measure the degree of association between NPL and other independent variables.

Co-efficient if correlation (r) = $\dfrac{N \quad XY \, \mathrm{Z} \quad X . \quad Y}{\sqrt{N \quad X^2 \, \mathrm{Z}(\quad X)^2} . \sqrt{N \quad Y^2 \, \mathrm{Z}(\quad Y)^2}}$

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

In this chapter, efforts have been made to present and analyze the collected raw data. Raw data collected from the various sources were classified, processed and tabulated as per the requirement of the study and in accordance to the nature of collected data. Different financial and statistical tools are used to analyze the data. Graphical presentation has been used to make the data more clear to understand. The final portion of this chapter includes major findings of the study.

4.1 Analysis of Assets Composition

Assets something possessed by a business entity from which future economic benefits may be obtained. Any item of economic value owned by an individual or corporation, especially that which could be converted to cash is called assets. On a balance sheet assets are equal to the sum of liabilities, common stock and retained earnings.

Assets composition consists of cash and Bank balance, Money at call and short Notice, Investments, Loans and Advances, Fixed Assets, Non-Banking Assets and other Assets. In balance sheet, the assets side shows the funds entrusted to the bank in which they are deployed. As balance sheet is prepared with a view to know the exact financial position of the business on the last date of every finance year. Assets composition helps to determine the soundness of a bank also it provide to determine the capability of the bank to earn profit.

Table 4.1

Assets Composition of NBL (Rs. in '000')

Fiscal Year / Assets	2062/63		2063/64		2064/65		2065/66		2066/67	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Cash and Bank Balance	5523248	12.41	7117292	16.65	5055204	11.51	9154759	18.22	11630387	21.84
Money at Call and Short Notice	-	-	200000	0.47	-	-	400000	0.79	550000	1.03
Investment	14501391	32.59	16072180	37.59	16640756	37.89	13397860	26.66	11204049	21.04
Loans and Advances	12879221	28.95	13756620	32.17	15770746	35.92	19482245	38.7	22036960	41.38
Fixed Assets	210649	0.47	205768	0.48	217289	0.49	233934	0.46	265496	0.49
Non-Banking Assets	798215	1.80	798214	1.87	702581	1.6	604071	1.20	827134	1.55
Other Assets	10580391	23.78	4605074	10.77	5522119	12.57	6970718	13.87	6735082	12.65
Total Assets	44493115	100	42755148	100	43908695	100	50243587	100	53249108	100

Source: Annual Reports, NBL

The above table presents the assets composition of NBL from the fiscal year 2062/63 to 2066/67. As shown in above table, the value of Cash and Bank Balance is in fluctuating positions. It decreases in the fiscal year 2064/65, after that it is in increasing trend. Money at Call and Short Notice is fluctuated. There is no Money at Call and Short Notice in the fiscal year 2062/63 and 2064/65. After that the trend is increasing. The Investment of the bank is in increasing trend up to the fiscal year 2064/65. After that it is decreasing.

Similarly, the Loan and Advance of the bank is in increasing position. Due to the increment of loans and advance there will be occurrence of bad loan in the bank The Non-Banking Assets and Other Assets of the bank are in fluctuating condition or trend. In aggregate the total assets of the bank is decreasing in the fiscal year 2063/64 and after that it is in increasing trend

Figure 4.1

Assets Composition of NBL

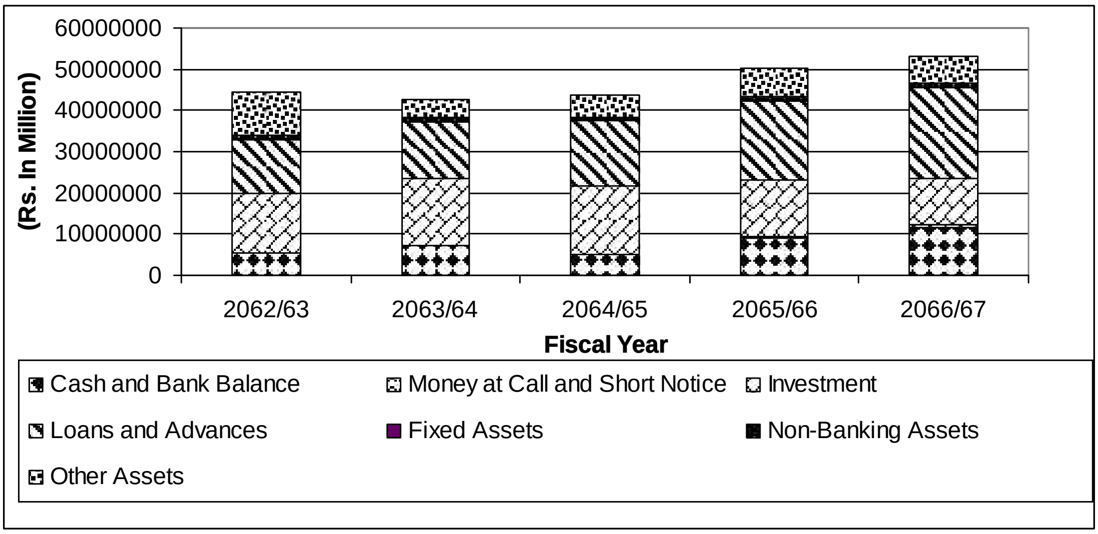


Table 4.2

Assets Composition of RBB (Rs. in '000')

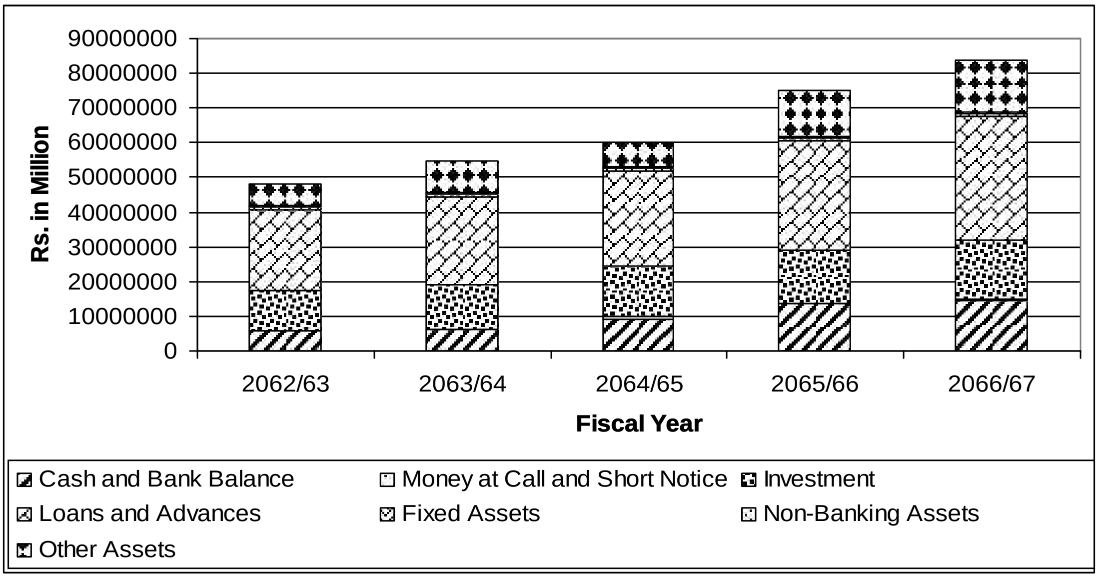
Fiscal Year	2062/63		2063/64		2064/65		2065/66		2066/67	
Assets	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Cash and Bank Balance	5653158	11.7	6151023	11.24	9269348	15.40	13483497	17.97	14574389	17.38
Money at Call and Short Notice	-	-	200000	0.04	550000	0.91	-	-	400000	0.48
Investment	11831582	24.50	12716401	23.24	14513141	24.17	15643046	20.84	16789321	20.03
Loans and Advances	23327863	48.31	25394627	46.41	27524922	45.75	31606964	42.11	35991726	42.94
Fixed Assets	594216	1.23	693305	1.27	756832	1.26	785204	1.04	843195	1.01
Non-Banking Assets	298317	0.62	320152	0.58	305920	0.51	256671	0.34	236372	0.28
Other Assets	6579054	13.63	9419694	17.21	7213564	11.99	13267543	17.68	14984703	17.87
Total Assets	48284190	100	54715202	100	60163727	100	75042925	100	83816706	100

Source: Annual Reports, NBL

Above table shows the assets composition of RBB from the fiscal year 2062/63 to 2066/67. The cash and bank Balance of the bank is in increasing trend. But it decreases in the fiscal year 2066/67. Money at call and short notice is in huge deviation in different fiscal year. Investment of the bank is in fluctuating trend. It is highest (24.50%) in the fiscal year 2062/63. Loans and advances are in increasing trend through out the research period. A fixed asset of the bank is highest in the fiscal year 2063/64 and after that it gradually decreases. Non banking assets of the bank are in declining trend where as other assets of the bank is in fluctuating position.

Figure 4.2

Assets Composition of RBB



4.2 Non-Performing Loan

Loans and advances are the most profitable of all the assets of a bank. Banks universally seeks after the assets. These constitute primary source of income to banks. As a business institution, a bank aims at making a huge profit and providing loans and advances are most profitable than any other assets, bank are willing to lend as much as of their fund as possible but it has to be careful about the safety of such loan and advances. The bankers have to timer liberality with caution. If he is too liberal, he may easily impairs his profit by bad debts, if he is too timid he may fail to obtain adequate return of the found.

Loan and advance dominate the assets side of balance sheet of any bank. Similarly, earning from such loan and advance occupy major space in income statement of the bank. Lending can be said to be the major source of generating income of the bank. However, it is very important to be remanded that most of the banks are failures in the world due to the shrinkage in the value of the loan and advances. Hence, loan is known as risky assets.

Non-performing loan measures the extent to which the banks have been unsuccessful in utilizing their assets for the profit generating purpose. Non-performing loan reflects the quality of assets that a bank is holding. Higher non-performing loan reflects the bad performance of the bank and bad recovery of the bank.

Table 4.3

Non-Performing Loan (Rs. '000')

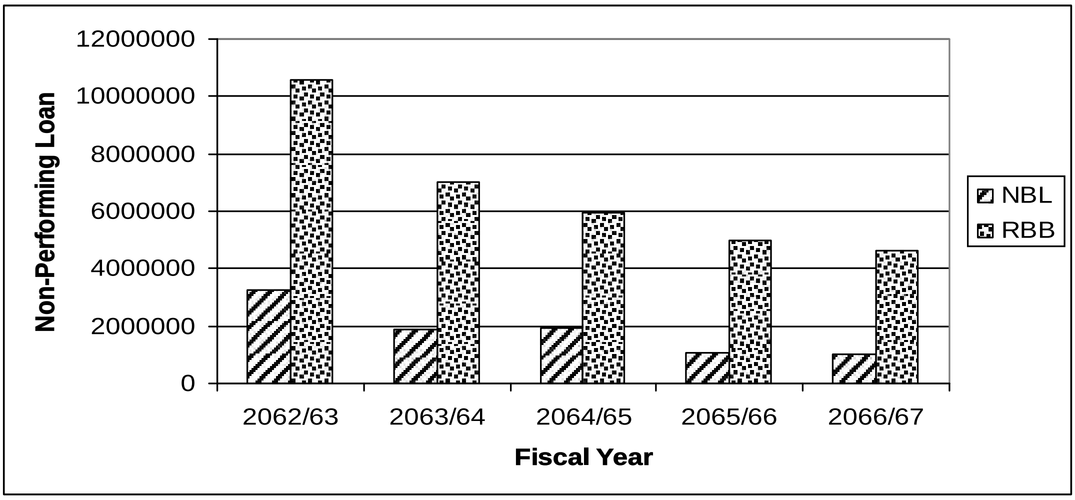
Banks	2062/63	2063/64	2064/65	2065/66	2066/67
NBL	3232684	1857144	1955573	1052041	991663
RBB	10567522	7008917	5972908	4962293	4606941

Source: Annual Report, NBL and RBB

Table 4.3 depicts the non-performing loan for the study period. Viewing the above table the non-performing loan of NBL is gradually decreasing which is a good symbol of the bank. Similarly, non-performing loan of RBB is also in decreasing position which shows the bank is able to recover the loan in somewhat.

Figure 4.3

Non-Performing Loan



Above diagram represents the comparative study of NBL and RBB in terms of non-performing loan. The non-performing loan of RBB is higher than the NBL. But both the banks show that they are in declining trend which is a good symbol to recover the loan.

4.3 Non-Performing Loan to Total Loan and Advances

Non-performing loan ratio measures the extent to which the bank have been unsuccessful the extent to assets for the profit generating purpose. Higher non-performing assets reflect the weak performance of the bank. If the bank is too liberal in the process of providing loan and advances it impairs the profit by bad debt. So, if the bank is too timid in providing loan and advance then the bank is unable to obtain adequate return. So, the bank has to measure the minimum financial strength to receive the credit. Basically 5c's can be used (Character, Capital, Condition, Collateral and Capacity).

Table 4.4

Non Performing Loan to Total Loans and Advances of NBL

(Rs. in '000')

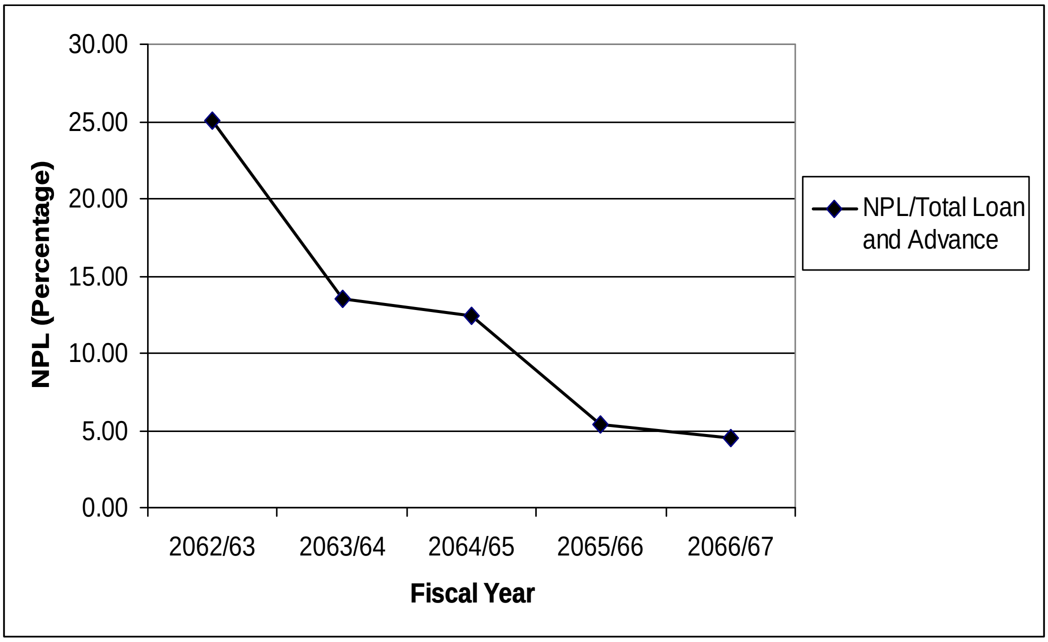
Fiscal Year	NPL	Total Loan and Advance	NPL/Total Loan and Advance
2062/63	3232684	12879221	25.1%
2063/64	1857144	13756620	13.5%
2064/65	1955573	15770746	12.4%
2065/66	1052041	19482245	5.4%
2066/67	991663	22036960	4.5%

Source: Annual Report, NBL

Table 4.4 depicts the non-performing loan as a percentage of total loan and advances. Viewing to the above table the non-performing loan of the bank is in decreasing trend throughout the research period.

Figure 4.4

Non-performing Loan to Total Loans and Advances



In the above diagram, the non-performing loan to total loan and advances of NBL is in decreasing trend throughout the study period. This trend is a good symbol of bad debt recovery of the bank.

Table 4.5

Non-performing Loan to Total Loans and Advances of RBB

(Rs. in '000')

Fiscal Year	NPL	Total Loan and Advance	NPL/Total Loan and Advance
2062/63	10567522	23327863	45.3%
2063/64	7008917	25394627	27.6%
2064/65	5972908	27524922	21.7%
2065/66	4962293	31606964	15.7%
2066/67	4606941	35991726	12.8%

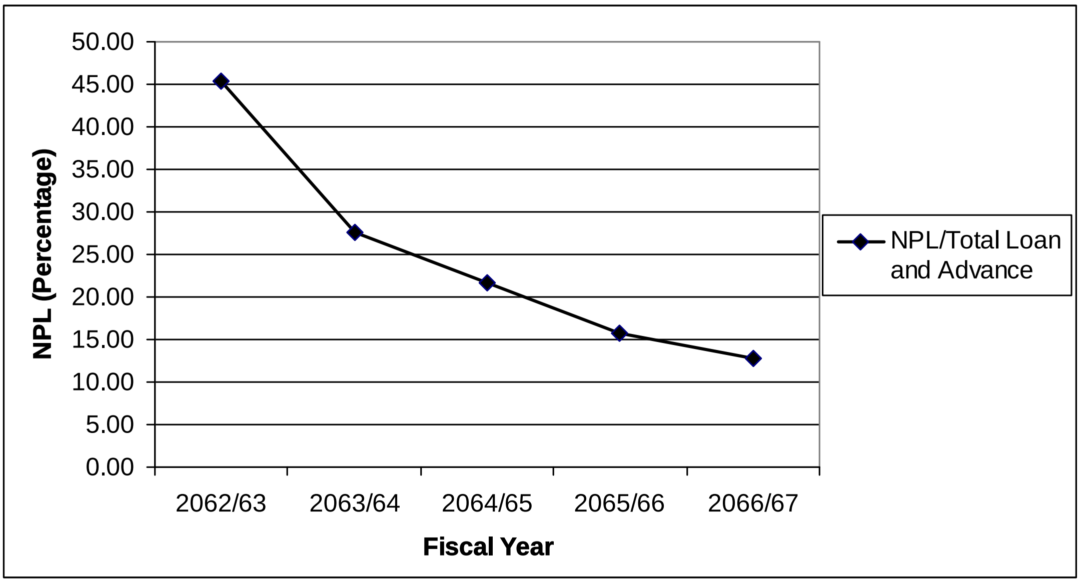
Source: Annual Report, RBB

Above table shows the non-performing loan as a percentage of total loan and advances. From the fiscal year 2062/63 to 2066/67 the non-performing loan of

RBB is in decreasing trend. The total loans and advances of RBB is increases but non-performing loan is in decreasing. It indicates that the bank is able to recover slowly its bad debt loan. Higher non-performing loan reflects the weak performance of the bank and profitability of the bank get affected.

Figure 4.5

Non-performing Loan to Total Loans and Advances



In the above diagram, the non performing loan to total loan and advances is gradually declining position throughout the study period. From the fiscal year 2062/63 to 2063/64 there is greater deviation of decreasing loan which is a good symptoms for the bank.

4.4 Analysis of Non-performing Loans Trend by Regression Model

Simple regression model is expressed algebraically by the equation of straight line. Since there are two regression equation which describes the changes in Y-values for a given changes in X-values and changes in X-values for a given change in Y-values.

Let the regression of Y on X be;

The normal equation is Y = a + bx …….. (i)

Where, a and b are constant

X is independent variable

Y is dependent variable

$\Sigma Y = na + b\Sigma x$ ………. (ii)

$\Sigma XY = a\Sigma x + b\Sigma x^2$ ………..(iii)

Table 4.6

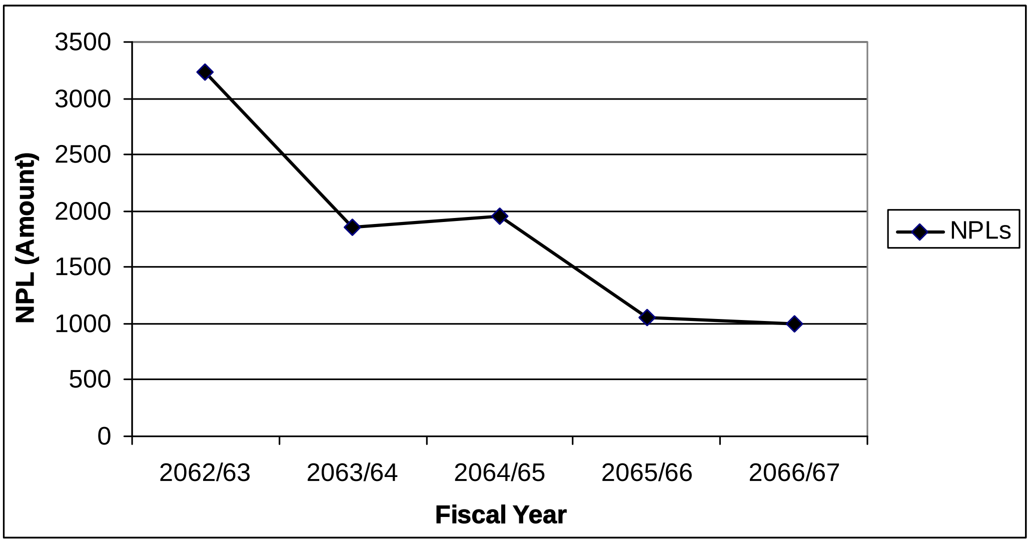
Non-performing Loan of NBL

Fiscal Year	2062/63	2063/64	2064/65	2065/66	2066/67
NPLs (Million)	3232	1857	1955	1052	991

Source: Annual Report, NBL

Figure 4.6

Trend of Non-Performing Loan of NBL



Above diagram depicts the non-performing loan of Nepal Bank Limited. In the fiscal year 2064/65 the loan is in increasing position. But after that it gradually decreases. NPL increases due to the debt instrument whose obligors are unable to discharge their liabilities.

The non-performing loan of NBL in the regression model is;

$$Y = 3403.5 - 528.7x$$

This regression model helps to forecast the NPL of the bank.

Project trend of NPL of NBL

If; $X = 6$ i.e. fiscal year 2067/68 then;

$$Y = 3403.5 - 528.7 \times 6$$
$$= 231.3$$

If, $X = 7$, i.e. fiscal year 2068/69 then;

$$Y = 3403.5 - 528.7 \times 7$$
$$= -297.4$$

Similarly, for the fiscal year 2069/70, 2070/71 and 2071/72 projected NPL is calculated and presented in the following table.

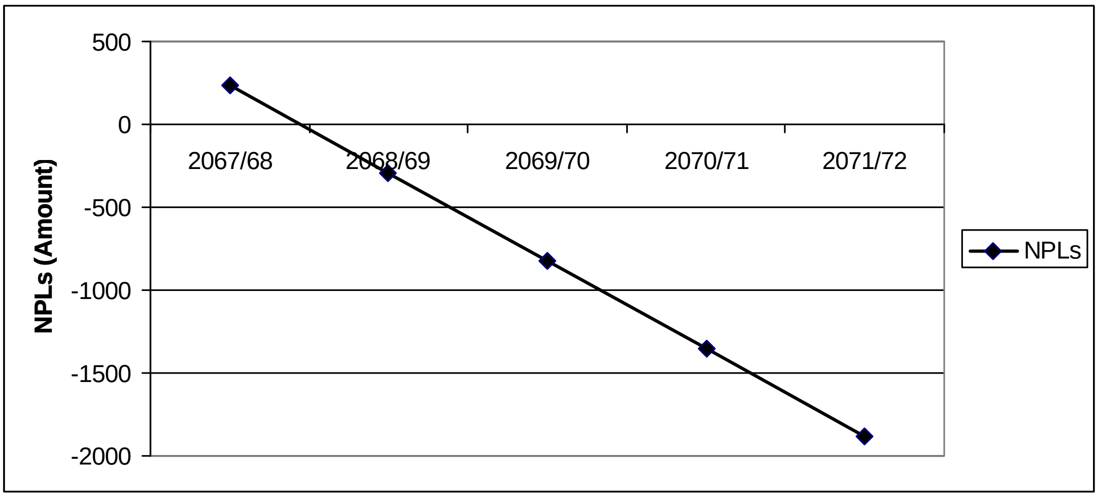
Table 4.7

Projected Trend of Non-Performing Loan of NBL

Fiscal Year	2067/68	2068/69	2069/70	2070/71	2071/72
NPLs (Million)	231.3	-297.4	-826.1	-1354.8	-1883.5

Figure 4.7

Projected trend of Non-performing Loan of NBL



Above diagram presents the projected trend of non-performing loan. With the help of regression analysis model we can forecast the loan of NBL which is shown in above diagram. This diagram presents the forecasted trend which is in good position to recover the bad debt recovery of the bank. Within this fiscal year 2068/69 to 2071/72 the bank is able to recover the non-performing loan and only performing loan is seen in the bank.

Table 4.8

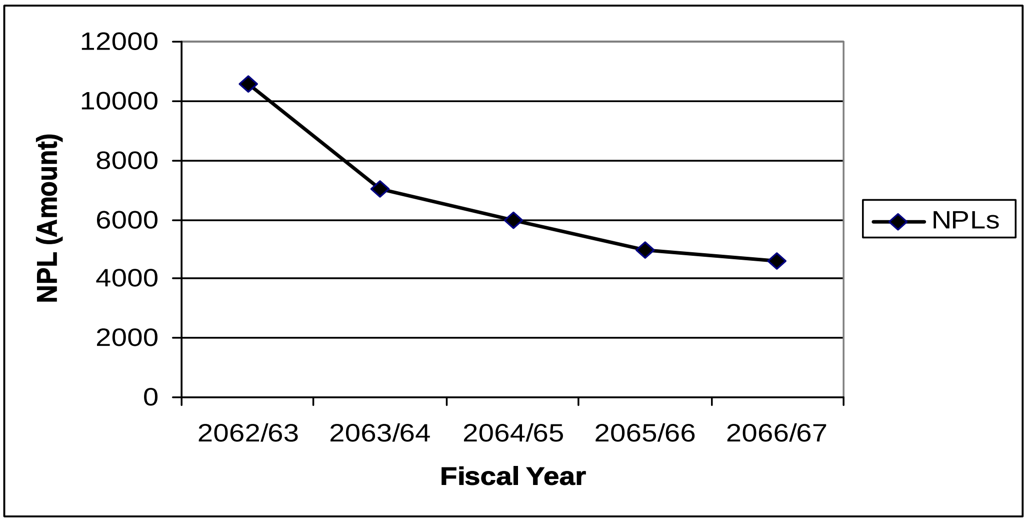
Non-Performing Loan of RBB

Fiscal Year	2062/63	2063/64	2064/65	2065/66	2066/67
NPLs (Million)	10567	7008	5972	4962	4606

Source: Annual Report, RBB

Figure 4.8

Trend of Non-Performing Loan of RBB



Above diagram presents the non-performing loan of RBB. It seems to be declining position throughout the research period. This indicates the good recovery of the bad debt of the bank. The non-performing loan of RBB in the regression model is;

$$Y = 8375.4 - 1396.8 X$$

This regression model helps to forecast the NPL of the bank.

Projected Trend of NPL of RBB

If $X = 6$; i.e. for fiscal year 2067/68

$Y = 8375.4 - 1396.8 \times 6$

$= -5.4$

If $X = 7$; i.e. for fiscal year 2068/69

$Y = 8375.4 - 1396.8 \times 7$

$= -1402.2$

Similarly, for the fiscal year 2069/70, 2070/71 and 2071/72 projected NPL is calculated and is presented in the following table.

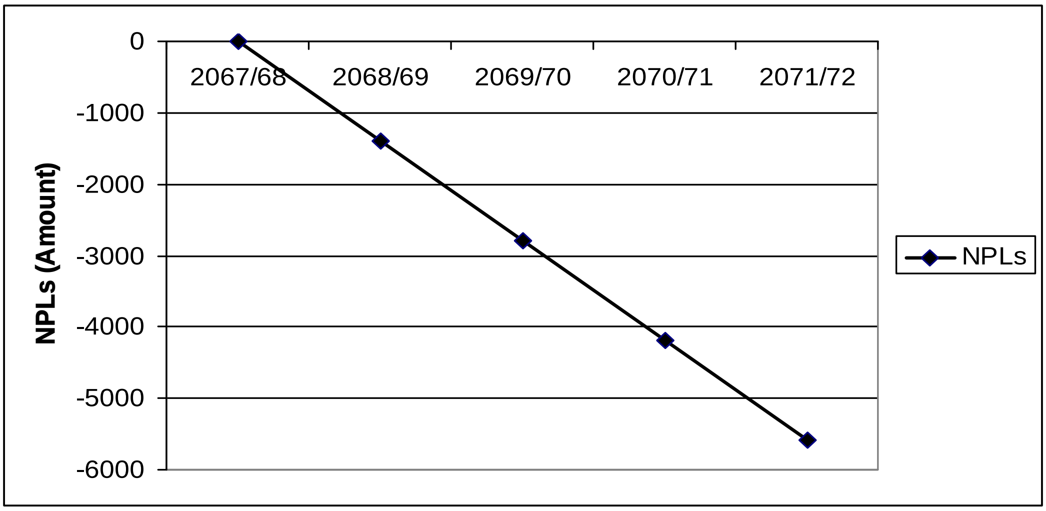
Table 4.9

Projected Trend of Non-Performing Loan of RBB

Fiscal Year	2067/68	2068/69	2069/70	2070/71	2071/72
NPLs (Million)	-5.4	-1402.2	-2799	-4195.8	-5592.6

Figure 4.9

Projected Trend of Non-performing Loan of RBB



Above diagram 4.9 presents the projected trend of non-performing loan. The bank is able to recover its bad loan according to the above calculation and the diagram. If so, the good performance of the bank is seen.

4.5 Analysis of Profitability

The operating efficiency of the banks and its ability to ensure adequate return to its shareholders depends ultimately on the profit earned by the banks. Sufficient profits must be obtained from investors for expansion and growth and to continue towards the social overheads for welfare of the society. Profitability is a measurement of operating efficiency of the company. It measures how efficiently the company has managed their funds to earn profit. Beside the profitability of a firm, creditors want to get interest and repayment on their principle amount. Owners want to get a reasonable return on their investment. All these are possible when the company earns sufficient profits.

The profitability measures the efficiency and provides incentive to achieve efficiency. It also indicates public acceptance of the product and shows that the firm can reduce competitively. Moreover, profits provide the company of repaying the debt, incurred to finance the project and resources for the internal financing expansion. The profitability of a firm can be measured by its profitability retained.

4.5.1 Return on Assets (ROA)

The effectiveness in using the total fund supplied by the owners and creditors is judged by this ratio. Higher ratio shows the higher return on assets used in business thereby indicating effective use of the resources available and vice-versa.

Table 4.10

Return on Assets (in Percent)

Fiscal Year / Banks	2062/63	2063/64	2064/65	2065/66	2066/67
NBL	1.64	0.53	1.20	1.58	1.54
RBB	3.21	3.07	2.34	2.71	2.56

Source: Annual Report, NBL and RBB

Above table shows the return on assets of NBL and RBB. The return on assets of NBL seems to be fluctuated position. It is highest in the fiscal year 2062/63 and lowest in 2063/64. Similarly, the return on assets of RBB is highest in the fiscal year 2062/63 and lowest in 2066/67.

Figure 4.10

Return on Assets

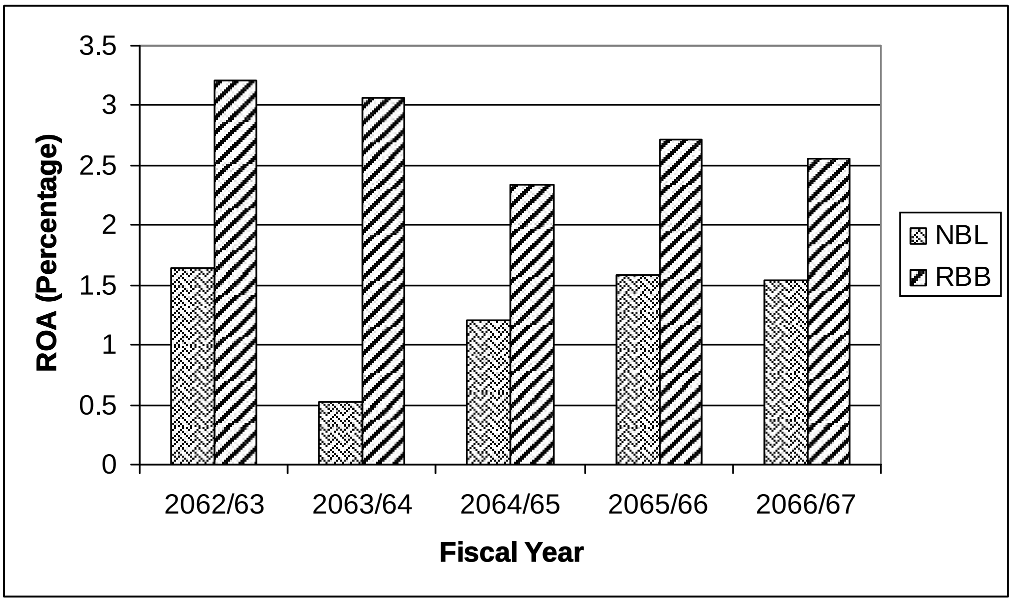


Figure 4.10 shows the ROA of NBL and RBB. While comparing ROA of NBL, it is highest in all fiscal year of RBB. It shows that RBB is utilizing its total assets and creditors in the same proportion. In every fiscal year the ROA of RBB is highest than of NBL.

4.5.2 Operating Ratio

The operating ratio indicates on operating efficiency increased on total assets. It determines the operational efficiency.

Table 4.11

Operating Ratio (in percent)

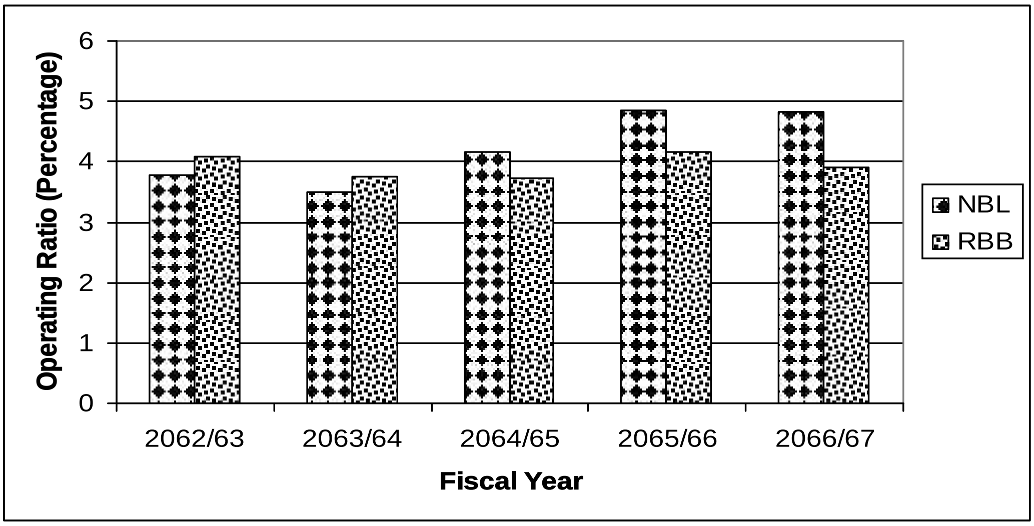
Fiscal Year / Banks	2062/63	2063/64	2064/65	2065/66	2066/67
NBL	3.79	3.50	4.17	4.85	4.82
RBB	4.08	3.76	3.74	4.15	3.91

Source: Annual Report, NBL and RBB

Above table 4.11 depicts the operating ratio of NBL and RBB. There is fluctuation in both the banks the operating ratio. There is also no huge deviation between these two banks in the operating ratio.

Figure 4.11

Operating Ratio



Above diagram 4.11 percents the operating ratio of NBL and RBB. The operating ratio of NBL is in fluctuating position. It is highest in the fiscal year 2065/66. Similarly, the operating ratio of RBB is also fluctuated. It is highest in the fiscal year 2065/66. Higher the operating ratio, higher will be the operational efficiency.

4.5.3 Interest Income on Loans and Advances

Interest income is the major source of income from loan and advances that comprises higher rate of interest income. It shows higher utilization of loan and advances.

Table 4.12

Interest Income on Loan and Advance (in percent)

Fiscal Year / Banks	2062/63	2063/64	2064/65	2065/66	2066/67
NBL	9.84	7.82	8.51	9.78	9.28
RBB	6.63	5.58	6.12	7.53	7.14

Source: Annual Report, NBL and RBB

Above table shows, the average interest income on loan and advances. NBL has highest interest income than RBB which is 9.84%. The interest incomes of both the banks are in fluctuated position.

Figure 4.12

Interest Income on Loan and Advances

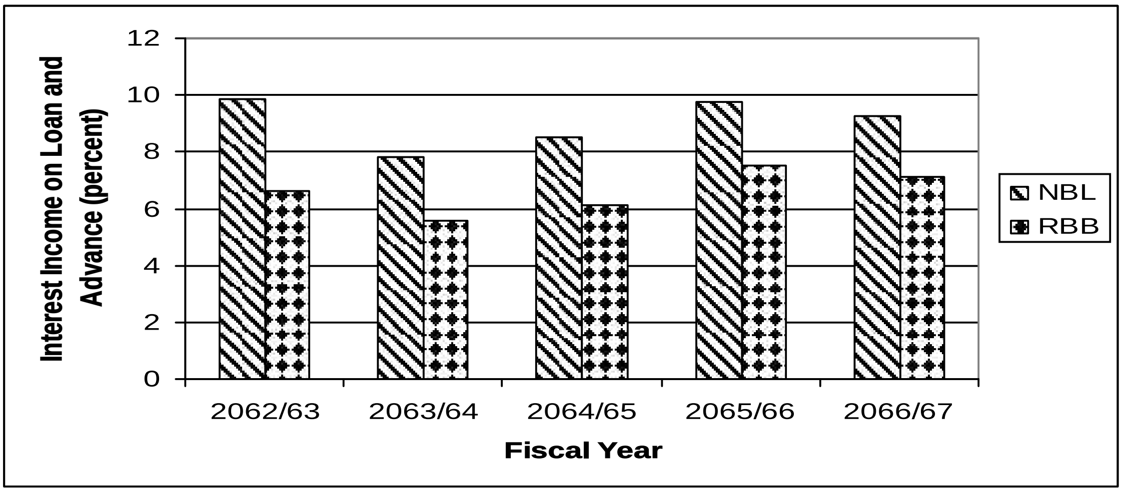


Figure 4.12 presents the interest income on loan and advance of the banks. RBB has highest interest income in the fiscal year 2065/66 which is 7.53%. Similarly, NBL in the fiscal year 2062/63 has a highest which is 9.84%. Both the banks of interest income is fluctuated. This is due to the low interest rate with the increasing number of banks and their competition.

4.6 Correlation Analysis

The correlation analysis generally used to describe to which one variable is related to another. In statistics it is used in order to depict the covariance between two or more variables. It helps to determine whether;

- positive or negative relation exit
- relation is significant or not.
- establish cause and relation if any

The statistical tool, 'correlation analysis' is preferred in this study to identity relationship between NPL and Net profit, whether the relation is significant or not.

Table 4.13

Correlation between Net Profit and NPL of NBL and RBB

Bank	Correlation Co-efficient (r)	Relation	Co-efficient of determination (r^2)	Probable Error (P.E.)	Significant / Insignificant
NBL	-0.197	negative	0.0388	0.2899	In Significant
RBB	-0.8899	negative	0.7919	0.0628	In Significant

Since correlation coefficient (r) is negative in both the banks; we can say that there is negative relation between NPL and Net Profit. It means the relation between NPL and Net profit is insignificant. In other words; because of close relationship whenever there is NPL decrease, Net profit increase and vice versa.

The co-efficient of determination (R^2) of NBL is 3.88% and RBB is 79.19%. This indicates that the dependent variable depends upon independent variable up to 3.88% and 79.19% respectively. There are still other factors that influence the cost.

4.7 Major Findings

4.7.1 The assets composition of NBL in fluctuating trend over the study period. This indicates that there is no consistency with the increasing trend. Similarly, the assets composition of RBB is in fluctuating trend throughout the research period.

4.7.2 In both the banks the percentage of total loan and advance in terms of assets is seems to be higher than other assets. NBL has 28.95%, 32.17%, 35.92%, 38.77% and 41.38% respectively. Similarly, RBB has 48.31%, 46.41%, 45.75%, 42.11% and 42.94% respectively throughout the study period.

4.7.3 The overall NPL is in decreasing trend. The trend shows that control of NPL is well and it should be below international standard of 5% in general. Recovery efforts and credit management is becoming effective.

4.7.4 The projected trend of non-performing loan in both the banks is gradually declining position i.e. the both the banks are able to recover their bad loan on coming fiscal years.

4.7.5 The return on assets (ROA) of both the banks is in fluctuated trend. The highest ROA of NBL is 1.64% in fiscal year 2062/63. Similarly RBB has 3.21% in the same year.

4.7.6 The analysis of operating ratio indicates both the banks are more successful to minimize the operating ratio. Interest income on loan and advance is also at satisfactory level.

4.7.7 The correlation between NPL and net profit is absolutely insignificant for both the banks. It validates negative impact of NPL on the banks profitability.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

All knows that collection of deposits and making of loan and advances are core functions of banks and financial institutions. While collecting the deposits the bank has to provide interest to the depositors, it is cost to the banks. The money collected in the form deposits income. In this transformation process bank have a small interests spread from which they have to meet the operating expenses, cost of bad debt and a small profit margins. In order to pay the interest to the depositors and meet withdrawals of depositors, there should be regular repayments of principle and intercepts of loan from the borrowers as per as agreed schedule. In order to make this system interrupted, banks should have all the loans as performing assets i.e. good loans. Good loans and advances are called performing assets. Banks and financial institutions always try to have almost all the financial assets as performing assets to make them sound, sustainable, profitable and healthy within the system. Sometimes, unfavorable internal economic shocks and other discrepancies affect quality of such assets. Deterioration in the quality and other assets, give birth to non-performing loans and ultimately invites the financial crisis.

Escalating level of NPAs has becoming great problem in banking business in the world. In this context, Nepal cannot be run off run such situation. The level of NPA in Nepalese banking business is very alarming. It is well known fact that the bank and financial institution in Nepal have been facing the problem of swelling. Non-performing Assets (NPAs) and the issue is becoming more and more unmanageable day by day. Therefore, this study is concerned to find out the level of NPA and assets composition and profitability interns of assets. This study is especially focused in two largest bank of Nepal i.e. Nepal Bank Limited and Rastriya Banijya Bank.

In Nepalese case, RBB and NBL are suffering from high level of NPL problem. Researcher has tried to find out the causes and effects of NPL, as well as the situation of these two biggest commercial banks of Nepal. For the analysis of relationship with NPA growth and expansion of credit it has been found that there is relationship between credit expansion and increment on NPA. The NPA level of both the banks NBP and RBB are in decreasing trend. This indicates that both the banks are gradually recovering the bad debt.

5.2 Conclusion

Nepal Rastra Bank has a provision regarding landing of Nepalese commercial bank. According to this provision, a bank should classify its outstanding loan into pass loan, substandard loan, doubtful loan and bad loan on the basis of over due aging schedule as per NBR's directives. The pass loan is called performing loan (assets) and total of substandard, doubtful and bad loan are called non Performing loan.

The assets composition of NBL and RBB are of fluctuating nature. This shows that there is no consistency in the quality of asset which indicates ineffective in landing. The increasing trend of loan and advance and fluctuating trend of other assets of NBL shows that the bank is unable to concern appropriate polices to manage and utilize the fund in income generating activities. Similarly, RBB also facing the same problem.
The trend of non-performing loan as a percentage of total loan and advance is gradually declining order. This shows that the NPL of both the banks are running to recover the bad debt loans. The projected trends of both the banks are negative. It shows that in the coming year, the banks will have no bad loans.

The research is focused on profitability of banks in terms of total assets. The ROA of NBL is in fluctuating trend. Whereas the ROA of RBB is in decreasing trend. Higher the level of ROA, higher the profitability. So, whenever there is a credit expansion NPL will increased and there will be mounting problem of profitability of the banks.

The operating ratio of NBL is in increasing trend up to the fiscal year 2065/66. Similarly, the operating ratio of RBB is fluctuated throughout the study period. The operating ratio indicates the operational efficiency of the bank.

The interest income on loan and advance of NBL is in fluctuating position. Similarly, RBB is also facing same condition. Higher the credit expansion, higher will be the loans.

The correlation co-efficient values must lies between -1 to +1. The correlation coefficient between NPL and Net profit of NBL and RBB both are negative. This indicates that there is negative relationship between NPL and Net profit. It means the relation is insignificant.

5.3 Recommendations

Based on the above discussion and conclusions presented, researcher recommends to the few major solutions to the authority, academicians, practitioners and bankers to overcome the current situation. Following are recommendation to minimize the level of NPA in NBL and RBB banks that may support to overcome NPA problem.

5.3.1 The banks has to identity the demand and challenge of time at its start and should go on using it correctly as competition is the key to success.

5.3.2 The bank has to diversify its assets composition equally in different sectors so that the risk can be minimized. Total loan and advance may turn into bad debt loan which is risky for bank solvency.

5.3.3 Detail analysis of the customer and their documents, inspection of collateral should be done properly. Analyzing the customer's position and their strength is a major factor to provide loan by bank.

5.3.4 NPA has affected the profitability and competitive functioning of the bank. And it leads to the credit risk management assuming priority over other aspects of banks functioning. Thus, the bank's whole machinery would be pre-occupied with recovery procedures rather than concentrating on expanding business.

5.3.5 Profit is generated from proper use of assets. This is reflected on ROA ratio. Both the banks are recommended effective utilization of fund (assets) so as to make more profitability. Interest income on loan and advances is at satisfactory. So it is recommended to keep on continuing. The lower the operating ratio the better it is.

5.3.6 From the analysis; it is found that no bank has been maintaining loan loss provision as per the requirement of NRBs directives. It may create legal hassles to the banks. Therefore, both the banks are recommended to maintain loan loss provision (1%) in accordance to the NRBs directives.

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