CHAPTER- I
INTRODUCTION

1.1 Background of the Study

Nepal is a land locked country with agro-based economy. It is rich in natural resources but these resources have not been utilized properly. The economic growth rate of Nepal is very low. The important components of economic dimensions of an economy are gross domestic product (GDP), Per Capita income, personal consumption expenditure, unit labor cost & private investment.

GDP of Nepal is US $ 5.3 billion. Per capita income of a country can be used as an indicator of the purchasing power of its people. Nepal's per capita income is US $ 220, which is one of the lowest in the world (*Pant, 2002: 27).* This is also the lowest among the SAARC countries. In fact, Nepal is the ninth poorest country in the world. Total population of Nepal is above 25000000 now & its growth rate is 2.24 %.

Every nation has come expectations from its financial infrastructure of that country. It is because financial system can contribute a lot for accelerating the pace of economic growth through mobilization of resource. However, the magnitude of expectations from the financial system may vary within the various stage of economic development; the financial system is expected to be a good facilitation and a partner to achieve a sustained economic growth all the times. Banking systems constitute an important segment of financial infrastructure of any country.

A bank is an organization whose principal operations are concerned with the accumulation of the temporarily idle money of the public for the purpose of advancing to other for expenditure. Bank is a financial institution, which deals with money by accepting various types of deposits, disbursing loan and various types of financial services. "A Bank can be defined as a 'financial department store' which renders a host of financial services besides taking deposits and giving loans.

Nowadays, there is much competition in banking business but less opportunity makes investment. In this condition, bank can take initiation in search opportunity, so that they can survive in the competitive market and earn profit. However, investment is very risky job, for the purposeful, safe, profitable investment, bank must follow sound investment and fund mobilizing policy. Banking sector is exposed to number of risk like interest rate risk, credit risk, liquidity risk, borrower's risk etc.

Among the most critical risk is borrower's risk, the risk of non-payment of the disbursed loan & advances. Failure to collect money disbursed may sometimes result in the bank inability to make repayments of the money to the depositors & return to the shareholders. The risk involved is so high that it can bring bank to a verge of bankruptcy. Banking system is volatile and sensitive section of national economy, which requires effective monitoring and supervision. Hence to such situation and protect depositors and shareholders money, Nepal Rastra Bank (NRB) issues various directives and guidelines from time to time with modifications and amendments for the sound regulation of the banking system. All the banks have to abide by the rules and regulation issued by the central bank.

"To start with performance in terms of profitability is a benchmark for any business enterprise including the banking industry. However, increasing Non- performing assets (NPA) have a direct impact on bank profitability as legally banks are not allowed to book income on such accounts and at the same time banks are forced to make provision on such asset"(*Manamohan; 2002; 6).*

Non-performing assets, also called non-performing loans, are made by a bank or finance company, on which repayments or interest payments are not being made on time.

A loan is an asset for a bank as the interest payments and the repayment of the principal create a stream of cash flows. It is from the interest payments than a bank makes its profits.

Banks usually treat assets as non-performing if they are not serviced for some time. If payments are late for a short time a loan is classified as past due. Once a payment becomes really late (usually 90 days) the loan classified as non-performing.

A high level of non-performing assets compared to similar lenders may be a sign of problems, as may a sudden increase.

However, this needs to be looked at in the context of the type of lending being done. Some banks lend of higher risk customers than others and therefore tend to have a higher proportion of non-performing debt, but will make up for this by charging borrowers higher interest rates, increasing spreads. A mortgage lender will almost certainly have lower non-performing assets than a credit card specialist, but the latter will have higher spreads and may well make a bigger profit on the same assets, even if it eventually has to write off the non-performing loans.

Loan and advances are the most profitable of all assets of a bank. Banks universally seek after the assets. These assets constitute primary source of income to banks. According to Dr. Walter leaf "in the term of advance to customer we have reached the central portion of the activity of banks." In the word of the Dr. leaf the bankers "have to timer liberality with caution. If he is too liberal he may easily impair his profits by bad debts, if he is too timid he may fail to obtain an adequate return on the fund, which are confided to him for use.It is by his capacity in lending that bank manager judged" (*Radhaswamy and Vasudevan 1979: 550).*

Performing Assets are those loans that repay principal and interest to the bank from the cash flow it generates. Loans are risky assets, though a bank interest most of its resources in granting loans and advances. If an individual bank has around ten percents of Non-performing assets/loan it sounds the death knell of that bank ceteries paribus call other thing remaining constant. The objectives of bound loan policy is to maintain the financial health of the banks, which result in safety of depositors money and increase in the return to the shareholders. Since loan is a risky assets, there is inherent risk in every loan;

however the bank should not take risk above the certain degree irrespective of returns prospects (*Dahal and Dahal 1999/2000: 115).*

1.1.1 Commercial Banks

According to oxford dictionary "bank is an organization that provides various financial services" (*Oxford Advance Learner Dictionary)*

A broader definition of a bank is any financial institution that receives, collects, transfers, pays, exchanges, lends, invests, or safeguards money for its customers. This broader definition includes many other financial institutions that are not usually thought of as banks but which nevertheless provide one or more of these broadly defined banking services" *(Microsoft Encarta 2005).*

Commercial Banks are one of the major financial intermediaries whose primary function is the transfer of monetary resources from the savers to the users. They are almost every where the largest of all the financial intermediaries. They have the widest range of activities and they provide a large amount of the money supply. On that account they receive far more attention than other intermediaries.

Commercial banks are defined as leading financial institutions, which issue demand liabilities used as means of payment and at the same time make loans to business in a tradition that goes back several hundreds years ago. In course of time, commercial banks have expanded their activities on both the assets and liability side. They accept various kinds of time and savings deposits while they have expanded their lending activities to include term loans to business, consumer loans, long term mortgage loans and investments in debt securities of all type of a wide range of maturities.

Function of Commercial Banks

Nepal Bank Ltd. is the first commercial bank of Nepal. It was established in 1994 B.S. it is a semi-government bank. The second commercial bank of Nepal is Rastriya Banijya Bank. It was established in 2022 B.S. Both of these local commercial banks are undergoing reforms and managements takeover for restructuring to minimize the mounting non-performing loans losses as well as reduce the employees under voluntary retirement schemes. After reinstatement of multiparty democracy in the country, several private and joint venture banks were established such as Standard Chartered Bank, NABIL Bank, Nepal investment Bank, Himalayan Bank, Nepal Everest Bank, Nepal state Bank of India, Nepal Industrial and Commercial Bank, Kumari Bank, Machhapuchhre Bank, Bank of Kathmandu, Siddhartha Bank and Nepal Credit and Commerce Bank. The newly emerging commercial banks are Nepal Bank of Asia, Prime Bank, Global Bank, Sunrise Bank and so on.

A modern commercial bank performs a variety of functions and services. In this study, functions of commercial banks are grouped under five sub-headings like acceptance of deposits, advancing of loans, agency functions, purchase and sale of foreign exchange and creation of credit. The fundamental functions, performed by modern commercial banks are discussed below.

Acceptance of Deposits

The bank accepts different types of deposits from the public.

- **Fixed Deposit**

Money in this account is accepted for a fixed period and cannot be withdrawn before the expiry of that period.

- **Current Deposit**

The depositor can withdraw money from this account wherever he requires it, so it is also known as demand deposit. Generally, the bank grants no interest on this account. On the contrary it can charge a small amount on the customer for the services by it.

- **Saving Deposit**

Some restrictions are imposed on the depositor under this account. For example, he can withdraw only a specified sum of money in day or week.

- **Recurring Deposit**

The purpose of this account is to encourage regular savings by the public, particularly by the fixed income group. Generally money in the accounts is deposited in monthly installment for a fixed period and is repaid to the deposit along with interest on maturity.

- **Call Deposit**

Call deposit incorporates the characteristics of current and saving deposit. Current in the sense, deposit is withdrawn at call and saving in a sense the deposit earns interest. Interest rate on call deposit is negotiable between the bank and the depositor and hence it is normally not announced in public.

Advancing of Loans

The various types of loans and advances are as follows:

- **Cash Credit**

It is running loan account. Normally granted stock and receivables and is regulates stock statements and drawing power where in Credit/Debit transactions are permitted within the sanctioned limit. The level to which debit balance can be permitted is decided by drawing power or limit whichever is lower. Cash credit is normally granted against security of certain commodities, products or book debt/receivables.

- **Overdraft**

The bank allows its respectable and reliable customers to overdraw their accounts through cheques. The customers, however pays interest to the bank on the amount drawn by them. An overdraft against security of certain investment like Bonds/Fixed Deposits or some time it is given against personal guarantee.

- **Demand/Term Loan**

Demand loan is a loan on repayment basis and is not a running account. Demand loan once granted will have a debit for the quantum sanctioned and thereafter only credits for repayment are permitted. It is given with or without security. If given against security, the security will be in the form of fixed assets or fixed deposits and it will never be given against stocks. These loans are granted to acquire fixed assets like machinery and construction works.

- **Trust Receipt Loan**

Trust receipt loans are normally sectioned as a limit to be utilized against hypothecation of stocks imported under own letter of credit.

General Utility Services

Apart from agency services, the bank also renders some useful services known as general utility services. They can be explained as follows:

a) Safekeeping of Valuables

During the middle ages, banks begun the practice of holding gold securities and other valuables owned by their customers in secure vaults. A modern bank also receives from its customers, valuables such as securities, jewelry, documents of title to goods, etc for safe custody. The bank acts as the custodian of the valuable belonging to the customers. The bank receives them and returns back when demanded.

b) Giving Information About its Customers

Since the bank is closely acquainted with its customers, it can pass on reliable information in respect of their credit worthiness to their parties at other places.

c) Assist in Foreign Trade

The bank assists the traders engaged in foreign trade of the country. It discounts the bills of exchange drawn by Nepalese exports on the foreign importers and enables the exporters to receive money in local currency. Similarly it also accepts the bills drawn by the foreign exporters.

d) Making Venture Capital Loans

Increasingly, banks have become active in financing the start-up costs of new companies, particularly in high-tech industries. This is generally through a venture capital firm that is a subsidiary of a ban holding company, and other investors are often brought in to share the risk because of the added risk involved in such loans.

e) Financial Advising

Bankers have long been asked for financial advices by their customers, particularly when it comes to the use of credit and the saving or investing of funds. Many banks offer a wide range of financial advisory services, from helping financial planning to consulting to business managers and checking on the credit standing of firms.

f) Automated Teller Machine (ATM)

Now days, banks allow customers to deposit and draw money from their accounts through automated teller Machine.

g) Anywhere Branch Banking Service (ABBS)

Banks offer account holder of a branch to avail some banking services from other branches which is called anywhere branch banking services.

h) Tele Banking

Customers may acquire information like, account balance, exchange rate and may instruct banks to do various jobs over the phone/fax.

i) Credit/Debit Card

Banks issue credit cards to highly credit worthy customers. Banks also issue debit cards as well. This relieves the customers from carrying cash.

Beside these function, a commercial bank also finance internal and foreign trade, collects statistic about money, banking, trade and commerce and underwrite shares and debentures issued by private companies, offers some of the banking services at the door of highly valued customers. It also guarantees to other parties on behalf of its customers to make payment up to a specified sum of money to the beneficiary on demand in case of default by its customer. Further, a commercial bank also facilitates the trading between two parties who live in different countries through letters of credit and guarantees the seller of payment in case the buyer defaults to pay.

1.1.2 Profile of Concerned Bank

In this study, Himalayan Bank Ltd and Lumbini Bank Ltd is compared in the field of financial performance. Here short glimpses of these commercial banks are given.

A. Himalayan Bank Ltd.

(A Joint Venture with Habib Bank Limited – Pakistan)

Himalayan Bank was established in 1993 in joint venture with Habib Bank Limited of Pakistan. Despite the cut-throat competition in the Nepalese Banking sector, HBL has been able to maintain a lead in the primary banking activities – Loans and Deposits. Products such as Premium Savings Account, HBL proprietary Card and Millionaire Deposit Scheme besides services such as ATMs and Tele-banking were first introduced by HBL. HBL holds of a vision to become a Leading Bank of the country by providing premium products and services to the customers, thus ensuring attractive and substantial returns to the stakeholders of the bank.

Capital Structure

Authorized Capital	Rs.2,000,000,000
Value per share	Rs. 100
Issued Capital	Rs.1,000,000,000
No. of shareholders	
Paid-up Capital	Rs.1,000,000,000
Reserve	Rs. 123m

B. Lumbini Bank Limited

Lumbini Bank Limited is a national level commercial bank offering a wide range of banking solutions and services meticulously customized to the needs of the customers.

Established in 1998, this is the first regional commercial bank in Nepal, which started its operation from Narayangarh spreading its wings to further four more places at Hetauda, Butwal, Durbarmarg and Biratnagar. The newly structured products by LBL cover personal loan, home loan, vehicle loan, mortgage loan, educational loan, time loan etc.

Capital Structure

Authorized Capital	Rs. 1.6 Billion
Value per share	Rs100
Issued capital	Rs. 1 Billion
No. of Shareholders	
Paid Up capital	Rs. 1 Billion
Incorporation year	A.D 1998

1.2 Focus of the Study

The concept of financial institutions in Nepal was introduced when the first commercial bank, the Nepal Bank Limited(NBL) was established in 30th Kartik, 1994 B.S. as a semi-government organization. In the first year 2039/40, new banking policy was introduced for the establishment of new banks by the joint investment of foreign nations. The establishment of joint venture banks gave a new horizon to the financial sector of the country. Commercial banks are the heart of the financial system. They hold the deposits of many persons, government establishment and business units. They make funds available through their lending and investing activities to borrowers, individuals, business firms and government establishments. In doing so, they assist both the flow of goods and services from the producers to consumers and financial activities of the government. They provide a large portion of medium of exchange and they are the media through which monetary policy is affected. These facts show that the commercial banking system of the nation is important to the functioning of the economy.

The main focus of this study is analysis of the non-performing assets of two commercial banks which are one Joint-venture Himalayan Bank Ltd. and other commercial bank is Lumbini Bank Ltd. Non-performing loans are those loans that do not repay principal and interest to the bank from the cash flow it generates. Nepalese banking sector has been becoming a victim of huge Non-performing assets. Therefore, this research is carried out in order to look into the comparative weakness and inefficiencies of concerned banks, with the help of the comparative analysis of their financial statement with the background of the present study.

1.3 Statement of the Problem

After the economic liberalization of the country in 1980, the quantity of the Nepalese Financial sector has increased tremendously. Central bank introduced prudent regulatory measures for some progress of financial sectors. However, the actual performance of the financial institutions could not improve. Non-performing assets is one of the major problems in Nepalese financial institutions facing today.

In case of Nepalese commercial Bank, Rastriya Banijya Bank and Nepal Bank Limited have huge portion of NPA in comparison to other private commercial banks. It is a burning problem of these banks. Overall NPAs of the commercial bank in Nepal has gone up to approximately 20 percent.

Financial institutions are giving top priority to reduce NPA. This research is also trying to find out the solution of these burning problems, which can be summarized as follows:

a. What are the major internal, governmental and regulatory causes that help the NPA growth?
b. What is the proposition of non-performing loans/assets in the Nepalese Commercial banks?
c. How generation of NPAs/NPLs be controlled?
d. What is the relationship between loan and loan loss provision in Nepalese Commercial banks?
e. What are the guidelines and provisions pertaining to loan classification and loan loss provision?
f. What is the overall impact of NPA on the profitability of bank?
g. Can liquidity problem and blocking of fund be mobilized in productive sector to play a major role for low economic development of a nation?

1.4 Objectives of the Study

The gradually increasing NPA has now become a major challenge for every commercial bank. Every bank is giving top priority to make them competent by reducing NPA.

The main objective of this research is to examine and study the level of Non-performing Assets in total assets, total deposit and total lending of Nepalese commercial banks. The specific objectives were:

a. To evaluate the relationship of loan and advances with total deposit and total assets.
b. To find out the level of NPA in total loan and advance and total assets and its relationship with loan and advances, total assets and loan loss provision.
c. To find out the return on loan advances and its relationship with loan loss provision.
d. To evaluate the relationship between profit (Loss) and loan loss provision.
e. To determine the trend of NPA, loan and advances, loan loss provision and profit(Loss)
f. To determine the basis of floating loan, causes, impact remedial action and sector which cover high NPA.

1.5 Significance of the Study

Nepalese commercial banks are operating in the competitive environment. In this situation, banks have to adopt suitable strategies for their existence. They should balance and coordinate the different functional areas of business concern. The success or failure of any organization depends on its strategy, which is affected by loans and advance. Non-performing assets is one of the problem which direct hamper the profitability of banks. Therefore, the study might be helpful for the management of the concerned bank as well as it might be valuable for the researchers, scholars, students who want to study the Non-performing assets of the commercial banks.

In present context, this study helps Nepalese Commercial banks to be competent with low level of non-performing assets. This study also tries to find out the impact of non-performing assets on macroeconomics. It also tries to indicate present weakness of NRB directives and rules regarding it.

This study has multi dimensional significance, which have divided into four broader headings:

- Its significance to the shareholders: This study might be helpful to aware the shareholders regarding the Non-performing assets. The comparison will help them to identify the productivity of their funds in each of these two banks.
- Its significance to the management: This study might be helpful to go deep into the matters as how Non-performing assets are affecting the management.
- Its significance to the outsiders: Among outsiders, mainly the customers financing agencies, stock exchanges and stock traders are interested in the performance of the banks and the customers (both depositors and debtors) can identify to which bank they should go. The financial agencies can understand where their fund is more secured and, stock exchange, stockbrokers and stock traders can find out the relative worth of the stocks of each bank.
- Its significance to the policy makers: Policy makers here refer to government and Nepal Rastra Bank. This study will be helpful to them while formulating the policy regarding commercial banks.

Therefore, considering all these facts, the study of Non-performing assets of Himalayan Bank Limited and Lumbini Bank Limited is considerably important.

1.6 Limitations of the Study

The scope of the present study has been limited in terms if period of study as well as sources and nature of data. Limitations of this study are as follows:

- This study has been confined to only two of the commercial banks, namely Himalayan Bank Ltd and Lumbini Bank Ltd.
- The lack of sufficient time and resources is another limitation of the study.
- The study is based on primary and secondary data. Judgmental sampling with proportionate allocation of percentage is followed to draw sample.
- The study follows with specific tools such as ratio analysis, mean, c.v, correlation and hypothesis.

- The study is limited from the point of view of submission on partial fulfillment of the requirement for the master degree in business study.

1.7 Research Methodology

Since the basic objective of this study is to analyze the Non- performing assets of commercial banks. Therefore, suitable research methodology as demanded by the study is followed. It is intended to use simple ad lucid methodology as follows:

1.7.1 Population and Sample

There are altogether 26 commercial banks functioning all over the country and most of their stocks are traded actively in the stock market. Among them Himalayan Bank Limited and Lumbini Bank Limited has been taken as sample for the study. Financial statements of last 5 years from 2003/04 to 2007/08 have been taken as sample data for the comparative study of Non-performing assets.

1.7.2 Research Design

This research design will be quantitative and less descriptive, specific and analytical and exploratory.

1.7.3 Nature and Source of Data

The research will be based on primary and secondary data. For primary source, questionnaire has been constructed. For the secondary source, Books, journals and other research papers are the secondary source of data that will be used for this study.

1.7.4 Statistics and Analytical Tools Used

This study comprises following tools and techniques:

- Bar and trend diagram.
- Trend Analysis
- Correlation Analysis
- Mean, Standard Deviation and Coefficient of Variation

1.8 Organization of the Study

This thesis has five chapters. They are:

Chapter- 1: Introduction

This chapter includes the introductory matters, which try to provide information about the burning problem of NPA, financial condition of the Nepalese Commercial banks, and its growing competition. Besides these, it also includes focus of the study, statement of problems, significance of the study, limitations of the study and objectives of the study.

Chapter -II : Review of Literature

This chapter deals with the conceptual framework and the review of relevant research studies, articles, banking journals, books, websites etc related to the study.

Chapter-III: Research Methodology

This chapter contains research methodology employed in the study. It includes the research design and tools and techniques used in the research work. It provides guidelines and gives a road map to analyze the collected data.

Chapter-IV: Presentation and Analysis of Data

This chapter covers analysis, presentation and interpretation of the acquired data, which was collected through the designed methodology. Data are presented in tabular, graphic or in an equation form to achieve pre stated objectives. This chapter produces a shape to facilitate the analysis of relevant data in an attractive way.

Chapter-V: Summary, Conclusion and Recommendations

This chapter contains summary of findings, conclusion, and recommendations that can be useful for academicians as well as for practitioners.

CHAPTER-II

REVIEW OF LITERATURE

The review of literature is a very important aspect of the research. It is reviewing of research studies of other relevant proposition in related area of the study, so that, all the past studies, their conclusion and deficiencies may be known and further research can be conducted. For this, several books, dissertation, reports, hands out and articles published in journals and newspapers are reviewed. This chapter has been divided into the following parts:

2.1 Conceptual Framework

This heading is devoted to the origin and concept of the bank, meaning and concept of the term used in the study.

2.1.1 Origin and Concept of the Bank

Interestingly, the world's oldest bank has been in existence since its founding in 1427.The Banca monte dei Paschi di Siena SPA(MPS) was created in the city state of Siena, Italy. The bank today is comprised of nearly 1800 brances,28000 employees and more than four million customers in Italy and abroad.

For centuries, banks have influenced the economies and politics of the world. Traditionally, banks originated as places where businesses could secure loans to purchase inventory, and thereafter collect the funds with interest once the goods were sold. The origin of the word bank is derived from the Italian word, Banco or desk. During the Renaissance, Florentine bankers conducted their transactions above desks covered in a green tablecloth.

It has been speculated the earliest banks were actually religious temples in the ancient world, where deposits of grain and other goods were made. Considered sacred places, these temples were well protected from potential thieves. There are also historic records which point to loan activity extended by priests to merchants in ancient Babylon.

Hammurabi's Code, the oldest, best preserved law code in existence was created circa 1760 B.C. and includes laws which were used to govern bank operations.

Not surprisingly, the Ancient Greeks further developed the concept of banking. Transactions such as loans, deposits, currency exchanges, and more were conducted in temples as well as private and civic components. Evidence also points to the concept of credit. In return for payment from a client, a creditor in one Greek port would write a note of credit that the client could later cash in another port city. This convenient method saved the client from the danger of carrying coinage with him on his journey. Historic records indicate that a Pythius of the early 5th century B.C. operated as a merchant banker throughout Asia Minor.

The rise of the Roman Empire brought about greater administrative and financial regulations for banking. The charging of interest on loans was further developed by scrupulous financiers, making the system highly competitive. However, the bank system eventually broke down in large part to the Roman preference for cash transactions. Following the fall of Rome, Western Europe essentially abandoned banking. It did not experience a revival until the need for financing the Crucades stimulated its re emergence.

Fast forward to Western banking history, which is generally traced to the coffee houses in London. Founded in 1565,the Royal Exchange acted as a center of commerce for the city. A hierarchy of banking started a the top with bankers who conducted business with heads of state, followed by city exchanges, and at the bottom, pawn shops. In 1609, the Amsterdamsche Wissel Bank(Amsterdam Exchange Bank) was established, making Amsterdam the financial center of the Western world.

Concepts of capitalism extolled by Adam Smith, considered the father of modern economics, and the advent of the Industrial Revolution gave way to a massive growth in the banking industry in the 18th and 19th centuries. In the United States, the first banks required special permission from the state government to operate. The state's supervision proved inadequate as individual banks began issuing their own notes. By 1860, more than 10,000 various bank notes were circulating throughout the country. Counterfeiting was rampant and hundreds of bank failed. Government reforms created a new system of banking which included an involved method for producing authentic bank notes.

With the unset of the worldwide depression in the early 1930s,banks took a hard hit, which led to Congress creation of federal deposit insurance. President Franklin D.Roosevelt oversaw the implementation of laws aimed at limiting risks to banks and restoring Americans confidence in the banking system.

Since then, banking has undergone a revolution with technology transforming the way Americans bank. First telephone banking, and then ATMs, debit and credit cards, have lead the way to new innovations. Today, online banking and electronic money are evolving. Banks strive to serve the greater public in a competitive market that ensures a safe and sound banking system. From religious temples and Italian desks to coffee houses and the Industrial Revolution, banking has forever changed the way we live.

2.1.2 Nepalese Banking Sector

In any economy, the importance of the financial sector in general and the banking sector in particular cannot be underestimated. Banking plays a pivotal role in the overall development of an economy. Economic reforms initiated by the government 18 years ago have changed the landscape of several sectors of the Nepalese economy. The Nepalese banking sector is no exception. This sector has been going through major changes as a consequence of the economic reforms. The changes affect the ownership pattern of banks, regulatory aspects, availability of funds, cost of funds, opportunities to earn, a range of services (fee based and fund based) and management of priority sector lending. As a consequence of liberalization in interest rates and cutthroat competition, banks are operating on a reduced spread.

The economic reforms have also generated new and powerful customers (the Nepalese middle class) and a new mix of players (public sector units, private banks and foreign banks).The emerging competition has generated new expectations from the existing and new customers. There still lies an urgent need to introduce new products. The existing products need to be delivered in an innovative and cost-effective way by taking full advantage of emerging technologies. Currently, the trend is to increase the number of financial institutions and not the quality of financial services being delivered. With 25 commercial banks already up and running, seven new commercial banks are waiting for the green signal from Nepal Rastra Bank. It is pretty evident that we are seeing growth in the width of the Nepalese financial sector; however, depth and specialization severely lack quality.

As the financial sector has evolved into the biggest sector in the economy, there is high demand for quality and competent human resources to manage it. Let's analyze Table 1.

Table 2.1

Nepali Financial Market

	Commercial Banks	Development Banks	Finance Companies	Micro Financial Institutions	Cooperatives	NGO in Banking Activities	Total
Number	25	58	78	12	17	47	237
No. of Employees	14273	2234	2568	989	1129	1842	20204
Asset Size	316.08 B	82.36 B	91.49 B	7.8 B	0.94 B	3.23 B	501.9 B
Op. Profit	13.99 B	3.68 B	2.56 B	1.13 B	0.81 B	0.84 B	23.01 B
Net Profit	8.39 B	1.84 B	1.28 B	0.66 B	0.41 B	0.44 B	13.02 B
Staff Expenses	1.62 B	0.65 B	0.32 B	0.16 B	0.09 B	0.39 B	3.23 B
Training Expenses	0.13 B	0.03 B	0.02 B	0.01 B	0.00 B	0.01 B	0.20 B

Source: Kathmandu Post Daily, July 15

Note:- Figures for these cooperatives, which are registered with NRB, have only been included. There are some 1000 plus additional cooperatives, which are registered with the National Cooperatives Board, operating in Nepal.

Figures for Op. Profit, Net Profit, Staff Expenses and Training Expenses pertain to a one-year period.

From the above table, it is evident that there are altogether 237 financial institutions(Other than Nepal Rastra Bank) in the country and more than 20,000 people working at these institutions. These human resources are responsible for managing approximately Rs.502 billion worth of assets (primarily loans and advances), out of which 21 percent comprises two government-owned banks, Rastriya Banijya Bank and Nepal Bank Ltd. An Annual net profit of Rs.13.02 billion generated by creating assets worth Rs.502 billion means a very low return on assets of a mere 2.59 percent, which is even below the average savings deposit rate in the country, which is 4.75 percent.

Table 2.2

Challenges of the Nepali Financial Market

	Commercial Banks	**Development Banks**	**Finance Companies**	**Cooperatives**
HR-Knowledge Level	Fair	Needs Improvement	Below Average	Below Average
Use of Technology	Fair	Fair	Needs Improvement	Needs Improvement
Offering of Products and Services	Undifferentiated Products and Services	Undifferentiated Products and Services	Undifferentiated Products and Services	Undifferentiated Products and Services
Corporate Governance	Fair	Fair	Needs Improvement	Below Average
Level of Competition	Intense	Intense	Intense	Intense
Stringency of Regulations	Stringent	Stringent	Stringent	Not Consistent

Source: Kathmandu Post Daily, July 15

While doing a root causes analysis of this scenario, two very strong reasons have evolved. The first reason is the poor quality of loans due to non-compliance of basic credit principles while granting loans coupled with lack of credit-skills assessment. The second reason is that almost all the financial institutions by and large are involved only in dealing with undifferentiated vanilla banking products. For example, if someone needs a car loan, which is typically a commercial bank product, he or she can walk into any development bank in the country. Yes, in the current scenario, it is very difficult for development banks in the country to burn their fingers by going into long-term project loans. However, they should be able to create their own niche market. To give another example, there are simple value added products like “funded-risk participation” and “private labeling” in the trade finance area, “options and other derivative products” in the global market area and “remittance securitization” in our most lucrative area of “remittance”.

There is a serious problem in knowledge about the above mentioned products in Nepal’s banking community. As depicted in Table 1, the annual staff training expense of these financial institutions is very low, that is, Rs.0.20 billion. This can be attributed to non-availability of structured banking related courses in the country. There is a handful of banking related training centers in the country, which are only providing piecemeal training courses in various areas, which are not adequate for true learning. Someone who has completed a postgraduate programme in banking and finance from an overseas university will be able to say how much more we can do in Nepal’s financial sector even if we implement only 10 percent of what he has learnt in his postgraduate programme.

The level of product diversification in areas such as trade finance, remittance, global markets and even credit management is very low in Nepal. In terms of comparison, if we disregard India as it is one of the large economies and compare our financial market with that of Bangladesh, the Bangladeshi financial market would be rated 10 while we are not even at three. This means there is a huge gap to be filled before our banking sector starts operating at the optimum level.

If we study the analysis presented in Table 2, we see that our financial market needs to bring much improvement in the knowledge level of human resources, use of technology and corporate governance. Something noticeable in the table is that there are stringent regulations for financial institutions and that the level of competition among the players is pretty intense.

After considering all these factors, we can safely conclude that for true and sustainable financial sector reform, we also need to, besides addressing the issues of loan recovery and loan management, focus on capacity building of the players in the financial market by providing them platforms which will enable them to acquire specialized and focused knowledge on global banking products. It is highly evident that an in-depth exposure to these products will not only add significant value to the banking sector's customers, but also enable banks to witness many new openings from where additional revenue streams can be generated for the banks.

2.1.3 Concept of Commercial Bank and Historical Review in Nepalese Perspective

Commercial Banks are one of the major financial intermediaries whose primary function is the transfer of monetary resources from the savers to the users. They are almost everywhere the largest of all the financial intermediaries. They have the widest range of activities and they provide a large amount of the money supply. On that account they receive far more attention than other intermediaries.

Commercial banks are defined as leading financial institutions, which issue demand liabilities used as means of payment and at the same time make loans to business in a tradition that goes back several hundred years ago. In course of time, commercial banks have expanded their activities on both the asset and liability side. They accept various kinds of time and savings deposits while they have expanded their lending activities to include term loans to business, consumer loans, long-term mortgage loans and investments in debt securities of all types of a wide range of maturities.

Banks hold cash assets to meet legal reserve requirements and daily transaction needs and they have "correspondent" relationships with other banks. Most bank funds, however, are used to acquire earnings assets. The most important of these are loans to business firms and to consumers. Banks also holds government securities for both liquidity and income reasons.

Commercial Bank Act, 2031 B.S. of Nepal has defined commercial bank as an organization which exchanges money, accepts grants loans and performs commercial banking functions and which is not a bank meant for co-operative, agriculture, industries or for such specific purpose.

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

However, the private moneylenders supported the economic development of a country. The transaction undertaken by them was totally based on their personal understanding. No legal restriction was against them and their monopolies in transaction were the reason for covering the interest in personal understanding and exploiting the people. Thus, it was realized to establish financial intermediaries in supporting the economic development of a country.

Nepal has been ruled over by many rulers like Kirat, Lichhavi, Malla, Ranas and Shahas. Mostly Kirat, Lichhavi and mallas regimes were concerned with the construction of temples, pati-pauwa, chautari etc. At that period neither the people nor the government wee interested to think about the economic development of the country. Acording to ancient "Vanshavali" in fourteenth century, the ruler of the Kathmandu, Jayasthiti Malla segregated the local domiciles into 64 different classes according to profession they had undertaken. Tankadhari was one of those classes who used to deal in coins and precious metals such as gold. These Tankadharis were said to have carried out the borrowings and lending on money(coins). Hence, Tankadharis can be regarded as the traditional bankers of Nepal (*Singh & Khadka, 2056).*

After long time, during the Rana regime, only handfuls of prime minister thought about the economic development of the country. They established some offices in 1993

B.S.(1877 A.D.).'Tejarath Adda' was established during the tenure Prime Minister Ranodip Singh Rana as a first institutionalized credit house. Tejarath Adda provided loan under the security of gold and silver to the government employees and public. The government established its various branches and sub-branches at different places of the country for the sake of benefits of people. In the overall development of the banking system in Nepal, the Tejarath Adda may be regarded as the father of modern banking institution and for a quite long time it tendered a good service to government employees as well as to the general public(*Shrestha,1995*).The government also implemented the rules against the vast interest rates taken by moneylenders. Thus, the government financial institution occupies an important role in the banking history of Nepal.

No financial institutions were established over a long period due to political reasons. To fulfill the growing need of economy in Nepal, banking activities were performed only after the establishment of Nepal bank Ltd in 1994 B.S. as the first commercial bank of Nepal. This bank was established under Nepal bank Act 1994 B.S. (1938 A.D).

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

Nepal Rastra Bank established in Baisakh 14,2013 B.S.(1956 A.D.) as the central bank of Nepal. It is totally owned by government. NRB is heavily assisting for the development of whole economy. It is giving timely directives to all financial institutions operated and conducted in all over the country.

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

The government introduced Commercial Bank Act in Nepal in 2031 B.S. to cover the vast field of financial sector. This act has helped to emerge number of commercial banks with a view to maintain the economic interest in comfort of the public in general facilitated to provide loan for agriculture, industry and trade and make a available banking services to the country and people.

Along vacuum in the banking sector got some rays of hope only when the government forwarded the economic liberalization policy in 2039 B.S. and decided to allow foreign banks to operate their activities in Nepal in “Joint-Venture Model”. Joint-venture banks can be defined as an association of two or more parties having common objectives and goals so as to get maximum satisfaction. Basically, at that time, it was envisioned that joint-venture banks(JVBS) would support the country in various ways (*Singh and Khadka,1999).*

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

The Nabil Bank Ltd is the first joint-venture bank established in 2041 B.S. and started its operation with modern banking services. In the same way, Nepal Indosuez Bank (at present Nepal investment Bank),the second joint-venture bank established in 2042 B.S. with an objective to encourage efficient banking services and facilities. Likewise, Standard Chartered Bank is operated under the direction of Indian Management.

With the satisfactory result of joint-venture banks, Nepalese promoters are highly encouraged and as a result, commercial banks, such as: NIC Bank Ltd., Lumbini Bank Ltd., Machhapuchhre Bank Ltd., Kumari Bank Ltd., Laxmi Bank Ltd and Siddhartha bank Ltd came into operation with cent percent domestic investment by Nepalese promoters which is the plus point of development of banking history of Nepal. Now, there is a cutthroat competition between commercial banks for their existence so that the growing needs of the customers can easily be achieved.

2.1.4 Joint Venture Banks

Nepalese commercial banks can be classified into two categories by nature viz commercial banks with habitual management and commercial banks with foreign association. The commercial banks with foreign association are also called joint venture banks. Joint venture is a general model for foreign direct investment. Joint venture means joining of forces between two and more enterprises for the purpose of carrying out a specific operation. Joint venture is the mode of trading through partnership among the nations and is also a form of negotiations between various groups of industries and traders. If one talks about joint venture, there must be at least two parties and concepts of complementary and synergy.

The joint venture concept has become mire acceptable and popular than other concepts these days. Hence banks operating in the form of joint venture are known as joint venture banks (JVBs). In common parlance, JVB in Nepal refer to foreign joint venture banks in which foreign parent banks purchase certain percentage of share (not exceeding to 50%), apply their international management and network. But, with a view of giving more liberty to banking sector and attracting more foreign investment in this sector bank and financial institution ordinance 2060 allowed to take maximum 75% stake in any joint venture Bank.

In Nepal, three major reforms were carried out in 1980 to encourage joint venture in banking sector. The reforms include allowing the foreign banks to operate as joint venture, lifting of control on interest rate and introduction of the auctioning of government securities. The government's policy of allowing foreign JVB operate in Nepal is basically targeted to encourage local traditionally commercial banks to enhance their banking capacity through competition, efficiency, modernization, mechanization via computerization and prompt customer services.

Joint venture Banks are registered in Nepal under Company Act 2063 B.S. and operate under the Bank and financial institutions Act 2063. They have joint venture between Nepalese investors and their parent banks. Financial and non-financial institutions as well as private investors have shared the domestic portion of investment. At present, there are 5 JVBs in Nepal they are; Nepal SBI Bank Ltd. Everest Bank Ltd Standard charted Bank Ltd. Himalayan Bank Ltd. And Nepal Bangladesh Bank Ltd. Foreign investors draw back their proportion of investment from Bank Kathmandu, Bank of Ceylon, and Indosuez Bank and from NABIL Bank. Initially they were established as a joint venture Bank. The growth of joint venture banks increase dramatically after the restoration of democracy when the government adopted liberal and market oriented has been contributing to a gradual development of banking culture i.e. by issuing ATM cards, debit cards ad Credit cards, tele banking, 365 days banking service etc. This has drawn a heavy attention from non-business organization or general public towards commercial banks.

2.1.5 Conceptual Framework of Non-Performing Assets

The nation of non-performing loans of assets is often used as a proxy for asset quality of a particular bank of banking system. "Although there is no uniform definition of non performing assets, in many countries, including most G-10 countries, assets are considered to be non performing when (a) Principal or interest is due and unpaid for 90 days or more: or (b) interest payment equal payment equal to 90 days interest or more have been capitalized, refinanced or rolled over."

"Non-performing assets means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relation to asset classification issued by RBl". An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement system, recovery climate, up gradation of technology in the banking system, etc. it was decided to dispense with 'past due' concept, with effect form March 31, 2001, Accordingly as from that date a non performing asset (NPA) shall be an advance where

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

"With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days overdue' norm for identification of NPAS, from the year ending march3, 2004." Accordingly, with effect form march 31, 2004 a non-performing asset (NPA) shall be a loan or an advance where,

1. Interest and / or installment of principal remain overdue for a period of more than 90 days in respect of a term Loan,
2. The account remains out of order for a period of more than 90 days, in respect of' an overdraft/cash Credit (OD/CC)
3. The bill remains overdue for a period of more than 90days in the case of bills purchased and discounted.
4. Interest and / r installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose and
5. Any amount to be received remains overdue for a period of more than 90days in respect of other accounts.

For getting the real meaning of non-performing assets first of all the meaning of assets should be clearly understood. Assets mean "the property of a persons or a company"[20] This indicates that the assets are the property of a company accumulated with the help of sources. "A Non-performing asset is defined as an asset noncontributing to the income of the bank. It is a risk asset whose recovery (principal and/ or interest) has been difficult for the bank/ financial institution for whatever reasons. In other words a risk asset from which repayment of principal or interest is not forthcoming as per the agreement between the bank and the borrower, or as demanded by the bank, is as an NPA."

In case of the banks the loans and advances are the assets of the banks. As the bank flow loans from the fund generated through shareholders equity, money deposited by the people and fund having through the borrowing, it expect the repayment of funds with some additional amount that is interest so that it could meet its all kinds of expense. When any loans could not be repaid in time, it directly effects to the performing of the banks. Hence, non-performing assets means that loans and advances, which are net performing well or those, loan and advance which are irregular. In this regard, it would be very useful to present cross-country definition with regards to non performing assets, which is presented below.

Table 2.3

Country Definition of NPA

Country	**Definition of Non-performing Assets**
India	Loans and advances which are due for sixth months
Indonesia	Loans and advances classified as substandard, doubtful and bad (overdue three months overdue)
Malayasia	Loans classified as substandard, doubtful and bad as per banks discretion (principal or interest overdue by three or six months at bank's discretion)
Philippines	Substandard doubtful and loss loan. Loans payable in months installments more than three months overdue and loans repayable on other term if one month overdue.
Singapore	Loans classified as substandard and all loans payable and advances which are overdue more than three months.
Thailand	Substandard, doubtful and bad loans (overdue more than three months

As per the circular no BP.BC97/21-043-93 dated April 27, 1992 and circular no B.B Bc 59/22/04.943-92 dated December 17, 1992 the reserve Bank of India has identified the non performing assets as an account of loans and advances where on the balance sheet of:

- Term loans interest and principal remains past due for more than 90 days
- If overdraft and cash credit account remain out of order.
- Bills purchase or discounted remains overdue or unpaid for more than 90 days The circular further says a Non-performing asset is a credit facility in respect of which interest has remains unpaid for 90 days.

As per the Nepal Rastra banks directives "non-performing assets are the classified loans and advances and this includes sub-standard, doubtful and loss categorized as defined by NRB directives NRB directives 2002 compiled by R. Bajraachary & Company.

2.1.6 Definition of Loan and Advances

Loan is defined as a thing that is lent, especially a sum of money. Likewise, debt means a sum of money owed to somebody. However in financial terms loan or debt means principle or interest availed to the borrower against the security. Debt means money that bank owes or will lend to individual or person. Further debt means ‘principle and interest provided to debtors by banks or financial institutions, with the pledge of immovable or movable property or other securities or guarantee of without guarantee, and the word also means overdue of the transaction beyond balance or fees, commission and interest incurred in that relation.

Loan and advances are the most profitable of all the assets of a bank. Banks universally seek after the assets. These constitute primary source of income to banks. As the business institution, a bank aims at making a huge profit and providing loans are advances are more profitable than any other assets, banks 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. “Banking when properly organized aids and facilities growth of trades and industries and hence of national economy. The bankers have to timer liberality with caution. If he is too liberal, he may easily impairs his profits by bad debts, if he is too timid he may fail to obtain adequate return on the fund *(M. Radhaswamy and SV Vasudevan,1991:29).*

Loan and advances dominate the assets side of balance sheet of any bank. Similarly earning from such loan and advances occupy major space in income statement of bank. Lending can be said to be the major source of generating income of the bank. However, it is very important to be reminded that the most of the banks are failures in the world due to shrinkage in the value of the loan and advances. Hence loan is known as risky assets. Risk of non-repayment of loan is known as credit risk or default risk. Performing loan has multiple benefits to the society while non performing loans erodes even existing capital (*Bhuvan Dahal and Sarita Dahal, 2002).*

2.1.7 Immediate Parent Discipline and Classification Model in Nepal

After the economy liberalization in Nepal numerous banks and other financial institutions were established. In order to regulate such banks and institutions, separate regulations were issued to banks and financial institutions. They are enumerated as follows:

To be effective from Fiscal Year 2058/59,NRB issued new Directives in 2058 regarding the loan classification and Loan loss provisioning including Development Banks, Finance Companies and Co-operatives. As per these directives, on the basis of their overdue aging, Loan and advances of Commercial banks were classified in to four categories, namely pass or Good, Substandard, Doubtful and bad Loan. The loan and advances other than good category were defined as NPA in these directives. Similarly, such Loan and advances of Development Banks, finance Companies and Co-operatives carrying out limited banking transactions were also classified in to the same four categories with the same definition of NPA. The Categories of Loan and their provisioning are given as follows:

Loan Categories	Criteria of Class Classification	Provisioning
Pass Loan	Not Past due and past due for period up to 3 months (Performing Loan)	1 %
Substandard Loan	past due for a period of 3 months to 6 months	25 %
Doubtful Loan	Past due for a period of 6 months to 1 year.	50 %
Loss Loan	Past due for a period of more than 1 year or	100 %

Source: NRB Directives, 2006

As defined in the directives no. 2 (1) of United Directives, 2063 performing Loan are the Pass or Good loans while Non-Performing Loan are Substandard, Doubtful and Bad Loan. Besides, NRB's benchmark criteria for NPA for commercials Banks according to FY 2064/2065 is 6%.

2.1.8 Loan Loss Provision for Special Category of Loan

The Loan against gold and Silver, fixed deposits, credit cards and Ng Bonds and NRB Bonds are included in gold Loan.

In case of acting running capital loan up to one year is being rescheduled, and then they are included in the good loan category. The interest against current capital loan is not regularly received; such loans are classified on the basis of overdue period.

2.1.9 Additional Provision for Bad Loan

Over due or non-overdue loans are classified in Bad Loan category if:

i. Security in not enough
ii. Borrower is declared Bankrupt/insolvent
iii. Loan is out of contact
iv. Reimbursement is not received within the ninety days of the maturity period of purchased or discounted bills and convergence of non-fund based facility like letter of credit and guarantee amount of fund based loan.
v. Loan is misused.
vi. Six months period of auction process after the default of loan repayment is exceeded or the case is filed in the court in the course of loan recovery.
vii. Project / business firm is not operationally viable, project or business is not being operated or.
viii. Credit card loan is not written off within 90 days of over due date.
ix. Loan loss provision made for performing Loan is called " General loan loss provision " and loan loss provision made for Non –Performing (NPA) is called "Specific loan loss provision."

2.1.10 Balance Sheet of Commercial Bank

The balance sheet of commercial Bank is a statement showing its assets and liabilities as on a particular date. It is usually prepared at the end of each year. The Balance Sheet of bank has greater importance than that of an ordinary trading company. The bank deals in other people's money and hence the entire community is interested in its Balance Sheet. The Business of the bank is reflected in the balance Sheet. The financial Position of the bank is made known to the public through the Balance Sheet. it proof rays the result of bank operation during the year. it may also regards as indicating the ways in which bank raises its fund and the way in which it uses them. Every bank inhabits a copy of its Balance Sheet in its premises *(Radhaswamy & Vasudevan, 1979).*

There is no common or standard form for presenting the Balance Sheet, the form differ from country according to law practices and custom prevailing there the following is the typical form of a bank Balance Sheet as in NRB's Directives 2063.

……………………….Bank limited

…………..……..………….Year

……………Dated Balance Sheet

(Rs. 000)

Capital & Liabilities			**Assets**		
Previous Year	Particulars	This Year	Previous Year	Particulars	This Year
***	Share Capital	***	***	Cash Balance	***
***	Reserve Funds	***	***	Bank Balance	***
***	Loan Payable	***	***	Money at call & short notice	***
***	Deposits	***	***	Investments	***
***	Other Liabilities	***	***	Loan & Advances & bills Purchased	***
				Fixed assets	***
				Other assets	***
***	Total	***	***	Total	***

Sources: NRB's Directives for Commercial Bank

The liabilities of a bank represent the sources of its fund, which are employed by the bank in the ordinary course of its business. Similarly assets of a bank represent the property and investment made by the bank.

2.1.10.1 Bank's Assets

The assets are given on the right hand of the Balance Sheet. The assets side indicates the manner, which the funds entrusted to the bank, are employed. The successful working of the investments known assets. Let us now discuss briefly the various items fond on the Balance Sheet.

Cash Balance

Cash Balance is the first asset in the portfolio of a Commercial Bank. It is perfectly liquid form of assets. It refers to the cash in the hand or kept in its vault and Cash held to meet the demands of the customer. Cash balance is also known as cash reserve ratio is determined as per the direction of central bank in the country in accordance to the fiscal as well as monetary policy of the country.

Bank Balance

Bank balance includes all the money at central Bank, commercial Banks and other finical Institutions. According to the central Bank Directives, Commercial Banks has to maintain required reserve ratio at central Bank in certain percent of its Total Deposits, which is called Central Bank reserved /Balance, As per Directives by the Central Banks or for other purposes, certain cash may be kept in other ban, which are known as balance at Commercial Banks. Similarly, banks may deposit money to other Financial Institutions as well. Present regulation has made provision for minimum 5% mandatory reserve at NRB to its total Deposit.

Money at Calls and Short Notice

This asset Includes loans to the bill market consisting of discount house and bills broker, loan to stockbrokers and loan between Banks themselves. Money lent at call and short notice is repayable either on demand or at a very short notice, generally less than 24 hours notice. Cash is an idle asset and the bank must not keep cash beyond the amount considered absolutely necessary. To meet seasonal demand and other contingencies the bank maintains these highly liquid but earning assets, which can be converted into cash quickly and without loss of value, Bank regards this is secondary reserve as against cash which is its primary reserve. Unlike cash this asset brings some revenue income to the bank.

Bills Discounted and Purchase

Bills Discounted may be promissory notes, bills of exchange or treasury bills. Commercial Banks prefer to have assets, which mature with in short period, say 90 days. They are easily marked and they also bring some revenue income to the bank. A bill of exchange is one such asset. It is a sound banking asset and it is described as a self-liquidating paper. A bill become liquid as it a mature for payment. It is backed by a genuine trade transaction at the end of which necessary finance is raised to pay the bill. The acceptor of the bill – the buyer of the goods arranges for the sale of the goods before the due date and makes the payment on the date of maturity. In time of need the bill can be rediscounted rate with the central bank of the country. The rediscounting rate will generally be highly be higher than the borrowing rate of the bank. Hence, the bank incurs a loss, if the bills are rediscounted. The loss is minimized in the case of short –dated bills.

Investment

In vestment constitute bankers fourth line of defense, after cash, money at call and short notice and bill discounted. They yield a higher return than that obtained from liquid assets. But the return is not as high as the return loan and advance. Bank invests a large proportion of their funds in government securities and other gilt-edged securities. When the demand for loans and advance increase the bank probably sells the securities. These securities can be converted into cash easily and without loss of value. Some securities mature after a long time, say 5 or 10 years. If they are sold before maturity, the bank incurs a capital loss. The bank also stands to lose, if the interest rate rises. If the banker can wait till the due date, the investment yields a fairly highly rate return.

Loan and Advance

This is the most important item on the assets side. It is this asset that fetches income for bank. The profitability of the bank depends upon the extent to which it grants loan and advances to customers. Loan and advances to customers. Loans are granted in the form on overdraft, cash credits and direct loans. Loans are granted against adequate securities.

Fixed Assets

They represent the fixed investment or the least liquid assets of the bank. They cannot be easily realized in times of an emergency. They cannot also be realized without mush loss of value. The Bank usually provides depreciation on these assets annually. so the values of the assets shown in the Balance Sheet will be much less than their real value.

Other Assets

This item includes silver and other items such as preliminary expenses, development expenses accrued interest on investment etc. These items are shown separately under suitable heading.

2.1.10.2 Bank's Liabilities

Bank's Liabilities include different heads viz. share capital, the deposits of people, borrowing from other Bank and financial institutions, reserve funds, provision and other contingent liabilities.

Share Capital

Share capital is the amount collected by the bank promoters to operate the bank. As per the memorandum of association of bank, the almost limit of capital Bank can issue is determined, which is known as authorized capital. The part of the authorized capital, which is issued to public subscription, is known as issued capital and the portion of subscribed capital which is taken by public is known as subscribed capital. Bank doesn't get whole amount of subscribed capital at once. The portion of share amount which is received at the time of subscription is known as paid capital and the total amount called out of subscription is known as called capital.

Deposits

Deposits occupy the major space in the liabilities of bank Balance sheet. Normally it is more than 70 percent of the total liabilities. As per NRB Directives, Commercial Banks can collected fixed deposits, saving deposits, current deposits and other deposits as introduced by the bank policy to carry out its business. These are the liabilities because bank must pay interest on them and pay back the deposits amount to depositors.

Borrowings

Banks borrows from other Commercial Banks, C Banks and other Financial Institutions to carry out their business in the state of lack of business funds.

Reserve Funds

Reserve funds constitute general reserve fund, share premium, capital reserve fund, assets revaluation fund, dividend equalization fund, retained earnings (profit/loss) and other reserve fund. The portion of undistributed profit establishes general reserve fund.

Other Contingent Liabilities

They include dividend to be distributed and unclaimed dividends, pension and gratuity funds, provident funds, sundry creditors, interest payable, income tax provision, Loan loss provision against Non-Performing Assets(NPA), interest suspense account and rebates etc (*Radhaswamy & Basudeven, 1979)*.

Importance of Loan and Advances to Bank

Commercial Banks grants certain part of its assets as loan and advances. Such Loan and advances are granted against enough securities and interest received against them is normally higher then they pay interest to deposits. Loan and advances are less liquid but are more profitable. These are known as fourth line of defense to bank regarding the chance of being converted to current cash. More than 70 percent of bank income is earned by the interest income received against such loans and advances. Without the transaction of loans and advances, bank neither can maintain its operating expenses nor can pay interest to the depositors and dividend to shareholders. In the bank of developing economy granting loans and advances are major transaction and interest received against such loan and advances are the major portion of income to total income. The loan and advances in our countries ' Commercial Bank occupies more than 45% of total assets.

"Banks make their profits primarily issuing loans. Some 68 percent of bank assets are in the form of loan and advances, and in recent years they have generally produced more than half of bank revenues. A loan is the liability to the individual or corporation receiving it but assets for a bank because it provides income to the bank. Loans are typically less liquid than other assets because they cannot be turned into cash until the loan matures. If the bank makes a one-year loan for example, it cannot get its funds back until the loan comes due in one year. Loans also have a higher probability of default than other assets. Because of the lack of liquidity and higher default risk, the bank earns its higher returns on loans" *(Frederick S. Mishkin, 1999).*

"Loan and advances dominate the assets side of Balance Sheet of any bank. Similarly earning from such loan and advances occupy major space in the income statement of bank. However, it is important to be reminded that most of the bank failures in the world are due to shrinkage in the value of loan and advances. Hence, loan is known as risky assets. Risk of non repayment of loan is also known as credit risk or default risk." (*Dahal & Dahal, 2002L:114*).

2.1.11 Glimpse of Performance of Commercial Banks in Nepal

1) The number of commercial Bank branches operating in the country in mid July 2008 totaled 422, of which 275 belonged to 17 Commercial Banks and the remaining 47 belonged to ADB/N, Performing Commercial Banking activities. The regional distribution of these Bank branches seemed to be much skewed. Of the total bank branches, 202 branches are being operated in the central development region, followed by eastern development region (88) and western development region (83). Only 27 and 22 branches are being operated in the mid-western and far western region respectively.

2) The size of the total assets of Commercial Banks increased continuously over the last few years. The total asset, which was Rs.209471.5 million in mid-July 2004, expanded to Rs.339816.7 million in mid-July 2007 and to Rs.411033.7 million in mid-July 2008. IT expanded on an average 14.43 percent per annum during 2004-08 and increased by 20.96 percent in mid-July 2008 compared to that of mid-July 2007.

   Loans and advances remained major component in total assets of the Commercial Banks during 2004-08. However, the share of loans and advances in total assets declined in the recent years. The total loans and advances as percent of the total assets was 46.0 percent in mid-July 2004. It decreased to 41.2 percent in mid-July 2007 and 39.8 percent in mid-July 2008. Similarly, the share of liquid funds in Total Assets declined in the period 2004-08. Unlike the loans and advances and liquid funds, the share of investments in Total Assets increased in the same period. It increased to 14.6 percent in mid-July 2007 from 8.6 percent in mid-July 2004 and remained more or less at constant level in mid-July 2008.

3) Deposit liabilities held almost two third of the total liabilities over the period 2004-08. Deposits reached to Rs.252409.8 million in mid-July 2008 from Rs.233811.2 million in mid-July 2007, with an increased of 8 percent. However, deposits as a percent of total liabilities declined in recent years. It has come down 61.4 percent in mid-July 2008 whereas these figure stood at 68.8 percent in mid-July 2007 and 74.0 percent in mid-July 2004. Exhibiting declining trend, total deposit if the banking system grew at a moderate of 10.25 percent per annum during 2004-08. It increased by 8.0 percent in mid-July 2008.

   The growth rate was 14.7 percent in last year. Saving deposits, with increasing trend, held major share in total deposit. In mid-July 2008, saving deposit gripped 51.50 percent on total deposit followed by current deposits 13.73 percent, fixed deposits 26.67 percent; call deposits 7.01 percent and other deposits 1.10 percent. All components of deposits experienced healthy growth rate during 2004-08. Call deposits grew with the highest average rate of 36.6 percent followed by saving deposits 14.62 percent, current deposits 11.62 percent and fixed deposits 1.6 percent during last 5 years. As compared to the figures of mid-July 2007, current deposits and fixed deposits increased by 2.72 percent, 13.89 percent, 17.38 percent, and 2.91

percent respectively. But call deposits decreased in mid-July 2008 by 2.10 percent as compared to the figure of mid-July 2007, whereas it had increased by 50.16 percent in 2007.

Other deposits increased by 55.02 percent in 2008 against the growth rate of 1.65 percent of 2007.

4) Non-deposits resources, which include capital and reserves, and borrowings, accounted only 5.4 percent of total liabilities in mid-July 2008. With an increase of 23.1 percent, it reached to Rs.22006.2 million in mid-July 2008 from Rs.17878 million that of mid-July 2007. It expanded with an annual growth rate of 16.9 percent over the past five-year's period. This growth rate is higher than the average growth rates of deposit and total liabilities of the same periods.
5) Liquid funds decreased by 17 percent and reached to Rs.38369.4 million in mid-July 2008 from Rs.46252.8 million in mid-July 2007. Liquid funds were Rs.48240 million in mid-July 2004. On an average it declined at the rate of 4.48 percent per annum during 2004-08. On the other hand, investments increased by 27.35 percent per annum during 2004-08 and reached to Rs.6081 million in mid-July 2008 from Rs.17967.3 million that of mid-July 2004. Investments in mid-July 2008 were 27.35 percent higher than that of previous year, i.e. mid-July2007.
6) Growth of total loans and advances remained moderate in the five years. Total loans and advances registered an average growth rate of 11.19 percent per annum during 2004-08 and reached to Rs.163718.8 million in mid-July 2008. The outstanding amount of loan and advances was Rs.140031.4 million in mid-July 2007 and Rs.96324.9 million in mid-July 2004. Loans to private sector always dominate on the overall outstanding figure of loans and advances of Rs.163718.9 million, 96.02 percent was allocated to private sector, 1.5 percent to Government enterprises, 2.39 percent to bills purchased and discount, and 0.10 percent against bills in mid-July 2008.

   Major portion of the loan portfolio of the Banking system was distributed to productive sector, and wholesale and retail business sector. Credit to productive sector alone stood at Rs.53743.5 million (33.93 percent of the total loans and advances) and credit to wholesale and retail business was Rs.34412.3 million (21.60

percent) in mid-July 2008. Agriculture sector was able to tap only 2.77 percent of total credit in this period. Other major credit distributed sectors included service industries (9.42 percent), construction (5.47 percent), and transportation, communication and public services (5.65 percent).

7) With 49.79 percent increase, priority sector credit reached to Rs.13499.24 million in mid-July 2008 from Rs.9012.3 million in mid-July 2007. Priority sector credit as percent of total credit stood at 8.25 percent in mid-July 2008 and 6.44 percent in mid-July 2007. Similarly, deprived sector credit increased by 55.62 percent and reached to Rs.4367.91 million in mid-July 2008 as compared to Rs.2806.8 million in mid-July 2007. It had grown by 21.74 percent in mid-July 2007 as compared to mid-July 2006. Deprived sector credit amounted to 2 percent of total credit in mid-July 2008.

8) Credit-deposit ratio of the Commercial Banking system did not undergo a noteworthy change during 2004-08. It remained around 60 percent during 2007 and increased to 65 percent in mid-July 2008.Post a net profit of Rs.3707.48 million in mid-July 2006. The net profit of the Banking system further improved and reached to 5263.5 million in mid-July 2008.

9) Despite some improvement, the aggregate capital funds to total risk weighted assets ratio of he banking system remained negative even in mid-July 2008. The huge negative capital funds of two big Banks namely RBB and NBL converted the total capital adequacy ratio at -4.46 percent in mid-July 2008 and -8.92 percent in mid-July 2007.

Table 2.4

Soundness Indicators of Commercial Banking System

Indicators	Mid-July				
	2004	2005	2006	2007	2008
Profitability	-7843	-9428	-3317.25	3707.48	5205.31
NPL as Percentage of Total Loan	29.3	30.4	28.7	22.8	18.85
Total Capital Fund as Percentage	-5.49	-9.88	-11.74	-8.92	-4.46

Source: NRB's Banking and Financial Statistics, Mid –July 2008

10) With marginal improvement, the level Non-Performing Loans and advances still stood at a significantly high level. The aggregate Non Performing Loan ratio to total ratio 29.3 percent in mid-July 2004 and it reduced to 18.85 (Rs.28103.7 million) in mid-July 2008.

2.1.12 Global Development of NPAs

The Core banking business is of mobilizing the deposit and utilizing it of lending to industry. Lending business is generally encouraged because it has the effect of funds being transferred from the system to productive purpose. Which result into economics growth. However lending also carries credit risk, which arises from the failure of borrower to fulfill its contractual obligation either during the course of transaction or future obligation.

A question that is how risk cans a bank affords to take? recent happening in the business world Enron, Com, Xerox, Global crossing do not give much confidence to bank, In case after case, these giant corporate became bankrupt and failed to provide investor with clearer and more complete information there by introducing a degree of risk that many investors could neither anticipate nor welcome. The history of financial institutions also reveals the fact that the biggest banking failures were due to credit risk.

Due to this, bank is restricting their lending operation to secured avenues only with adequate collateral on which to fall back upon in a situation of default (*http://www.indianinfoline.com/legal/feat/thle.html*).

2.1.13 Non Performing Assets /Loans in South Asia

India

More authentic information about the volume of Non-Performing Assets (NPAS) of Indian Bank is available from 2004 onwards and therefore the growth of Non-Performing Assets (NPAs) since 2004 is presented here. Non-Performing Assets (NPAs) contains of the aggregate of sun standard, Doubtful and loss assets. (Table-2) In the case of India sector banks, the percentage of NPAs to total advances (Comprising 5.1 percent to Sub-

Standard assets, 10.7 Percent of Doubtful assets and 2.1 percent of loss assets) amounted to 17.8 percent at the end of March 2004 and Declined to 11.1 percent (Comprising 3.1 percent of sub –standard assets, 6.6 percent of Doubtful assets and 1.4 percent of loss assets) as at end of March 2009.

Table 2.5

Percentage of Different Categories of Loan Assets to Total Advances of Scheduled Commercial Banks in India

Public Sector Banks

Fiscal Year	Standard Assets	Sub-Standard Assets	Doubtful Assets	Loss Assets	NPAs
2004	82.2	5.1	10.7	2.1	17.8
2005	84.0	5.1	9.1	1.9	16.0
2006	84.1	4.9	9.0	2.0	15.9
2007	86.0	4.3	8.0	1.7	14.0
2008	87.6	3.3	7.6	1.5	12.4
2009	88.9	3.1	6.6	1.4	11.1

Old Private Sector Banks

Fiscal Year	Standard Assets	Sub-Standard Assets	Doubtful Assets	Loss Assets	NPAs
2004	89.3	5.5	4.1	1.1	10.7
2005	89.1	5.5	4.2	1.3	10.9
2006	86.9	6.6	5.0	1.4	13.1
2007	88.8	4.5	5.8	1.0	11.2
2008	88.7	4.1	6.2	1.0	11.3
2009	89.0	4.2	6.1	0.8	11.0

New Private Sector Banks

Fiscal Year	Standard Assets	Sub-Standard Assets	Doubtful Assets	Loss Assets	NPAs
2004	97.4	2.1	0.0	0.5	2.6
2005	96.5	3.3	0.1	0.2	3.5
2006	93.8	5.2	0.9	0.0	6.2
2007	95.9	2.5	1.3	0.4	4.1
2008	94.9	3.1	2.0	0.0	5.1
2009	91.1	3.8	5.0	0.1	8.9

Foreign Banks India

Fiscal Year	Standard Assets	Sub-Standard Assets	Doubtful Assets	Loss Assets	NPAs
2004	95.9	2.4	0.9	0.9	4.3
2005	93.6	3.9	0.8	1.7	6.4
2006	93.0	4.0	1.6	2.0	7.6
2007	95.9	2.9	2.1	1.9	7.0
2008	93.1	1.9	2.6	2.3	6.9
2009	94.5	1.7	2.0	1.8	5.5

Sources: Trend and Progress of Banking in India, B.S. Sreekantaradhya 2009:116

In the case of old private sector Banks, the percentage of NPAs to total advances increased from 10.7 percent (comparing 5.5 percent of Sub-standard assets, 4.1 percent of Doubtful assets and 1.1 percent of loss assets as at end of March 2004 to 11.0 percent (comprising 4.2 percent of sub-standard assets, 6 percent of Doubtful asserts and 0.8 percent of loss assets) as at of March 2009. In the case of new private sector banks, the percentage of NPAs to total advances increased from 2.6 percent (comprising 2.1 percent of Sub-standard assets and 0.5 percent of loss assets) as at end of March 2004 to 8.9 percent (comprising 3.8 percent of Sub-standard assets, 5percent of Doubtful assets and 0.1 percent of loss assets) as at end of March 2009. In the case of Foreign Banks in India, the percentage of NPAs to total advances increased from 4.2 percent (comprising 2.4 percent of Sub-standard assets, 0.9 percent of Doubtful assets and 0.9 percent of loss assets as at end of March 2004 to 5.5 percent (comprising 1.7 percent of Sub-standard assets 2.0 percent of Doubtful assets and 1.8 percent of loss assets) as at end of March 2009. Thus, the proportion of NPAs of all Commercial Banks in India to total advances is much higher than the international standard of 2-3 percent of total advances.

Bangladesh

Financial sector of Bangladesh, like most poor countries, is dominated by banking enterprises. Banks at early stages of history of Bangladesh were nationalized and there was mismatch between assets and liabilities. Currently, the banking sector comprises Nationalized Commercial Banks (NCBs), 5 Government-owned Specialized Banks (SBs) dealing with Development Financial Institution (DFIs), 30 Private Commercial Banks (PCBs) and 10 Foreign Commercial BANKS (fcbS). Those all banks of Bangladesh are suffering by Non-Performing Loans. Stringent loan rescheduling conditions were introduced to stop ever greening of loans. Strict measures have been laid and enforced on loan loss provisioning, and tier 1and2 capital adequeinces. Loan write off guidelines were issued by the Bangladesh Bank, allowing the banks for the first time, to write off "bad" debts against which full provisioning has been made. The Bangladesh Bank has fixed the limit of the single of the single borrower/single group- borrowers credit to a bank. Large loan limit has been linked to bank's NPL ratio. The Bangladesh Bank is encouraging syndication of several banks for large loans and has issued guidelines for restructuring such loans.

Table 2.6

Non- Performing Loan Ratios in Bangladesh

(in Percentage)

Types of Banks	**Gross Non- Performing Loan Ratios**				
	2004	**2005**	**2006**	**2007**	**2008**
NCBs	38.6	37.0	33.7	29.0	25.3
DFIs	62.6	61.8	61.8	47.4	42.9
PCBs	22.0	17.0	16.7	12.4	8.5
PCBs	3.4	33.0	2.6	2.7	1.5

Types of Banks	Gross Non- Performing Loan Ratios				
	2004	**2005**	**2006**	**2007**	**2008**
NCBs	26.1	25.2	22.6	22.3	17.6
DFIs	29.2	33.8	26.9	25.0	23.0
PCBs	9.1	5.5	6.7	6.7	3.4
PCBs	-1.1	-1.7	-1.8	-1.0	-1.5

The ratio of gross Non-Performing Loans (NPLs) of the banking system stood as high as 41 percent in 2001, which came down to 31.5 percent in December 2004. As a result of the policies adopted in recent years the Non-Performing Loans of the banking system as whole went down to 17.6 percent in December 2008. NCBs' gross NPL ratio has improved 37 percent to 25.3 percent, and the net position has also improved from 25.2 percent to 17.6 percent to 17.6 percent from 17 percent to 8.5 percent, and net NPL of the PCBs has gone down from 5.5 percent to only 3.4 percent at the end of 2008. The improvement in the Non-Performing Loans of banks is positive has been remarkable *(Fakhruddin Ahmed, 2008)*

Srilanka

In the case of Central Bank of Srilanka has issued Directives to Commercial Banks regarding the classification of loan and advances. As per the existing CBSL Directives, Banks have to classify outstanding loan and advances into four categories. The loan classification and their provisioning requirements are as follows:

Loan Category	Criteria for Loan Classification	Provision Requirement
Good loan	Not overdue and overdue up to 901 days	No
Substandard Loan	Overdue for 90 days to six months	20% of the total outstanding loan
Doubtful Loan	Overdue for six months to 18 months	50% of total outstanding loan
Loss Loan	Overdue for 18 months and above	100% of total outstanding loan

2.1.14 Non-Performing Assets/Loan in East Asia

Introduction

Three years have passed since the financial crisis hit Asian economics in July 1997. As a result, East Asian countries in 1998 recorded negative growth ranging from 5 to 12 percent. In 1999, however, economics improved in several countries; South Korea in particular recorded a “V” type of recovery. Although the growth process has slowed somewhat in 2000, progress continues and on the basis of the recent rapid recovery, there is optimism that the East Asian Financial Crisis has ended. On the other hand, there is also the opinion that the situation doesn’t warrant optimism, as structural reforms, include Non-Performing Loan (NPLs) problem in the finance and corporate sectors, have not progressed sufficiently. This paper looks into the issues that East Asian economics, based on the assessment of the current status of NPL reconstruction in Malaysia, Thailand, and Indonesia.

Immediately preceding the Asia Financial Crisis, Japan was tackling a NPL problem that result from the bursting of the so-called bubble economy in 1990. Economic Depression has continued for nearly ten years since then, and the Japanese economy gas yet to get back to the track of sustainable growth. The chief cause of this crisis, in a nutshell, was that the government did not take measure to deal with NPLs in a timely manner. Cooperative credit purchasing company was lunch in 1993 to buy NPLs, and the Housing Loans Management Company was set up in 1996 to deal with the problem of housing-related NPLs. These efforts were inadequate and all the real solution had to wait for large-scale public funds that were made available to financial institution in March 1998, eight years after the bursting of the bubble economy. The process of resolving NPLs in Japan was indeed too little, too late. Japan adopted the policy of waiting for the economic environment to take a favorable turn, instead of taking swift, decisive action.

On the other hand, many East Asian Countries addressed the problem of NPLs rather swiftly. South Korea, for example, immediately injected large amount of public fund into financial institution. Three years after the financial crisis, the solution to NPLs is progressing relative well in South Korea and Malaysia, while Thailand and Indinesia are lagging behind. To solve this issue of NPLs, it is necessary to make structural improvement, especially in the financial system and corporate governance that actually caused the NPL problems.

The economic growth rate in each of these countries is projected to register a downward trend in 2000, compared to the previous year, and the current account surplus is diminishing. Since East Asian Economics depend heavily upon the US economy, its current slowdown will be a damper to these countries' recovery. It is therefore necessary to analyze the current status of NPL problem, financial reconstructing and corporate to make sure they can cope with adversely changing economic environment.

Malaysia

The measures by the Malaysian Government against NPLs were swift and strong. Originally, the external debt of companies was not large, and the debt capital adequacy ratio was relatively low. Further, since the Company Act of 1965 was relatively well structured in comparison to Thailand, out-of-court settlement progressed relatively smoothly under the Bankruptcy Act. Danaharta, the assets management company, completed purchase of NPLs by December 1999, and the NPL ratio fell 11.2 percent by February 2000. Danamodal, the organization for the infusion of public funds, has pumped 6.4 billion Ringget (equivalent to US$2 billion) into 10 banks so far, and already six of them have repaid their debt amounting to US$600 million. Therefore, the capital adequacy ratio of Banks had improved to 12.8 percent in March 2000. The Corporate Debt Restructuring Committee, an organization promoting out-of-court restructuring, entered the field somewhat late, but by March 2000 there were 68 applications totaling US$9.5 billion. All debt restructurings are scheduled on is settled by September 2000, included transfer to Danaharta.

The Malaysian Central Bank has the initiative to settle NPL problems by year-end. The authorities will also restructure Financial Institutions, consolidating them into around 10 groups that will be completed within this year. Since it is necessary to open up the domestic market by 2003, per the arrangement with the WTO, the government needs to strengthen the competitive edge of Banks. Since Malaysia has not resorted to IMF loans, its financial reforms may not be as forceful as other countries and there is concern that it may have undergone only partial structural changes in the financial system and corporate governance.

Thailand

The process of settlement of NPLs is delayed in Thailand, primarily because the government's has been rather weak. It did not adopt a centralized solution to NPLs, but rather encouraged each bank to set up and transfer NPLs to its assets management company. By this method, where valuation is depreciated at the time of transfer, there is the risk of not doing enough or delaying the transfer, since it is left to the discretion of individual banks. In addition, the actual amount of public funds made available was less than banks needed. As a result, the solution to the problem of NPLs has been delayed and bank lending has not yet picked up.

A framework for corporate debt negotiation outside court was set up in September 1998, but revision of the bankrupt act was left pending before the upper house for as long as one year. Bankruptcy courts began to function in the third quarter of 1999 and by June 2000, 553 large cases worth US$23 billion, were reorganized. Nevertheless, the whole process has been lagging behind.

In Thailand, it is not usual to settle matter before a court of law. There is strong public resistance to pumping public funds into a particular financial institution, and dislike of official interference in management when public fund infusion is made. Unless the government overcomes these obstacles, a quick solution to Thailand's NPL problem will be elusive .According to an announcement by the Bank of Thailand between October 1999 and February 2000 NPLs worth 3334.3 billion Bhat were reduced based on the agreement for restructuring of NPLs , but fresh NPLs worth 201.3 billion Bhat were also generated. Further, as a result of reorganization, loans that were regard as healthy became bad; such loans totaled 55.8 billion bath. Bad Loans that were settled once, but turned bad again imply that the restructuring process has not been carried out properly.

Indonesia

Among the four nations citied here, Indonesia was the most seriously affected by the Asian Economics Crisis, and many of its banks became insolvent. Despite the pumping in of large amount of public funds- including emergency loans by the central bank- the road to recovery is still loan, and a solution to the NPLs problem has been the most delayed among the four east Asian countries. The Indonesia Bank Restriction Agency (IBRA) was established in January 1998, to pool NPLs and infuse public funds. It presently holds NPLs worth 625 million rupees. A breakdown includes: shares corporate real estate worth 125 million rupee collected from the owner of 28 Banks (later nationalized) that received emergency funding from the Central Bank; NPLs of nation/nationalized or liquidated Banks worth 250 trillion rupee, and share of Banks worth 250 million rupee taken over as a result of capital allocation. In short, a considerable amount of inferior quality loans is included. One year after its inception, IBRA continues to be bogged down by policies, and there was scarily and progress in the resolution to NPLs in 1999.

IBRA started its activities after President Wahid's Government assumed office in November 1999, and when Mr. Chachuk became its president in January 2000. A basic agreement to restructure 35 percent of IBRA's top debtor was reached in IMF in June 2000, and it is believed that 21 percent top debtor account for one-third of total NPLs of 250 trillion Rupaih. All are either related to Suharto family of their followers. The problem of NPLs in this country is complicated, since it involves political as well as economic issue.

The Jakarta initiative, in charge of out-court settlement, was set up in January 1998. It began to function only in the first quarter of 1999, after it was recognized as Jakarta initiative task force, and given legal sanction following the promulgation of the revised bankruptcy act. It is said to have settled 57 NPL case worth US$3.3 billion in 1999. Foreign Banks which provides loans to relatively better quality companies, have settle in many cases through negotiation with individual debtor, without going through the Jakarta Initiatives Task force.

2.1.15 Non-Performing Assets/Loans in Other Asian Countries

South Korea

Like Malaysia, the South Korean Government took immediate steps against NPLs. The Korea Asset Management Corporation, which was set up in December 1997, has settled NPLs worth 35 trillion won (US$32.1 billion) and recovered 18 trillion won (US$16.2 billion). Further, the government initially decided to provide 64 trillion won (US$57.6 billion) in public funds, but made fresh allocations, so far pumping 89.6 trillion won (US$107.7 billion) in public funds into the banks and non-Banking Financial Institutions. As a result, bank lending started increasing in May 1999.

The process of-out-court negotiations between creditors and debtors began somewhat late; it was in June 1998 that a framework targeting 73 medium and small business, was agreed upon. With regard to five large business conglomerates, the government has carried out reforms based on five principles: enhanced transparency, withdrawal of financial guarantees, and improvement of financial structures, business restructuring, and strengthening of managerial responsibility. The cross financial guarantee within a business group (equivalent to US$ 20 billion as December 1997) was resolved to a great extend by March 2000, but the debt capital adequacy ratio (target below 200%) is yet to be improved. (As of December 1999, it stood at 349 percent for four business conglomerates, on a consolidated basis). In July 1999, Daewoo went Bankrupt, and the Hyundai group is currently in the process of dismantling due to the adequate liquidity of Hyundai construction. The page of improvement varies from group to group, but on the whole, reforms of large businesses by the government are behind original schedules.

Japan

In mid-January the Ministry of Finance shocked the financial markets by announcing that the value of problem loans at Japanese Banks at the end of September was a staggering Yen 77 trillion or 15 percent of GDP. The Federation of bankers' Associations of Japan had previously estimated that problem loans at Japanese Banks at the end of September totaled just Yen 21.7 trillion.

From fiscal 1988 financial Institutions will be required to conduct a self assessment of their assets basis (Semi annually in the case of banks) as part of the new Prompt Corrective Action (PCA) system of regulation. This information will be used to ensure that the banks have made adequate provision for their bad debts and that they meet the PCA capital adequacy provision for their bad debts that they meet the PCA capital adequacy requirement (4% for domestic Banks and 8% for international banks). The first that the ministry of Finance (MOF) published in January were a dry run for the PCA system. The ministry asked the Banks to classify their loans into four Categories. Healthy loans; Loans which require careful risk management (Class2); loans about which banks have serious concerns about their ultimate collection (Class 3); and loan which banks judge to be non-collectible or of no value (class 4); It would be a mistake to assume that all borrowers in class 2 and 3 will ultimately default. According to the rules of thumb used by regulatory authorities in the United States would indicate that borrowers would default on around 20 % of class 2 Loans and around 50% of class 3 loans.

If we assume that these default rates are correct then the Ministry of Finance figure would imply that Japanese Banks faced default on around Yen 20 trillion of their outstanding loans at the end of September. The banking sector already had loan loss provisions of Yen 9.4 trillion at the end of September and in most cases the loans were secured on some collateral. The ministry of Finance published its assessment of the bank's bad debt problem in mid January it was already seriously out of date, Between September, when the Banks competed their self-assessment, and mid –January when the results were actually published the economic situation had deteriorated radically ;The Japanese economy had slipped into recession ; the Asian currency crisis had spread from the ASEAN-4 to Hong Kong and South Korea; the largest securities companies had gone bankrupt and two of the five largest securities companies had gone also gone bankrupt.

Table 2.7

Japanese Banking Sector Non-performing Loans as at End –September 2008

	Total Loans	**Class-1**	**Class-2 " Sub-Standard"**	**Class-3 " Doubtful"**	**Class-4 " Lost"**	**Non-Performing Loans**	
Types of Banks	Yen trillion	Yen trillion	Yen trillion	Yen trillion	Yen trillion	Yen trillion	% GDP
Majors Banks	431.7	377.4	45.3	6.9	2.1	54.3	10.7
Regional Banks	139.2	124.7	13.1	1	0.4	14.5	2.8
Seconds tier Regional Banks	54	46.1	6.9	0.8	0.2	7.9	1.6

All Banks	624.9	548.2	65.3	8.7	2.7	76.7	15.1
" Likely " Default Rate			20%	50%	100 %		
Projected Defaults Loan			13.1	4.4	2.7	20.1	

Sources: Ministry of Finance of Japan; 2008; Economic Outlook

China

Bank restructuring, including resolution of Non-Performing Loans (NPLs) and the associated recapitalization of Banks is often costly, but is crucial for the stability and efficient functioning of Banking systems. Although effectively stemming the flow on new NPL is necessary for sustained improvement in the banking system, the importance of dealing with stock of legacy NPL still on the books of banks or within the system should not be understand: it might reveal the political willingness of authorities to confront serious problem in the banking sector. Moreover, Non-Performing Loans (NPLs) resolution is often inextricably linked with bank recapitalization and is a major component of the broader financial safety net. Therefore, the questions of how banks restructuring should be financed and how the associated potential loss should be allocated among parities involved must not be swept under the carpet.

The bill for bank restructuring in china might in china might eventually approach 30 percent of GDP. Cost of this magnitude should not be surprising, given that Non-performing Loans (NPLs) are believed to have accounted for as much as 40-50 percent of outstanding loans at their peak in the late 1990s.Since the late 1990s, the Chinese Government has taken several major steps to recapitalize its banks and to reduce Non-Performing Loans (NPLs). First and fore most, it has focused on repairing Banks Banks' Balance Sheets, but has also recognized the importance of strengthening corporate governance, fostering a credit culture and liberalizing markets. The question of how bank-restructuring efforts on this scale will be found is obviously of great interest, Second, the funding arrangement for China's Bank restructuring have been quite elaborate. Taxpayers, shareholders and bank customers have all paid for the restructuring bill, with the Ministry of Finance (MOF) and the people's Bank of China (PBC) splitting some percent of the cost between then.

in 1990, the Chinese Government carved out (US$173bn, or 20 percent of the total loan balance at that time) in Non-Performing Loan (NPL) from the big four Banks at par value and transferred them over to four state-owned Asset Management Companies (AMCs), In return, the AMCs issued bonds to the four banks and assumed some of their liabilities ton the PBC. Effectively, this batch of NPL acquisition was financed 55 percent by AMC bonds and 45 percent by PBC credit. This move was a double act of NPL removal and Bank recapitalization (*Ma and Fung, 2002).*

However, because of the "constructive ambiguity" of the MOF towards its backing of these bonds issued by the AMCs was initially called into question. Indeed there might still be risk that the big four banks have swapped their own NPL for AMC bonds with uncertain prospects of timely debt service. Disclosure is such that it is not clear if the AMCs have made regular interest payments to the big four Banks on their bonds, or to the PBC on the liabilities assumed by the purchasing AMCs. So far, the four AMCs have resolved approximately half of the acquired NPL, with a 20 percent cash recovery rate.

Since 2004, the PBCs Balance Sheet has been tapped on two occasions to fund the transfers of the Doubtful Loans at the recapitalized onto of the AMC. Further the PBC Balance Sheet has additional exposure to the AMCs because it provided the credit to finance their two NPL acquisitions.

2.1.16 Future Issues

There is no other option or effective method other than to solve NPL problems through government initiatives. South Korea and Malaysia achieved positive result through powerful government intervention. On the other hand, the absence of separation between management and capital, along with aversion to Government intervention in some cases (such as family-managed companies in Thailand), has delayed the process of recovery. In Indonesia, political reforms were given precedence over the resolution of NPLs. Moreover, a large number of NPLs held by local and nation banks, which were transferred to IBRI, are of inferior quality. The occurrence of scandals related to NPLs has further complicated the matter, and the economic recovery in countries like Thailand and Indonesia.

To solve NPL problem and to inject capital into Banks, many countries except for Malaysia had to incur a financial burden that far exceed the cost originally estimated. In Indonesia, public funds provided to the financial sector-focusing on national Banks-amounted to 650 trillion Rupaih (US$87 billion). The combined eternal and public debt of Indonesia has jumped to US$150 billion. While the recovery rate of NPLs in Malaysia is over 60 percent, in Indonesia it is estimated to be much lower, since the loan held by IBRA are of inferior quality.

As seen in Thailand's case, the fact that once-reconstructed loans became bad again calls for caution. This occurs when an "easy" approach is taken towards corporate restricting. It is often the case that financial restructuring is carried out by simply extended the loan period, and there may be a number of Doubtful cases where restructuring has been carried out without strict cash flow management. Even in Malaysia, it has been said that simply extension of loan period is the main method used , while debt equality conversion and changes in management is hardly seen. Compared to other regions such as Latin America, there are few instance of conversion of debt into equalities. According to the accounting practices of some East Asian Countries it is believed that once NPLs are restructured, they may be recognized as healthy loans that do not require reserves. Therefore there may be cases where banks and creditor have entered into relative easy restructuring plans, and it is feared that in such cases resolution to problems may simply be deferred. Though it id not easy to grasp the detail of corporate restructuring, it is necessary to pay attention to the fact that the decline in NPL ration does not necessarily mean the real amount of NPLs has been reduced.

Five Thai Bank and two South Korean Banks have been sold to foreign investors. In Thailand, as a result of a build-up in capital through the stock market instead of infusion of public funds, it is said that of shares of big banks by foreigners has taken place in significant manner. In Indonesia, as seen in the failure by the foreign bank to buy out bank bail, acquisition of banks by foreign capital has not succeeded. In Malaysia, there are no instances of acquisition of Malaysian Banks by foreign capital. In Latin America, as a result of opening its market, acquisition of banks of foreign capital is quite common, but still limited in East Asia. In Thailand and South Korea, management of banks based of foreign capital will prove to have positive impact on the local financial system.

Although the process of recovery has been delayed in Thailand and Indonesia, considerable progress is expected in the coming one to two years. It is vital to reform from business practices based on connection, bribery, and lenient credit screening by banks. Fundamental changes are necessary to correct such a system. Revamping financial supervisory systems concerned with the health of a bank management, introduction of strict accounting system and transparency at the managerial level, are a necessity. Moreover, improvement in corporate governance, including elimination of cronyism, and transparency of corporate management should be advanced under government initiatives backed by public support. Whether or not east Asian economies can strengthen their capacity to cope with future financial crises in their challenge to reform their banking and corporate structure.

Tending the loan period and their may be a number of doubtful cases where restructuring has been carried out without strict cash flow management. Even in Malaysia, it has been said that simple extension of the loan period is the main even method used, while debt equality conversion and changes in management is hardly seen. Compared to other region such as Latin America, there are few instant of conversion of debt into equalities. According to the accounting practices of some East Asian countries it is believed that once NPLs are restricted, they may be recognize as healthy loans that do not require reserve. Therefore, there may be cases where banks send creditors have entered into relatively easy restructuring plans, and it is feared that in such case resolution problem may simply be differs. Through it is not easy to grasp the details of corporate restructuring; it is necessary to pay attention to the fact that the decline in NPL ratio does not necessarily mean that amount of NPLs has been reduced.

Conclusion

We can conclude that Non-Performing Assets (NPAs) means unable to repayment of principal and interest in specific period by lendee to the bank. And also NPAS is Bad Debt or Bad Loans. From the above description, we know that how and why does NPA create or loans go bad or banks suffer by bad debt as follows;

2.1.17 Why Loans Go Bad

We assured that when loans are overdue to repay their specific period then it goes to Bad Loan as known by NPAs is denied above reviewed various kinds of books, reports, articles, journals, newspaper and other different websites. So we know that how and why do loan go bad. The following terms are the major reasons that convert the loans into Bad Loans:

(a) Lack of Credit Philosophy and Culture

In order to set management's priorities with respect to the matter situation a clear written credit philosophy is a must in every financial institution. Philosophy generally guides the emphasis on highest quality. Credit culture decides behaviors of credit team. If behaviour of credit team is not aligned with institution's priorities, then the credit culture of the institution is worthless. Credit culture reflects institution's system and procedures. A good credit culture will definitely help in attainment of management priorities with minimum errors.

However, in our case, only few Financial Institutions have a clear-cut credit philosophy. Further having clear-cut policy is not enough if it strictly adhered to.

(b) Risk Management Strategy

Varieties of risks are associated with a lending. A comprehensive list of risk is given below. Most of the time and most of the bankers of our society tend to compromise in analyzing all the risk can be measured with the help of formulae, but some risks like regulatory risk, defalcation risk is quite to measure and, therefore, need in-depth examination before finalizing a loan.

(c) KYC-Know Your Customer

If we don’t know our customer-in terms of his capacity, managerial ability, past tract record, market reputation, business he is involved and lend him, then the loan extended to such a customer may be booked as a “Bad loan” co-instant, it is disturbed.

(d) Generous Terms and Lack of Clear Standards

When the term of loan is beyond the market practice or the institution-making loan has a very flexible credit standards, it is least likely the loan will be served timely or even ever.

(e) Lack of Proper Financials

One of the chronic problems of our market is that most of the borrowers do not furnish the financials or even if furnish genuineness or euthenics of the information is questionable. This result difficulty in analyzing various risk associated. Due to this bankers of our market are forced to make name/security based lending, whereas financial based lending, whereas financial based lending system is the only tested and proved system of lending.

(f) Stiff Competition and Size of the Market

The growing numbers of financial institution have given birth to stiff as well as unhealthy competition amongst the institution on the one hand and the size of the market in proportion to the number of institution has not increased. Rather, in recent years some international and national events have shrieked the Nepalese market. No sign of improvement is observed and instead problem seems aggravating. Urge of the time is to be more careful on making loans and review of lending system for further strengthening it.

Competition is indispensable in an open economy and it cannot be avoided. But atmosphere of healthy competition can be created by dissemination information amongst the financial institution. Presently only banks, through Credit Information Bureau or directly are sharing some information. Finance companies should also be brought into the preview of CIB.

(g) Un-due Influence

One of the major factors contributing for Bad Loans is undue influence exerted by politicians, bureaucratic and sometime even by the member of the board and Senior Executives of the bank itself.

The lists of factors contributing bad loans are many more apart from enumerate above. It is not possible to address all of them in short time.

2.1.18 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 implementing 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 comprise on setting the minimum acceptable level of code of conducts for Directors, CEO, employees. Similarly, provision of fair dealing with borrowers, prohibition to work in conflict with organization , maintaining of proper records, maintaining of confidentiality, timely submission of returns, qualification of CEO and reporting of compliance of code of conduct, requirement of audit committee, and responsibility of audit committee are also incorporate in it.

Adequate Capital in Relation to Risk Weighted Assets

Generally, unidentified credit risk should be covered by the capital fund of bank and financial institutions. Therefore, in order to absorb this type of risks, two type of measures have been prescribed by the NRB. The first is the minimum paid of 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 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 substandard, 50% for doubtful and 100% for bad loan categories.

Requirement to Monitor the Concentration of Assets

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 that limit. Exposures upto 10% 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 Implementing 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 specified by the CPG. A standard CPG should address all the area that cover all aspects on credit risk management policies and procedures.

Strengthening the Credit Information System and Blacklisting Procedure

In order to strengthen the financial discipline a system for obtaining credit information needs to be developed. For this purpose, the directives of blacklisting was 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 bankers and the borrowers.

Provisioning of Loan Write-offs

Each bank and financial institution should have its own loan write off policy. Generally, write offs are charged against reserve made for loan losses. Top management, normally, with the concurrence of legal and audit department makes decision to write off the loans. It will be prudent to write off a loan when the amount of loan is less than that of the amount to be spent to recover the loan or while proceeding to the legal steps, there will be still an excess 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.

Strengthening of Consortium Loan Management

The consortium loans disbursed in the past were turning into problematic loan due to lack of adequate procedures for risk management in the bank. To fill this gap NRB issued policy directives to guide such exposures. It is observed that there is still a huge exposure in the consortium NPL in the Nepalese banking system.

Refinance Facility to Sick Industries

NRB has provided refinance facility for the rehabilitation of sick industries since 201/02. During the last five years a sum of Rs.3 billion has been disbursed to 151 hotels and industries NRB still has allocated Rs. 2billion in current fiscal year to facilitate them. If the loan is performing and fulfill the criteria, then these industries can benefit from this facility. The provision has also helped to make the loan as performing for difficult time.

Working with government to deal with big defaulters of this system: It has been observed that the credit culture among the borrowers have not improved to desired level. It is international practice that either the loan should be repaid by the borrower(or by his collateral) or needs to be declared as bankrupt . Nepal government has constituted a high level committee under the vice chairmanship of NPC, in order to suggest the measures to build financial discipline in the financial system. This committee has recommended several long term and short term measures for implementation. Government has made several decisions to deal with willful defaulters.

Other Measures

Other measures 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.

2.2 Review of Related Studies

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 in (1997).

2.2.1 Review of Books and Articles

Assessing the gravity of the problem Tannan found saying that banks and financial institution 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 banks credit written by Suneja (1992) has also been consulted. Suneja pointing out the cause of NPA says that the risk connected with leading to business depend on an enormous number of factors. For any particular trend in demand for the product or service provided, competition from any other suppliers, financial resources are too limited and management skills are lacking. Reiterating the difficult decision facing a banker is to determine when it becomes necessary to recall a loan and to begin the process of liquidating the security. Further, she suggests that if a customer fails 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 mentioned that a dream of globalization led to huge investment which unfortunately could not be utilize properly due to hesitant liberalization policies. Large corporate misused the credits and delayed payments and contributed indirectly for enhancing NPA ratio. He further argues that lack of vision in appraisal of proposal while loan sanctioning, reviewing or enhancing credit limits, absence of risk management policy of financing, concentration of credit in few group of parties and sector, lack of initiatives to take timely action against willful defaulters, indecision on existing out of bad loans for fear of investigation agencies like special police CIAA, public accounts committee of the parliament have also contributed in whatsoever measures to the worsening situation on NPA front. He further pointed out that most crucial reason for the increase in the NPA is the shabby and defaulter friendly legal system. Suggesting the remedy of NPA, he adds that administrative system should be strengthened. Legal reforms should be made and assets Reconstruction Company should be formed.

Dhungana (2063), in his article *"Problem of NPL and the Ned of Financial Discipline in the Nepalese Banking System"* states that Nepalese financial system still has a high level of NPL. System's soundless cannot be restored without resolving the problem of NPL. He further says, the level of total loan is the highest level in the Nepal in 2003 than that of other South Asian Countries. According to him, the main causes for NPL problem in the Nepalese banking system are internal and external factors consist 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, poor recovery efforts even the loan is categorized under bad, lack of loan write-off policies, poorly managed few banks. External factors consists lack of financial discipline within borrowers and in financial system, poor legislative regime, fragmented legal environment, lack of supportive institutions helping ton reduce the NPA, deterioration in economic growth rates and activities last few years, poor legislative and super visioning capacity of the central bank in the past, security problems and conflicts in the economy. He further suggest that for the management of the NPL and a good banking there should be a proper risk management . Preventive and curative measures are acquired to be initiated in the system. He insist that the financial discipline is most crucial to enhance the good credit culture for the benefit of the society and achieving the high level of economic growth. preparation of best CPG, establishing best credit approval procedures installing proper credit management system and credit culture are some of the preventive measures to control NPL growth. Curative measure such as assisting the banks and financial institutions to dispose the distress loan and facilitating to recover NPL are also equally important. He says both strengthening of the internal capacity of the financial institution and improving capacity of the system, building financial discipline in the system as a whole is the need of the day.

Basyal (2065), discussing about the financial sector reform in his article *"Financial Sector Reform Program in Nepal: Prospects and Challenges"* states 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 portions of NPA, predominance of the informal financial system, high interest rate differential between the formal and informal sectors, large interests spread between lending and borrowing rates in the formal financial sector etc. it is estimated that the size of the NPA in the commercial banking is as high as 18% and 50% of this ratio we can found in the two largest banks (RBB and NBL). For resolving this situation the government has initiated FSR program. He argues that the government has a paramount role in building an atmosphere for paving the way for the emergence of professional management and efficient financial operations not only in the institutions owned by it but also in the private owned institutions. To tackle this problem, the financial system should be strengthened by improving its regularity and supervisory systems. He explain the FSR strategy should ensure that financial institution are run in accordance with the sound business principals and practices. The central bank's capability for effective supervision of the financial institutions should be enhanced. Similarly, financial discipline based on adequate provisions of disclosure and implementation of internationally recognized accounting and auditing practices and systems should be ensured. Competition oriented policies should be pursued along with strong regulatory supervisory framework to enhance financial sector efficiency and effectiveness.

He gives an example of Asian crisis of 1997-98 and suggest to take lessons from it. The crisis seriously affects the financial system and economic stability of the region. Large currency depreciation, capital market collapses, large scale bankruptcies, swollen NPA level of the financial system, negative economic growth rate, massive unemployment, disrupted social services, dwindled investor confidence and sharp reduction in the general standard of living were the immediate effect of crisis. It is commonly believed that one of the critical factor behind the crisis was the absence equate central banking autonomy which substantially reduce the efficiency and effectiveness of the central banking functions and responsibilities. He suggests the concerned parties should review the measure they taken for solution of the crisis.

Poudel (2061), 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, Malaysia, Philippines and Thailand. NPL in Nepalese banking sector has been mounting since early 1990's and its main resource 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 governance resulted from political inference and insider lending, lack of independency at the top management, weak information system and weak legal framework and accounting practices in the main cause of NPA problem, he clarifies. Heavily concentrated lending in a few large groups beyond normal prudent risk acceptability, larger consortium loans, higher credit risk exposures with a serious collateral short falls adversely affected both banks liquidity, profitability, asset quality and capital base. He insists lack of responsibility and accountability, weak regulation and supervision of banks, global security problem after September 11 incident and domestic insurgency problems affected repayment rates of their total loan. He agrees with the intervention of NRB over NBL and RBB by handing over the bank management to foreign management groups. He says the NRB should formulate and implement all the necessary rules, regulation, acts, policies and guidelines to address the NPA problem. He supports that enactment of banks and financial institutions Act establishment of Debt tribunals, enactment of banks and financial institution Act 2004 are expected to reduce NPL and avoid future shocks in the banking system. In addition, Assets Management Company is in the process of establishment in near future, which aims at acquiring, managing and realizing cash by disposing impaired bank assets.

Speaking at the inauguration of a two day management conference of the NBL, Alexander Pitt, Resident Representative of IMF Nepal, said "we are all now waiting for action and the government must rise to the challenge and step up support to the banks' effort to collect debt" printed on the Kathmandu Post on Nov.3, 2006. Another participant Bharat Bahadur Karki, Coordinator of the NBL management committee, said "It is important that we track down the property of willful defaulters, which they have amassed here and parked abroad". He also expressed vexation over defaulter's audacity to protest the idea that they should repay what they owe to the banks.

World Bank, principal donor of the country, has clarified that it will not start any new Budget support to loan negotiation as long as the government does not take concrete actions against blacklisted willful defaulters, posted on the Kathmandu Post on dated Nov. 24, 2006. Made it clear by WB vice- president for South Asia Praful Patel in Ktm that the WB first wants action against defaulters before initiating any future loan negotiations. Addressing an interaction organized by FNCCI in Ktm, Assistant Secretary General of United Nations Kulchandra Gautam expressed his views about NPA that FNCCI should take a strong stand against bank defaulters and encourage it's members to be law abiding citizens" posted on Kathmandu Post ON Aug 28, 2006. "It is unconscionable that well-to-do businessmen, industrialists and investors abuse the banking system and get away with impunity, while small borrowers are deprived of loans and penalized for delayed payment" he said, he urged the business community to act responsibility and ensure that the defaulters pay off the debts promptly.

Dr. Shankar Sharma, former vice chairman of NPL said, *"Courts are Easily Issuing Stay Orders to Defaulters Hurting the Bank's Loan Recovery Initiatives.The government must Act Urgently to Address it",* printed on Kathmandu Posts on September 2, 2006. he added it must exert social pressure against willful defaulters from the state's facilities, should be implemented. Addressing the banker's conference 2006' Ken Ohasi, Country Director of WB, viewed the defaulters issue was no longer an issue of survival of banks, but the issue of survival of the market system in Nepal. He said the political leaders and the government should deal with the matter seriously and urgently.

In an article *"Is Biz Community Only the Culprits"* published on Kathmandu Post on Aug 28, 2006, Arun K. Subedi, Industrialist, Printing and Packaging, Hetauda argues that business community not solely responsible for the growth of NPA but bankers also equally responsible. He says the fails to analyze study the report financially, managerially and technically. He says it is the cash flow that repatriates the loan not the collateral which most bankers rely on. So, existing investigation and analyses must be concentrated on project status. He further states it is the duty and right of the banker to undertake the project before the problems arise because a bank is not only the financier but also the partner of the project. Hence, the bank must undertake and start to recover the loan by operating and managing it. He agrees writing off the loan may be controversial but necessary. He gives the true example of Haratic Wire. It took loan for exporting copper wire to India and at that time wire export to India was free. The company commissioned and started to production. Then India band the copper wire import and now it is a sick unit and promoters are blacklisted. In such case, bankers together with the promoters have to sell the properties. If it is inadequate for recovery, the loan is to be written off instead of claming unrelated properties of the promoters. They must not be blacklisted because they could promote other business. He supports liabilities of particular company are to be limited to company.

An another article "*Defaulters Are The Villains of Market Place*" published on Katmandu Post of same day, Rajib Upadhya, Sr. External Affairs Specialist of the WB, says defaulting or the impunity with which borrowers refuse to pay back their bank loans on various pretext is symptomatic of the larger governance problem that bed evil Nepal. He writes further commercial banks have been a source of easy money for a predatory and politically well connected clique. He says when banks have provision for these losses, the cost of borrowing rises for honest business and the return on deposits diminishes for the depositors, everyone suffers. He warns ahead, if defaulting continues the government will have to spend money from its budget to fix the problem at the expense of programs that would help the poor.

Published on the Kathmandu Post an article "*Defaulters Jeopardizing Reforms*" written by former vice chairman of NPC Dr. Shanker Sharma states Nepalese financial sectors are suffering from three major problems. First, despite reform policy the progress of reduction of NPL has remained slow still 5% of GDP. Second, NRB's capacity for prudential supervision and regulatory functions is weak and needs to be strengthened especially in the areas of enforcement of the banking regulations and taking action against financial institutions involved in the irregularities of the financial norms. Third, Nepal being a member of WTO, the country should prepare itself to manage entry of foreign financial institutions. He says if the bank has to be rescued by the taxpayer's money the fiscal system will crumble. He states most of the today's defaulters, according to the bank did not pay back their loans of these two state bank, RBB and NBL, even when the economy was doing well and the external sector was relatively favorable. He further insists the problem of NPL can not be minimized if we only squabble around the issue of definitions. The government should take strong action against the defaulters, once the committee formed by NRB feels that the party concerned is a willful defaulter .The government and NTB should provide maximum help to the banks in recovering the bad debts. He accuses the judicial system for giving stay orders for long time and it is weak in handling recovery and other bank and related cases. Any improvement in legal system and in strengthening of judiciary to make it more professional ha to be done urgently, he suggest. He further strengthens his suggestion by giving many examples of countries who once suffered from huge NPA in their banking system got back on tract by strong Debt Recovery Tribunal. He supports that DRT, established by the government of Nepal, should be further strengthened for minimizing the problems of NPL of the banks.

In an article "*Bank Defaulters*" published in Kathmandu Post written by a former senior economic advisor, Government of Nepal, Ministry of Finance, and a former executive director, Nepal Rastra Bank, Tula Raj Basyal writes-By now, Dr. Bhattarai must have realized that managing the Nepali economy is far more complicated than waging a people's war. At least, during war, if you are short of money, there are banks to be looted and properties of the "feeling feudal class" to be captured. If there are no banks, you have other methods of extracting money. And they all worked with military precision. It will be fascinating if somebody some day did research on how the Maoists financed their people's war. If the Maoists are practical enough, there is immense scope for exporting their financing techniques, not their.

Unfortunately, wartime methods do not work during peacetime. Dr. Bhattarai must be doubly frustrated as he encounters a series of bottlenecks while implementing revenue generating schemes like VDIS, tax revenues and recovering bank loans. He is also working hard to introduce austerity measures to control extravagance in public spending. In the coming days, I will take up the issues of how corruption has churned out public revenues, expenditures and assets. In this issue, let us look at the faults of bank defaulters.

On Jun. 30, 2006, Kantipur had carried a small news item in its business and economy section. The gist of the news goes like this. A group of b bank debtors in Nawalparasi unionized themselves demanding that interest payments on bank loan up to Rs. I million be waived besides relaxing repayment of the principal. If their demands were not fulfilled, they threatened to release the names of bank managers and other staff members who took bribes while issuing loans. In his budget speech, Dr. Bhattarai did waive loans up to Rs. 30,000 and interest and penalties on loans ranging from Rs. 30,0000 to 1,00, 000. He is now pointing his guns at the big borrowers.

The recent naming and shaming of 339 bank defaulters showed that they collectively owned a cool Rs. 16 billion, excluding interest which may total several times this amount. Segregation of the Bank defaulters showed that nearly 30 percent of then (101 individuals) owned over 81 percent of the loans (Rs. 13 billion). This nearly resembles the 80:20 rule -80 percent of the problem is being explained by 20 percent of the causes.

The Problem of massive loan delinquencies came to light in the early 200s when Nepal went into a deep financial crisis, and the donors pushed for country fiduciary risk assessments prior to making their commitments on budgetary support. The businessmen were drawing massive loans without ever bothering to pay them back.

The picture become clearer when one looks at high degree of financial lever –age (high debt / equity ratio) in Nepali business companies. Literally, with corruption, debt capital was coming as risk –free capital by 2004, defaulters exceeded Rs. 40 billion, representing 30percent of all credit flows in the country. This implied as serious impending financial disaster, defaults on loan repayments by 1,159 debtors who had borrowed over Rs. 2.5 million each from two major banks, Nepal Bank Ltd. and Rastriya Banijya Bank, reached a hopping Rs. 15.67 billion. Nepal's Credit Information Bureau still carries a listing of the 2,225 defaulter (www.cibnepal.org).

The largest corruption case ever filed by the commission for the investigation of Abuse of Authority (CIAA),dubbed 1.2 billion. To add insult to injury, even the then sitting president of the Federation of Nepalese Chambers of commerce and Industry (FNCCI), the apex body of the business community in Nepal, was accused of major bank default.
Last December, while evaluating a private sector led anti-corruption project in Nepal, implemented by the FNCCI with DFID (UK Department for International Development) money, this scribe was in formed, in a hush-hush tone, how British taxpayer's money was going to be justified by supporting an anti-corruption project headed an accused banks defaulter. When it comes to anti-corruption as we are in discerning remedy from malady and malady from remedy. By December 2006, over 2,000 cases were pending at the debt Recovery Tribunai, out of them, 962 cases totaling Rs. 13.48 billion were from Nepal Bank Ltd. alone. The massive default on loan repayments was one of the several factors that pushed the then government to award management contracts of the bank to foreigners. The then finance minister, Dr. Mahat, knew clearly why he was doing this amid opposition from the unions and the private sector. Definitely, a foreigner without social attachments can better recover debts than a native manager.

The then government went to extent of blacklisting the defaulters, boycotting them socially, seizing their passports and sending letters to foreign embassies requesting them to deny travel visas to the listed defaulters. Businessmen tried to divert attention by asking the government to define willful and non-willful defaulters.

An average Nepali would hardly get an opportunity to see a banknote of Rs.1000 denomination. Taking of millions and billions of rupees is definitely a mind-boggling exercise. Therefore, to simplify the matter, here is an anecdotal evidence related by no other than Suryanath Upadhyay himself in his recently published memoirs : A piece of land bought today for Rs.500,000 was re-valued the next day at Rs.9.5 million to be used as collateral for a bank loan .Got my point? Some people are on a looting spree here.
In an article "*Cheque it Out*", published in Kathmandu Post, written by Mr. Suman Joshi, CEO of Laxmi Bank writes-While the fundamentals of corporate governance are the same for all sectors of the business world, the banking sector is unique in some respects. Firstly, Nepali banks have been much more transparent than businesses in other sectors of the economy. The banking sector profitability has been a topic of innumerable discussions and critique. This is because banks publish their performance figures at regular intervals; hence people know how much money they are making. The profits of other businesses generally are neither disclosed nor discussed, although we do have companies with earnings greater than those of some banks do.

Secondly, banks carry a more stringent and far heavier regulatory burden. The health of the banking sector has huge implications for the wider economy. A significant portion of the country's wealth is tied up with banks in the form of deposits and equity. The banking system is the lynchpin of the nation's payment systems. Not to forget, the management skills and professional development achieved by the Nepali Banking sector are far greater than those of Nepali Businesses. Banks, therefore, must lead the way in development of human resources and governance standards.

Thirdly, the relationship between management and the board plays a prominent role in the governance of banks. The prominence is heightened in the Nepali context as our boards tend to comprise investors many of whom are not conversant with modern banking practices. Nevertheless, given the nature of the business, it is crucial that board members be sufficiently well versed in financial and regulatory issues and aware of the many details of the bank's state of affairs. Communication changes between the board and management, therefore, should be both open and robust.

Regulatory compliance and effective board oversight undoubtedly are formidable pillars in the corporate governance scheme of things. And appropriately designed norms and regulations can play a vital role in supporting a healthy financial system. Nepal Rastra Bank must lauded for its initiatives during the past few years towards introducing and implementing prudential directives for the banking sector. These directives, apart from setting the rules of the game, have a clear focus on defining the role and responsibility of the board in practicing and upholding good governance. There are cases where the board members to seek explanations on affairs connected to the running of banks, thus keeping them fully aware of their accountability. Some of the actions in recent months have been far more stringent. Regulatory directives require that the board, management and the staff adhere to a code of conduct designed to uphold the interest of the bank they are associated with. Slowly but surely, banks are working toward improving their governance standards.

But while regulation is essential, it is not enough to improve governance standards. Efficacy of rules-based regulatory supervision is increasingly being questioned. Many unintended consequences of directives and regulations can create barriers to competition and have a different or even opposite effect from what was originally intended. Furthermore, the rules are not always consistently applied. Frequent changes in regulations that are not necessarily convergent bring abut different sets of problems. It certainly would not be fair that a bank that operates under a certain regulatory regime finds that the rules of the game have changed overnight.

What is critical is to improve the competitive environment for banks, which is itself will work as a catalyst to improving disclosure levels and responsible management practices.. In order words, healthy competition can serve as a key driver of good governance by way of increased market demands for better transparency and accountability. Freeing up markets gives more flexibility to the stakeholders-including depositors and shareholders-to provide the signals that compel banks to behavior in manner consistent with their financial standing. In a genuinely competitive market, excessive risk-taking or lack of transparency by a bank automatically leads to greater uncertainly and lower efficiency. Customers then respond by taking their business else where; investors b6y offloading their holdings.

What can be done to improve the competitive environment? Well, first and foremost, bank managements and boards must accept the banking business as a long-term proposition and avoid taking shortcuts. Not all banks take shortcuts, but the market believes that there are few who do. Banks owe it to the investors and depositors to be transparent and accountable. Other than that, enhancement in effectiveness of regulatory supervision is necessary to ensure that a true and correct picture of bank's state of affairs is presented to the market on an ongoing basis.

However, excessive emphasis on a rigid regulations-based approach diverts attention from the prime objective of promoting free and fair competition. Also, within individual banks, such emphasis runs the risk of encouraging a passive attitude towards governance, reducing compliance to mere "reporting" activity. It encourages complacency rather than dynamic and proactive management of governance issues. Aregulatory intative must not stifle competition but make markets more efficient. The primary goals ought to be to foster a culture of creativity, innovation and entrepreneurship and to protect the banks from becoming uncompetitive and eventually failing. It should also aim to leverage the unbanked and unarticulated customers.

An equally important element of good corporate governance is the ethical standard of the bank management or the board. Corporate governance codes are not worth the paper they are written on if they are divorced from ethical leadership. The management culture must embody committed and responsible business ethics. Core values must be established at the top and clearly enforced throughout the bank. Individual responsibility and accountability must be clearly defined and stressed.

In conclusion, initiatives aimed at improving corporate governance across the banking sector must encompass regulatory compliance with healthy competition and a high ethical standard. A vigorous regulatory framework is, of course, essential. But it needs to be alive, debated and understood through regular dialogue between all the stakeholders. The need for good corporate governance does not eliminate the need for value creation via new products, improved services and a larger market, which is why a healthy competitive environment is highly desirable. Good corporate governance is also a management issue, in that the right ethical tone at the top is essential, which must further create an organizational culture where a high standard of ethics embraces every aspect of a bank's conduct. Unlike many other businesses, a bank must have a long-term orientation.

In an another article "*The Economic Outlook*" published in Kathmandu Post, written by Bishwambher Pyakuryal, professor of economics at Tribhuvan University writes-It all started in midsized US cities such as Phoenix and Las Vegas. The banks which financed the housing booms of those towns then pooled their loans, tranched and resold them to willing investors via securitization. This opportunity to immediately sell the loan incentivized these banks to innovate new methods to increase their lending. In particular, banks started to issue adjustable rate mortgage (ARM) to even those people with credit rating lower than 600 called "sub prime" borrowers who had defaulted or delayed in their credit payment in the past. It was a classic moral hazard problem: since the banks could "sell" the loans to other investors, they were careless in screening the borrowers. A bubble started to form in the housing market, abetted also in part due to a 1997 law that allowed capital gain in houses to be deductible, making speculation very attractive.

During the last decade, several banks of Nepal deposited their money in India, due to lack of investment opportunity at home, which had depressed the interest rate in Nepal. Around the same time, the interest rate was also low in the US economy because many Indian, Chinese and other banks had bought US securities to hedge against currency depreciation against the dollar. Several Asian governments also bought US securities to peg the exchange rates at the level their export-oriented industries find favorable. Those how purchased risky securities could also purchase credit default swamps (CDS) – an insurance against default. For a brief time, these layers of financial instruments made almost everybody feel they were safe, and that they were getting their share of the housing market boom.

The availability of cheap loans to buy houses increased their demand, which led to the increase in the price of houses. However, several of these buyers were speculators, who did not intend to line in the houses they bought. It was inevitable that once demand for houses started dropping, they would try to sell the houses quickly and if they couldn't do that, they would default on the payment. In February 2007, the first sign of default in mortgage arrived: mortgage related index, ABX, dropped. Then, in May, UBS closed Dillion Read, its hedge fund, after incurring a loss of 125 million dollars. In July, the major US home loan provider, Countrywide Financial Crop, reported a drop in earnings, and National Association of Home Builders reported a year-on-year home sale drop of 6.6%.In Europe, a German Bank, IKB, had to be rescued, because its home related roll over asset-backed papers couldn't be sold in the short term liquidity market and it lacked enough liquidity to operate. After this incident, banks became cautious, and became reluctant to extend loans to other financial institutions. Meanwhile, this slowly resulted in the liquidity crunch for firms.

To mitigate this situation, the Fed lowered the discount rates by half a percentage point. The measure worked temporarily, as funds operated by foreign governments (sovereign funds) responded by investing 38 billion in the November 2007-January 2008 period. In January, Fitch downgraded Ambac, a normally reliable giant that insures municipal bonds against default, which sent a shock wave throughout the world

In India, where the stock market exchange SENSEX had risen from 13,000 in March 2007 to its all time high 20,873 in January, decline in the stock market started at this period. Some major Indian firms which were able to raise money abroad to finance their projects suddenly faced a very risk-averse international financial market. Later, in a talk at the International Monetary Fund (IMF), Dr Rakesh Mohan, deputy governor of the reserve Bank of India, said that if the situation persisted, these firms would be forced to seek loans domestically, driving interest rates up. This probably of Nepali banks deposition their money in India.

Around that time, a Saudi-backed investment firm, Carlyle Capital, couldn't meet its margin calls, and a fraction of its assets was liquidated. Bear Stearns was a major creditor for Carlyle, and this action affected Bear Stearns. The hedge fund clients of Bear Stearns felt uneasy about this, and there was a run on the firm the next day. The New york Fed then arranged an overnight deal for JPMorgan Chase to acquire Bear Stearns. During the July-August period, IndyMac, three large mortgage firms, were put in conservator ship by the Federal Deposit Insurance Corporation (FDIC) and the US government respectively. In September, Lehman Brothers declared bankruptcy and Merrill Lynch was acquired by Bank of America . In India, this alarmed authorities, and they asked the banks to furnish their exposure to Lehman Brothers. Out of 77 banks, 14 banks reported their exposure to Lehman Brothers (The concern for Nepal lies here: in particular, it is crucial to find out whether our banks have any ties with These Indian banks and the extent of such ties in order to estimate the exact impact on Nepal.) On Sept.16, 2008, AIG, a big insurance firm, saw its share price plunge by 90 percentages. Meanwhile, though more than 20 banks failed in the United States during this period, Asian banks remained largely immune from the crisis. The attitude in Asia can be summarized by the result of a study done by Reserve Bank of India in September 2007 which concluded that there had been no direct exposure of Indian banks to the sub prime disaster of the United States. However, as it turned out later, some banks had purchased collateral debt obligation of American banks, and would suffer a bit.

Back in states, the way thee firms fell had a significant effect on the trust among firms and banks. Firms stopped trusting other firms, and the mechanism that was greasing the wheels of the giant financial machine almost stopped functioning. Panic spread, and in the chaos, Washington Mutual, a 158 year old bank, became victim of an electronic bank run, and was sold to JPMorgan Chase by FDIC. Another big bank Wachovia was sold to wells Fargo in September. During this panic, firms, state and local governments too reported difficulty in getting credit. To restore normalcy, The US government passed an

800-billion-dollars bailout package. The market however though it was too small, given that 8 trillion dollars had been lost in one previous year in the stock market and reached negatively to it. The Fed meanwhile kept on buying asset backed securities and reduced the interest rate to almost zero in December, just to facilitate the credit access of the firms.

Around this time, the global fiscal crisis alerted Nepali businessman and Binod Chaudhary emphasized that the first order effect – in which Nepali firms were directly affected – would be significant, whereas the finance minister and others seemed to think first order effect would be insignificant while allowing for second order or higher order effect. In India, the equity market suffered because of reversal of portfolio equity flows. It caused negative effects on the Forex market and liquidity conditions. Besides that, India as a country was deemed to be unaffected. Assuming Nepali financial institution only foreign exposures is to Indian banks, the Nepali financial ministers and other who claimed Nepal to be quasi-immune from international financial system, were right. Furthermore, the Nepali equity market is not financed with foreign money; the corporate world is not big enough to raise money for the international sector, so, it is unlikely to feel any heat due to the liquidity crunch. However, policymaker perhaps underestimated the effect by ignoring a channel through which Nepal could be hit badly: foreign employment of Nepali youth.

Nepal’s exposure to the foreign world has always been limited. Nepal’s major export has been its low-skilled youth, which are normally employed in recession proof sectors such as military or household defense. Lately, the Nepali youth has responded to the labour demand surge in Arab countries. The surge was due to extra money Arabs reaped during oil price hike. Some of the extravagant projects initiated in the Arabian countries are likely to suffer now, and their labour demand will decrease. To what extend will it affect Nepal is difficult to predict. Given Nepal’s labour market situation, in which year roughly 250,000 people enter the labour market, and given an overall hostile attitude towards industrialists in current Nepal, mainly because of powerful labour unions, new job creation by the industrial sector has come to a standstill. In this context, how those unemployed and returned youth will behave will determine the true effect of the financial crisis.

2.2.2 Review of International Studies

In order to get the idea of analyzing NPA, the researcher has visited several web sides. No actual core studies were found during web search. How're, various journals, working papers & seminar papers from the web sites of IMF, world bank, IFC & Nepal Rastra Bank in course of searching pilot studies were found. In order to gather concepts and conclusions about the various aspects of non-performing asset the researcher has collected and studied those journals, working papers & Seminar papers. Conclusions drawn from those studies are presented here in below:

Adrian M. Bloem and Corneils No. Gorte have classified non-performing assets according to internal statistical manuals and international norms of Banking and accounting institution. They analyzed the NPA's on both the standards as mentioned above. Main finding of their study was the income effects of NPA as the NPAs reduce the pie of earning assets.

Luis Cotbaria & Inwon Song, on their working paper entitled "*Loan Review provisioning and Macroeconomic Linkages*" Luis Cotvaria & Inwon Song analyzed the classification of Loans with their respective provisioning effect and trace out the linkage of NPAs' with Capital Adequacy Ration. They find out the provisioning for NPA (Specific Provisioning) could not be included in Capital fund but it reduces the portion of net income by eating through means of provisioning for NPA thus, NPA reduces the Capital adequacy ration.

Lue Laeven and Giobanni Majononi analyzed the relationship of loan loss provisioning with the loan portfolio of large commercial Banks in different geographical areas of the world. Their studies revealed that a sound bank should show positive association between the amount of loan loss provisioning and the growth of loan portfolio. In their conclusion they are station that " We find the positive link between earning provisioning is stronger for countries with highly in development countries than in developing countries".

Alain Laurin and Giovanni Majnoni presented the finding of World Bank survey of loan classification and provisioning practices in the countries represented on the BASEL Principal Liaison Group. Through their working paper they find that differences in provisioning and classifications approaches have made it difficult to compare the banking system weakness across different region, making peer pressure and market discipline difficult.

Kay Ellen Herr and Goe Miyazaki find out the securitization as a better solution to solve the problems of non-performing assets. They analyzed that securitization would helps the Banks to reduce the levels of non performing assets from their balance sheet and enables them to get tax benefit which would otherwise not been by simple write off of non-performing assets.

Prashant R. Reddy, on his thesis entitled " *A Comparative Study of Non-performing Asset in India in the Global Context: Similarities, Dissimilarities and Remedial Measures"* Mr. Prasant R. Reddy analyzed the noticeable improvement in the financial health of India banking sector as the ratio of gross NPA and net NPA to total credit have been falling from 23.18% and 12.4% to 14.46% & 6.74& respectively. On his research he further nailed that " the level of NPA on large industrial sector is very high in India but the overall level of NPA of Indian Banking Sectors seems low mind manageable in comparison to chain's 28% and Indonesia's 26%.

2.2.3 Review of Previous Studies in Nepal

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, total deposits and total lending of Nepalese Commercial banks. He says escalating level of NPA has been becoming great problem in banking business in the world. It is well known fact that the bank and financial 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 Bangladesh 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. Heb warns ahead if the increasing trend remains continue in coming days, the situation will be unmanageable. He states the commercial banks could not give full attention towards supervising their lending and towards recovering their bad loans perfectly. He recommends to overcome the problem of NPA than being loan a risky asset, effort should be made to have proper control in every step of loan management. Corporate structure of the bank play key role in the effective loan management. He further insists the banks should take collateral from the borrower so that in the event of default this collateral is disposed for recovery of loan. Proper financial analysis of the borrower should be done by the bank. He thinks the fundamental changes are necessary to correct business practices based on connections, bribery and lenient credit screening by banks. He has followed descriptive research design with analytical approach. His research is based on secondary data. He considered twelve commercial banks as target population which are inside the Kathmandu Valley as on mid July, 2003 among them five banks are taken as sample bank by the researcher. He has used simple percentage tool like arithmetic tool, Karlpearson coefficient 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 (2005) aims to study the level of NPL in 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 or not in his thesis titled "*Non-Performing Loans of Nepalese Commercial Banks*". He found the level of NPA in Nepalese banking sector is alarming and increasing. His study is focused only on five banks i.e. Nepal SBI Bank, Nepal Investment Bank, Nepal Bangladesh Bank, Bank of Kathmandu and NABIL bank Ltd.

Only. Level of NPA in the sample banks is not so alarming and the situation is quite satisfactory. He further states not any bank could meet the requirement of NRB directives. He thinks that corporate structure of the bank play key role in the effective loan management .lack of proper financial analysis, management inefficiency, and the 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. His research is based on secondary data. He considers twelve commercial banks as target population which is inside the Kathmandu Valley as on mid July, 2003. Among them five banks are taken as sample bank by the researcher. He has used simple percentage tool like arithmetic tool, Karl Pearson 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.

Saroja (2006) says ineffective credit policy, political pressure to lead to uncreditworthy borrower, overvaluation of collateral are the major cause of mounting non-performing assets of the banks in her thesis titled "*A Study of the Non-Performing Assets Of Commercial Banks Of Nepal"* To identify effects of NPA on ROA and ROE, to solve one of the cases of the NPA i.e. analysis and interpretation of the case and to find out the factors behind the accumulation of NPA, to analyze whether the Nepalese commercial banks are following the NRB directives regarding loan loss provision for NPL/NPA or not and to recommend to overcome the difficulties in managing NPA . She takes N ABIL and SCBNL for the sample of the study. She found negative correlation between NPA and ROA and VNPA and ROE of different commercial bank. She found that these two banks have NPL in control and accordingly provision for such loan. These banks are very much cautious about the matter regarding NPA. She states 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. Strict monitoring and control system should be there for timely recovery of the loan, she adds.

She recommends to create separate department in every commercial bank to control their NPA like credit appraisal dept., credit administrative dept., legal dept., etc. On the way of her conducting research, she follows analytical and descriptive research design in research methodology. Population for her study comprised all the license commercial banks of the country and sample for her study comprised two commercial banks namely NABIL and SCBNL by using judgmental sampling method. She thinks these two banks could represent true picture of so-called successful commercial banks that is why we select these banks as sample. Different kind 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.

Though these studies are formed to be quite useful in their own side but the question of NPA and it cause as well as effect on various aspects empirically and qualitatively in Nepal Bank & Banijya Bank, commercial bank is yet to be researched. These thesis are mainly focused 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% on overall NPA. Previous researcher have analyzed only other commercial bank' NPA problem. None of them could address the cause and effect of NPA in profitability of these two major commercial bank. NPA problem in these two commercial bank are mounting regularly. The problems are needed to be solved promptly. In view of these, this study has been based on the various contributing factors that increase NPA level in these banks specifically in Nepalese perspective and its effect on profitability position on the banks. The methodology adopted in this research are research design, population and sample, type and nature of data, data gathering procedure, data processing procedure, techniques of analysis and so on. Secondary as well as primary data are used for the purpose of the study. Primary data is based on opinion survey, which focused on the causes of NPA from the perspective of employees of the sampled banks.

2.3 Research Gap

There is a certain gap between the present research and past research. Previous several researches are done in this topic called *Non-performing Assets*. Previously many researches were done by using secondary data. The information of this very research is also based on secondary data as well as primary data, but many effective tools and techniques are used to get the desired result as per the objective of this study. To analyze the facts financial tools as well as statistical tools were used to get the desired objective of the study. Financial tools include ratio analysis and the statistical tools include mean, standard deviation, coefficient of variation, correlation of coefficient analysis and also include trend analysis. In present context, these are the heart issue in Nepalese commercial banks. The previous researchers could not submit the present fact. This research will deliver the answer to the recent questions and it will also give the latest information about the current practices of concerned commercial banks.

CHAPTER-III
RESEARCH METHODOLOGY

3.1 Introduction

Research Methodology describes the entire methodological approaches employed in the study. It is the procedure by which researchers go about their work of describing, explaining and predicting phenomena. Mostly in the case of the empirical studies, the consistencies of findings are solely based on empirical methodologies it has employed. Research methodology is way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. In it we study the various steps that are generally adopted by a researcher in studying his research problem along with the logic behind them.

Research methodology refers to the various sequential steps to be adopted by the researcher while the studying a problem with certain object in view. Its focus is made on the application of the technique and procedure to analysis the relevant variables to see the basic relationship between relevant topics. To achieve the basic objectives of the study, this chapter has been divided into 5 sections. Sections-1 represents the research design of the study, while section-2 describes the nature and source of data from the related organizations or institutions. Section-3 indicates the sample and population size of the Nepalese Commercial banks. Sections-4 explains the method of analysis employed in interpretation of data. Similarly, conclusion and results verification defines on key terms are indicated, in 5 sections.

3.2 Research Design

The formidable problem that follows that the task of defining the research problem is the preparation of the design of the research project, popularly known as the "research design". Research design stands for advance planning of the methods to be adopted for collecting the relevant data and the techniques to be used in their analysis, keeping in view the object of the research and the availability of staff, time and money *(C. R Kothari 2005:32).*

"The Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance. The plan is the overall scheme or program of the research" *(Kerlinger, 1986:275).*

"A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure" *(Claire Selltiz, 1962:52).*

In fact, the research design is the conceptual structure within which research is conducted; it constitutes the blueprint for the collection, measurement and analysis of data. Decisions regarding what, where, when, how much, by what means concerning an inquiry or a research study constitute a research design. As such the design includes an outline of hat the researcher will do from writing the hypothesis and its operational implications to the final analysis of data. Preparation of the research design should be done with great care as any error in it may upset the entire project. Research design, in fact, has a great bearing reliability of the result arrived at and as such constitutes the firm foundation of the entire edifice of the research work.

In detail, the research design has main two purposes. The first purpose is to answer the research question or test relationship; then other second purpose of a research design is to control variance. Thus research design is a plan of action to be carried out in connection with a research project. This study is based on both secondary and primary data. The requirement primary data and secondary data have been collected from various sources covering a period of 5 (five) years for Nepalese Commercial Banks.

To study seeks to analyze the impact of NPA on profitability, NPA effects on externally and internally. The research design of the study is therefore combination of two major research designs i.e. description design for secondary data and survey research for primary data.

3.3 Nature and Sources of Data

This constitutes the most important factor affecting the choice of a particular method. The method selected should be such that it suits the type of inquiry that is to be conducted by the researcher. This factor is also important in deciding whether the primary data are to be used and the data already available (secondary data) are to be collected.

Generally this study aims to assess the NPA level and its influence on profitability of the banking system, so as to the necessary data and information have been collected from both primary and secondary sources. The primary sources are: data has been collected o visit and ask the questionnaire through the individual of banking staffs as well as most of the data are collected from the secondary sources. Those data are collected and contributed and Banks & Financial Institutions Regulation Department of Nepal Rastra Bank.

3.4 Population and Samples of Study

From a statistical point of view, the term ‘Universe’ refers to the total of the items or units in any field of inquiry, whereas the term ‘population’ refers to the entire group of people, events or things of interest that the researcher wishes to investigate, or total of items about which information is desired. All units in any field of inquiry constitute universe and all elementary units constitute population.

A sample is a collection of items or elements from population or universe. Hence, a sample is only a portion or subset of the universe or population. It comprises some observations selected from the population. Sampling may be defined as the selection of some part of an aggregate or totality on the basis of which judgment or inference about the aggregate or totality is made.

During the last two and a half decades, the Nepali financial system has grown significantly. The banking environment has gone through a sea change. At the beginning of 1980, there were only two commercial banks and two development banks. After the adoption of the economic liberalization policy, particularly financial sector liberalization, new banks and non-banking financial institutions came into existence. Consequently, by the end of mid-July 2008, altogether 235 banks and non-banking financial institutions licensed by the NRB were in operation, constituting 26 “A” class commercial banks, 58 “B” class development banks, 78 “C” class financial companies, 12 “D” class micro-credit development banks, 16 saving and credit cooperatives and 46 NGOs. Furthermore, seven development banks and 12 finance companies agree in the pipeline.

The final step in the sampling process is the actual selection of the sample elements. Sample size has drawn from the elements of the target population. We drew only two Commercial Banks in the sample number one has their central office is outside in Kathmandu; then remaining has in the Kathmandu Valley and especially pure Nepalese Management bank and other is continuously Foreign and Nepalese Management(Joint Venture) Bank.

The following table, below clearly describes about total population, target population and sample drawn.

Table 3.1

List of Licensed Commercial Banks in Nepal

S.N	Names	Operation Date (*A.D.*)	Head Office	Paid upCapital (*Rs. In Million*)
1.	Nepal Bank Limited	1937/11/15	Kathmandu	380.4
2.	Rastriya Banijya Bank	1966/01/23	Kathmandu	1172.30
3.	Agriculture Development Bank Ltd.	1968/01/02	Kathmandu	10777.50
4.	NABIL Bank Limited	1984/07/16	Kathmandu	965.75
5.	Nepal Investment Bank Ltd.	1986/02/27	Kathmandu	2407.10
6.	Standard Chartered Bank Nepal Ltd.	1987/01/30	Kathmandu	932.00
7.	Himalayan Bank Limited	1993/01/18	Kathmandu	1216.20
8.	Nepal SBI Bank Limited	1993/07/07	Kathmandu	874.50
9.	Nepal Bangladesh Bank Ltd.	05/06/1994	Kathmandu	1822.70
10.	Everest Bank Limited	1994/10/18	Kathmandu	838.80
11.	Bank of Kathmandu Limited	1995/03/12	Kathmandu	844.40
12.	Nepal Credit and Commerce Bank Ltd.	1996/10/14	Siddharthanagar	1399.50
13.	Lumbini Bank Limited	1998/07/17	Narayangadh,	1015.30
14.	Nepal Industrial & Commercial Bank Ltd.	1998/07/21	Biaratnagar	1140.50
15.	Machhapuchhre Bank Limited	2000/10/03	Pokhara, Kaski	1479.10
16.	Kumari Bank Limited	2001/04/03	Kathmandu	1078.27
17.	Laxmi Bank Limited	2002/04/03	Birgunj, Parsa	1098.10
18.	Siddhartha Bank Limited	2002/12/24	Kathmandu	952.20
19.	Global Bank Ltd.	2007/01/02	Birgunj, Parsa	1000.00
20.	Citizens Bank International Ltd.	2007/6/21	Kathmandu	1000.00
21.	Prime Commercial Bank Ltd	2007/9/24	Kathmandu	700.00
22.	Sunrise Bank Ltd.	2007/10/12	Kathmandu	875.00
23.	Bank of Asia Nepal Ltd.	2007/10/12	Kathmandu	1000.00
24.	Development Credit Bank Ltd	2001/01/23	Kathmandu	1107.5
25.	NMB Bank Ltd.	1996/11/26	Kathmandu	1100.00
26.	KIST Bank Ltd.	2009/05/07	Kathmandu	200.00

Source: - www.nrb.org.np(mid-jun-2009

3.5 Data Collecting Procedure

Whenever the source and nature of data have been identified, the required data (primary and secondary) of this study have been gathered or collected from the respondents of concerned banks and annual reports through the head office of the concerned sample banks research departments of Nepal Rastra Bank, different websites have been taken for the period of five years i.e. during fiscal year 2058/2059 to 2062/2063.

3.6 Data Processing Procedure

Data are collected from various sources were in raw from, which are included the annual financial report of concerned banks, the related publications of NRB and relevant websites of concerned banks. They were classified and tabulated as per the nature of the study and in accordance of the data. The tabulation is specially made on the basis of their consequent five fiscal year's data available and need base headings" such as Performing Loan, total NPA, Substandard Loan, Doubtful Loan and Bad Loan. The tabulation mainly contains the calculations of the percentage of required variables, as it is needed. The Tabulation also comprises the Total Assets. Total! Lending , Calculation of the return on Total Assets and the return on Shareholder's Equity. Simple percentage tool was used as arithmetical tool and Karl Pearson Coefficient of Correlation was also used as a statistical tool.

3.7 Nature of Survey

The primary data are collected from the concerned sample five banks. It has basically designed for the assessment of internal factors having growth of NPA level, whether or not to be followed of NRB has been gathered and enumerated by the direct questionnaire through the respondents/staff of sample Commercial Banks. Their details are arranged and analyzed in the fourth chapter.

The researcher has been directly approached to the related department of Banks staff and asked the question them and they had answered, which are maintained in last annex-1 chapter of this thesis.

3.8Research Variables

As being the research was mainly based on NPA, the level of NPA in different parameters was the major research variable. This study also focused on the level of performing Assets, affect of Non- Performing Assets on ROA and ROE of concerned banks.

Other research variables used in this study are Total Deposit, Total lending, Total Assets and Loan Loss Provision.

3.6.1 Total Deposit: The amount of Total Deposit in the sample selected banks.

3.6.2 Total Lending: Total Loan and advances and amount of bill purchased and discounted of the sample selected banks are studied as Total Lending.

3.6.3 Total Assets: Total Assets of the banks compromise all the assets of Balance Sheet item excluding preliminary expenses, profit 7 LOSS a/C and other fictitious assets (goodwill etc).

3.6.4 Net Profits: Profit earned during the normal course of Bank's operation (which includes profit and loss from bank's extra-ordinary items)after tax and other mandatory provisions required as per bank's policy. It is profit finally remained for appropriation purpose (dividend and other general reserve)

3.6.5 Loan Loss Provision: Loan Loss provision is the amount charged to profit and loss account against the revenue due to credit risk involved in loan and advances disbursed by banks.

3.6.6 Performing Assets/Loan: Performing Assets/Loan are loan and advances where interest and principal are regularly served as per the repayment commitment of the loanee.

3.6.7 Non-Performing Assets (NPA): Performing Assets/Loan are those loan and advances where interest and principal are not regularly served and defaulted as per the repayment commitment of the loanee.

3.6.8 Returns on Shareholder's Equity (ROE):The shareholder's equity comprises share capital, general reserves, profit & loss a/c and other reserves. In other word it is total assets – outside liabilities. Return on Shareholder's Equity is calculated as follows.

$$\text{ROE} = \frac{\text{Net Profit before Tax}}{\text{Total Assets}} \times 100$$

3.6.9 Returns on Total Assets (ROA): Return on Total Assets measures the utilization level of assets. In other words it shows how well a Bank is utilizing its assetsn in business Returns on Total Assets is calculated as follows.

$$\text{ROA} = \frac{\text{Net profit Before Tax}}{\text{Total Assets}} \times 100$$

3.9Statistical Procedures

Calculation of simple Coefficient of Correlation is used to found out the correlation between Return on Total Assets (ROA) and Non-performing Assets (NPAs) and correlation between NPAs and Return on Shareholder's Equity (ROE) as statistical tools whereas percentage calculation is used as arithmetic tool.

- **Correlation Analysis**

Correlation is defined as the relationship between dependent variable and independent variable. If the two or more variables are so related that the change in the value of dependent variable then they are said to have correlation. Correlation analysis is defined as the statistical technique which measures the degree and direction of relationship between the variables.

"Correlation may be defined as the degree of linear relationship existing between two or more variables. Two variable are said to be correlated when the change in the value of one is accompanied by the change of another variable." (Sitapit, Gautam, Joshi, Dangol, P 362).

The most important method of measuring the correlation is "Karl Pearsons's coefficient of correlation."

$$r = \frac{Cov(XY)}{(S.D)(S.DY)}$$

Where,

r = Coefficient of correlation

S.Dx = Standard deviation of X

S.Dy = Standard Deviation of Y

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

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum X)^2}\sqrt{n\sum y^2 - (\sum y)^2}}$$

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

r=0 there is no relationship between the variables

r<0, there is negative relationship between the variables

r□>0,there is positive relationship between the variables

r = 1, relationship is perfectly positive

r = -1, relationship is perfectly negative

CHAPTER- IV

DATA PRESENTATION AND ANALYSIS

4.1 Data Presentation and Analysis

In this chapter, data are presented and analyzed systematically to fulfill the objectives of the study. Inferences are made according to objectives stated in first chapter with relevant tables, figures and charts to make the data more understandable. Different arithmetical and statistical tools are used to analyze the data. In this chapter, efforts have been made to present and analyze the collected data.

Nowadays, Non-performing assets have been occupying major space in bank's total assets and total loan. It stands around 18% in Nepalese banking sector. Keeping this fact into the consideration, a provision has set by Nepal Rastra Bank in F/Y 2057/58 to control the level of NPAs of Nepalese commercial banks. According to that provision, every commercial bank has to classify its total loan and advances(including Bills purchased and Discounted) as Pass loan, Substandard loan, Doubtful loan and Loss/Bad loan on the basis of overdue aging schedule. NRB's directives for commercial banks 2061/62 direct commercial banks to maintain loan loss provision to find out and control the level of NPA in Nepalese commercial banks in future.

In the category of loan, Pass loan is called Performing assets and others i.e. Substandard, Doubtful and Loss loan are called Non-performing assets.

Data for five fiscal years have been presented starting from F/Y 2003/04 to 2007/08 to study and analyze the level of NPA. In this chapter conclusion is drawn regarding position of NPA of sample banks, various factors contributing for NPA, impacts of NPA on profitability and other suggestive measures for the management and mitigation of NPA's. To study about NPA ratio, analysis, trend analysis, Correlation analysis and opinion survey analysis is done.

4.2 Analysis and Presentation of NPA

An NPA is defined as an asset non-contributing to the income of the bank. NPA Analysis is one of the major aspects of this study that analyzes the level of NPA of Himalayan Bank Limited and Lumbini Bank Limited. While analyzing the NPA two categories of NPA are analyzed, one is Gross NPA and other is Net NPA.

4.1.1 Analysis of Gross NPA

Gross NPA is the total of those loans and advances which are due for more than 90 days. More specifically they are the sum total of loans and advances categorized as substandard, doubtful and loss according to NRB directives. Since the NPAs are the part of the banks assets, they are analyzed with respect to total assets and total loan.

Table 4.1

Gross NPA Level of HBL

(Rs. in Million)

F/Y	**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**			
Total Assets	24762	27844	29460	33519	36175			
Total Loan	11951	12424	14642	16997	19497			
Total NPA	1147	1001	1040	641	477	Mean	S.D.	C.V.
NPA As % of Total Assets	4.63	3.60	3.53	1.91	1.32	3.00	1.21	40.33
NPA as % of total Loan	9.60	8.06	7.10	3.77	2.45	6.20	2.68	43.19

Source: Annual Report of Himalayan Bank Limited

During the study period, Gross NPA with respect to total assets of HBL are ranges from 4.63% to 1.32% with average, standard deviation and C.V. of 3.00, 1.21 and 40.33 respectively. These statistical figures impel us to conclude that gross NPA with respect to total assets of Himalayan Bank Limited is in decreasing trend.

Similarly, gross NPA with respect to total loan of HBL are ranges from 9.60% to 2.45% with average, S.D. and C.V. of 6.20, 2.68 and 43.19 respectively. These statistical figures impel us to conclude that gross NPA with respect to total loan of Himalayan bank is in decreasing trend during the study period. In conclusion, we found that HBL's average NPA ratio as a % of total loan is 6.20% which is under the criteria of NRB's directives issuing for commercial banks for managing NPA.

Table 4.2

Total Assets, Total Loan and Total NPA of HBL

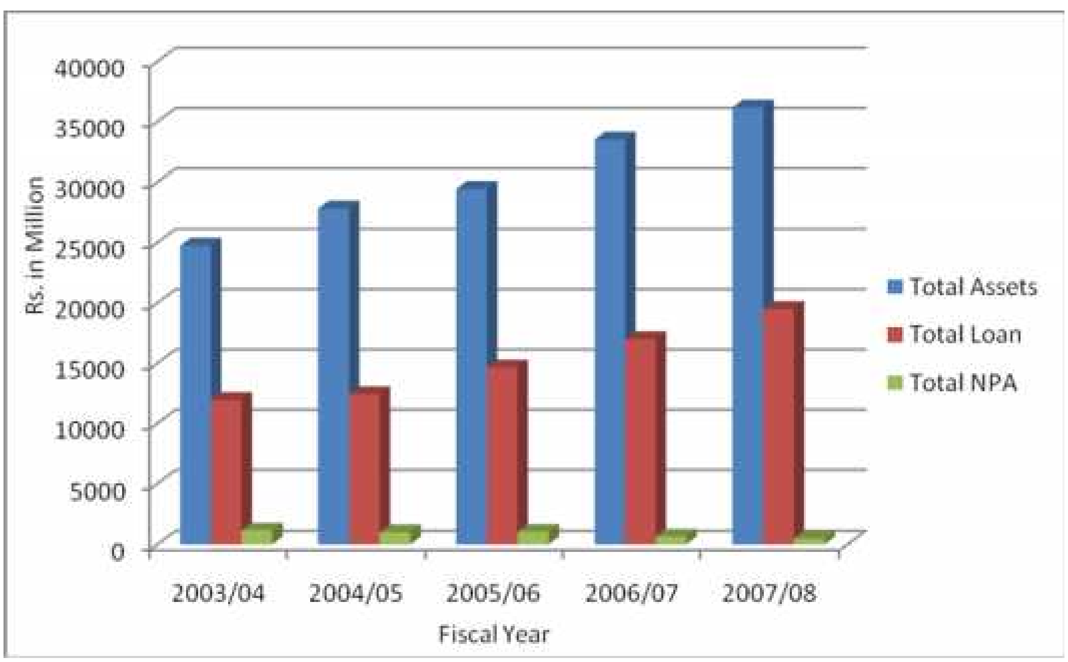
(Rs. in Million)

Fiscal Year	Total Assets	Total Loan	Total NPA
2003/04	24762	11951	1147
2004/05	27844	12424	1001
2005/06	29460	14642	1040
2006/07	33519	16997	641
2007/08	36175	19497	477

Source :Annual Report of Himalayan Bank Limited

Figure 4.1

Total Assets, Total Loan and Total NPA of HBL



From the above table and figure, we depict that total assets of the bank are in increasing trend. Likewise, total loan of the bank also is in increasing trend and non-performing assets of the bank is in fluctuating trend.

Table 4.3

Gross NPA Level of LBL

(Rs. in Million)

F/Y	**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**			
Total Assets	4364	4383	4259	5705	6151			
Total Loan	2980	3168	2984	3841	4489			
Total NPA	237	561	1339	1007	801	Mean	S.D.	C.V.
NPA As % of Total Assets	5.43	12.80	31.44	17.65	13.02	16.07	8.62	53.67
NPA as % of total Loan	7.95	17.71	44.87	26.22	17.84	22.92	12.41	54.14

Source: Annual Report of Lumbini Bank Limited

During the study period gross NPA with respect to total assets of LBL is ranges from 5.43% to 31.44% with average, s.d. and c.v. of 16.07, 8.62 and 53.67 respectively. This statistical figure reflects that the gross NPA level with the respect to total assets of LBL is high and is in increasing trend initially and then in decreasing trend after that. Similarly, gross NPA with respect to total loan of LBL is ranges from 7.95% to 44.87% with average, s.d. and c.v. 22.92, 12.41 and 54.14 respectively. These statistical figures impel us to conclude that gross NPA with respect to total loan of LBL is in increasing trend except in F/Y 2006/07 and 2007/08.Average NPA level of LBL is high.

Table 4.4
Total Assets, Total Loan and Total NPA of LBL

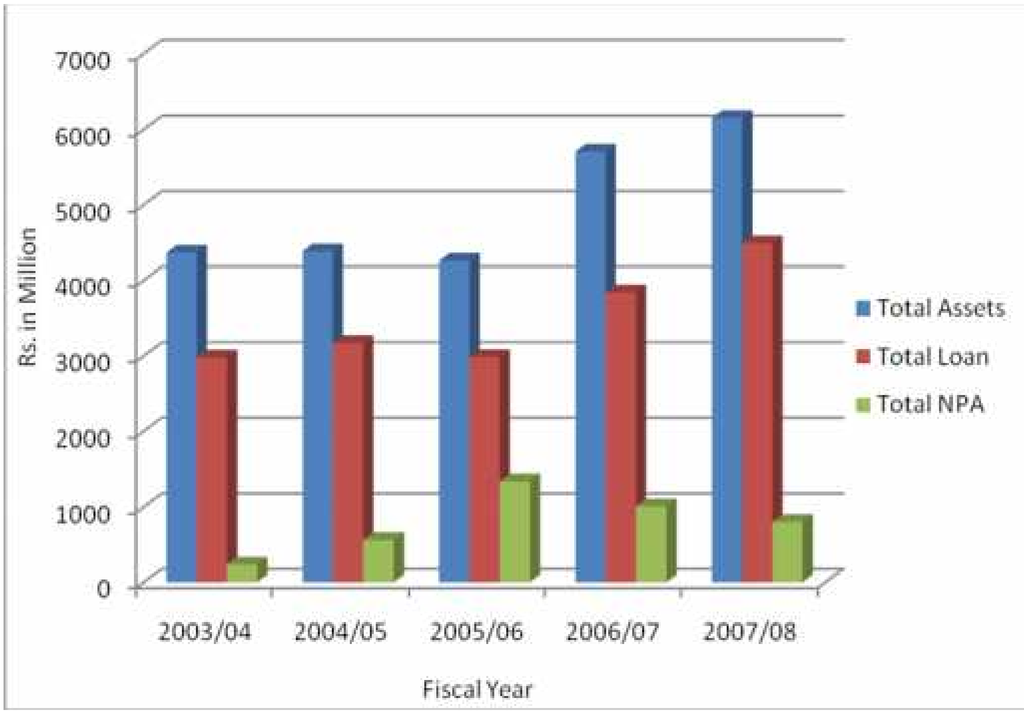
(Rs. in Million)

Fiscal Year	**Total Assets**	**Total Loan**	**Total NPA**
2003/04	4364	2980	237
2004/05	4383	3168	561
2005/06	4259	2984	1339
2006/07	5705	3841	1007
2007/08	6151	4489	801

Source: LBL's Balance Sheet

Figure 4.2

Total Assets, Total Loan and Total NPA of LBL



From the above table and figure, it reveals that there is fluctuating trend in the total assets. Total loan is also in fluctuating trend but total NPA is in increasing trend till F/Y 2005/06 and then in decreasing trend till F/Y 2007/08.It shows the improving situation of LBL.

4.1.2 Analysis of Net NPA

Net NPA is the total of those NPA against which there is no cushion maintained for possible loss on the value of loans. In other words net NPA is the value of loans after subtracting specific provisioning from gross amount of NPA. Net NPA reflects the actual position of bad loan on the total loan portfolio.Net NPA is also analyzed with respect to total assets and total loans.

Table 4.5

Net NPA Level of HBL

(Rs. in Million)

F/Y	2003/04	2004/05	2005/06	2006/07	2007/08			
Total Assets	24762	27844	29460	33519	36175			
Total Loan	11951	12424	14642	16997	19497			
Total NPA	1147	1001	1040	641	477			
Provisioning for NPA	186	58	145	90	58			
Net NPA	961	943	895	551	419	Mean	S.D.	C.V.
Net NPA as % of Total Assets	3.88	3.39	3.04	1.64	1.16	2.62	1.04	39.80
Net NPA as % of Total Loan	8.04	7.59	6.11	3.24	2.15	5.43	1.27	23.37

Source: Annual Report of Himalayan Bank Limited

From the above table, it is found that net NPA ratio as percent of total assets of HBL is ranging from 1.16 to 3.88. While expressing net NPA with respect to total loans is ranges from 2.15 to 8.04 during the study period. Average, s.d. and C.V. of net NPA with respect to total assets are 2.62, 1.04 and 39.80 respectively. It concludes that during the study period, net NPA ratio as % of total assets is in decreasing trend and net NPA ratio as % of total loans is also in decreasing trend. NPA level of HBL meets the criteria according to NRB's directives.

Table 4.6

Net NPA Level of LBL

(Rs. In Million)

F/Y	2003/04	2004/05	2005/06	2006/07	2007/08			
Total Assets	4364	4383	4259	5705	6151			
Total Loan	2980	3168	2984	3841	4489			
Total NPA	237	561	1339	1007	801			
Provisioning for NPA	73	303	856	218	165			
Net NPA	164	258	483	789	636	Mean	S.D	C.V
Net NPA as % of Total Assets	3.76	5.89	11.34	13.83	10.34	9.03	3.68	40.77
Net NPA as % of Total Loan	5.50	8.14	16.19	20.54	14.17	12.91	1.05	8.13

Source :Annual Report of Lumbini Bank

Above table reflects that the net NPA ratio as a percent of total assets ranges from 3.76 to 13.83 and average, S.D. and c.v. of Net NPA is 9.03, 3.68 and 40.77 respectively during the study period. While expressing net NPA with respect to total loans it comes within the range of 5.50 to 20.54. Average, S.D. and C.V. of net NPA with respect to total loan is 12.91, 1.05 and 8.13 respectively. During the study period net NPA ratio of total assets is in increasing trend except of F/Y 2007/08 and net NPA ratio of total loan is also in increasing trend except in F/Y 2007/08.The position of LBL is not so bad. It's average net NPA ratio as % of total loan is 12.91 %, which is according to NRB directives.

4.1.3 Analysis of NPA with Respect to Loan Loss Provisioning

Loan loss provisioning is a vehicle to adjust in the loss arises from the gone loan. Higher amount of provisioning indicates that the bank is maintaining sufficient cushion for the loss that could be arise in future. Analysis of NPA with respect to provisioning reflects that the position of future loss that could be arising from the further degradation of loan.

Table 4.7

Analysis of NPA with Respect to Loan Loss Provisioning of HBL

F/Y	**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**			
Provisioning for loan Loss	968	1027	1119	796	682			
Total NPA	1147	1001	1040	641	477	Mean	S.D	C.V.
Loan loss provisioning as a % of NPA	84.394	102.6	107.6	124.18	142.98	112.35	19.886	17.70002

(Rs. in Million)

Source: Annual Reports of HBL

During the study period, amount of loan loss provisioning over the total NPA of HBL is ranging from 84.394% to 142.98%. Mean, standard deviation and C.V. of loan loss provisioning to NPA is found that 112.35, 19.886 and 17.70 respectively. This statistical figure impels us to conclude that 112.35% of total NPA of HBL is secured by loan loss provisioning. There is increasing trend in the growth of Loan loss provisioning with respect to portion of non-performing assets, which they are holding in their portfolio.

Table 4.8

Analysis of NPA with Respect to Loan Loss Provisioning of LBL

(Rs. in Million)

F/Y	2003/04	2004/05	2005/06	2006/07	2007/08			
Provisioning for loan Loss	242	517	1338	1104	878			
Total NPA	237	561	1339	1007	801	Mean	S.D	C.V.
Loan loss provisioning as a % of NPA	102.11	92.157	99.925	109.63	109.61	102.69	6.5583	6.386625

(Source: Annual Reports of LBL)

During the study period, amount of loan loss provisioning over the total NPA of LBL are ranging from 92.157% to 109.63%. Mean, S.D., C.V. of loan loss provisioning to NPA is found 102.69, 6.56 and 6.39 respectively. These statistical figures impel us to conclude that 102.69%of total NPA of LBL is secured by loan loss provisioning and there is fluctuating trend in the growth of loan loss provisioning with respect to portion of non-performing assets which they are holding in their portfolio.

4.1.4 Analysis of Net NPA with Respect to Gross NPA

This is the very important ratio in the analysis of NPA. As net NPA is the amount of loans and advances against which there is no provision maintained. This ratio helps to analyze how much NPA is not protected out of the total NPA by means of provisioning. Higher of this ratio is considered dangerous from the viewpoint of further provisioning in coming future. This is analyzed on the table given below.

Table 4.9

Net NPA to Gross NPA Ratio of HBL

(Rs. in Million)

F/Y	2003/04	2004/05	2005/06	2006/07	2007/08			
Net NPA	961	943	895	551	419			
Gross NPA	1147	1001	1040	641	477	Mean	S.D	C.V.
Net NPA ratio as	83.784	94.206	86.058	85.959	87.841	87.569	3.5587	4.063914

% of gross NPA								

Source: Annual Reports of HBL

From the analysis, part of net NPA out of gross NPA of HBL is ranging from 83.78% to 94.206% during the study period. Average, S.D. and C.V. are 87.569, 3.5587 and 4.0639 respectively. This statistical figure suggests us to conclude that in average 87.569% of NPA of HBL is not secured by means of provisioning. Net NPA with respect to total NPA are slightly fluctuating during the study period.

Table 4.10

Net NPA to Gross NPA Ratio of LBL

(Rs. in Million)

F/Y	**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**			
Net NPA	164	258	483	789	636			
Gross NPA	237	561	1339	1007	801	Mean	S.D	C.V.
Net NPA ratio as % of gross NPA	69.198	45.989	36.072	78.352	79.401	61.802	17.609	28.49259

(Source: Annual Reports of LBL)

Analyzing above table, it is found that part of net NPA out of gross NPA of during the study period is ranging from 36.07% to 79.40%. Average, S.D. and C.V. of terminology is 61.80, 17.61 and 28.49 respectively. This statistical figure suggests us to conclude that in average 61.80% of NPA of LBL is not secured by means of provisioning. Net NPA with respect to gross NPA is in decreasing trend in F/Y 2003/04,2004/05 and 2005/06 but in increasing trend in F/Y 2006/07 and 2007/08 during the study period.

4.2 Trend Percentage (Index Number) Analysis

This analysis is useful to measure the relative change in the value of the variables in any given period is called the "current period" with respect to its value in some fixed period called the "based period". Index number is a tool, which is used to study the direction of some particular changes in a phenomenon. To get objectives of research trend percentage analysis of loans, NPA provisioning is done on the following way.

4.2.1 Analysis of Trend Percentage of Total Loans

This analysis is done to find out the direction of growth of loan portfolio. From this analysis, it has tried to find out the growth trend of loan portfolio of sample banks during the period of study. Following table and graph presented below reflects the actual scenario of the subject.

Table 4.11

Trend Percentage of Total Loans

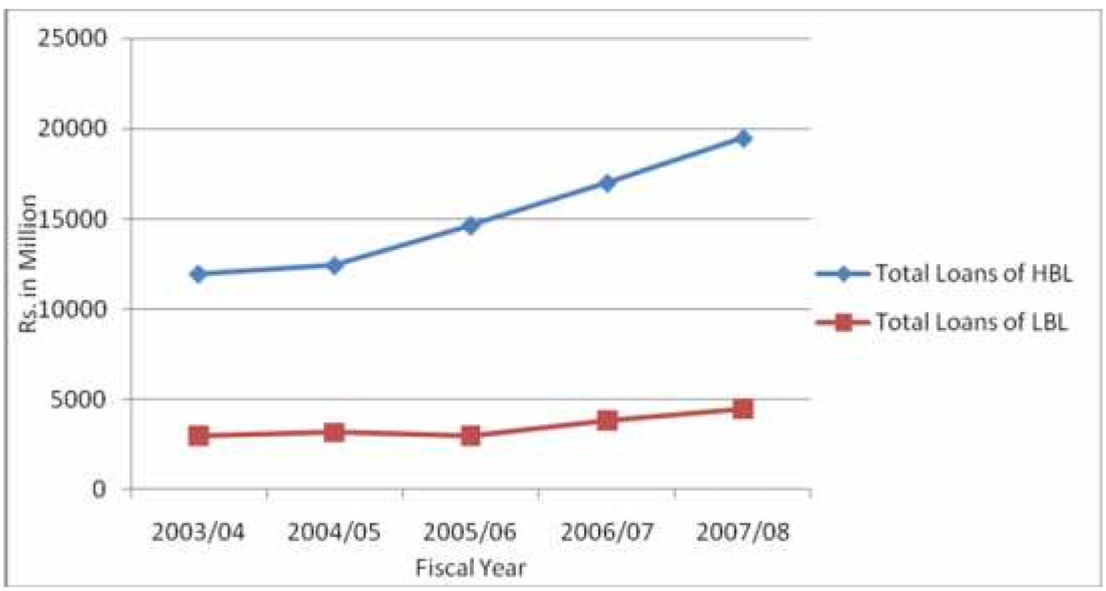
(Rs. in Million)

Fiscal Year		**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**
HBL	Total Loans	11951	12424	14642	16997	19497
	Index number	100	103.96	122.52	142.22	163.14
LBL	Total Loans	2980	3168	2984	3841	4489
	Index number	100	106.31	100.13	128.89	150.64

Source: Security Board of Nepal

Figure 4.3

Trend of Total Loans



By analyzing the above table and graph it is found that among the sample banks trend of HBL's total loan portfolio is increasing and in case of LBL, it is also in increasing trend except in F/Y 2005/06 during the study period. During the study period HBL's total loan portfolio is increased by 1.63 times and LBL's loan portfolio is increased by 1.50 times.

4.2.2 Analysis of Trend Percentage of Non-Performing Assets

This analysis helps to know the growth trend of non-performing assets of banks under study period. This analysis is done basically to know the exact trend of bad loans of sample banks. Following table and trend figure shows the trend of non-performing loans of HBL and LBL during the study period.

Table 4.12

Trend Percentage of Non-Performing Assets

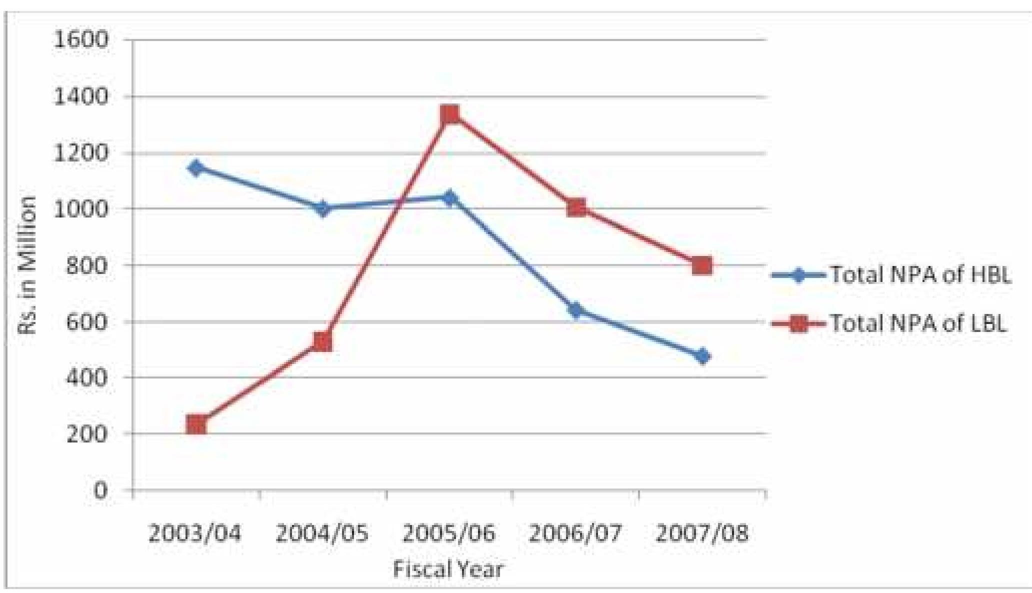
Rs. in Million

Fiscal Year		2003/04	2004/05	2005/06	2006/07	2007/08
HBL	Total NPA	1147	1001	1040	641	477
	Index number	100	87.27	90.67	55.88	41.59
LBL	Total NPA	237	531	1339	1007	801
	Index number	100	236.71	564.98	424.89	337.97

Source: Security Board of Nepal

Figure 4.4

Trend of Non-Performing Assets



By the analysis of above table and figure it is found that the trend of NPA of HBL is fluctuating. In the case of Lumbini Bank Limited, it is in increasing trend in F/Y 2003/04,2004/05 and 2005/06 but in decreasing trend in F/Y 2006/07 and 2007/08. By the analysis of above table, it is found that trend of NPA's of both banks are in fluctuating trend. NPAs of LBL is 3.37 times during the study period.

4.2.3 Analysis of Trend Percentage on Loan Loss Provisioning

In this part of analysis, direction of loan loss provisioning is done to get the idea of position to secure loans and advances. Following table and graph gives the idea of trend of loan loss provisioning on sample banks under study.

Table 4.13

Trend Percentage on Loan Loss Provisioning

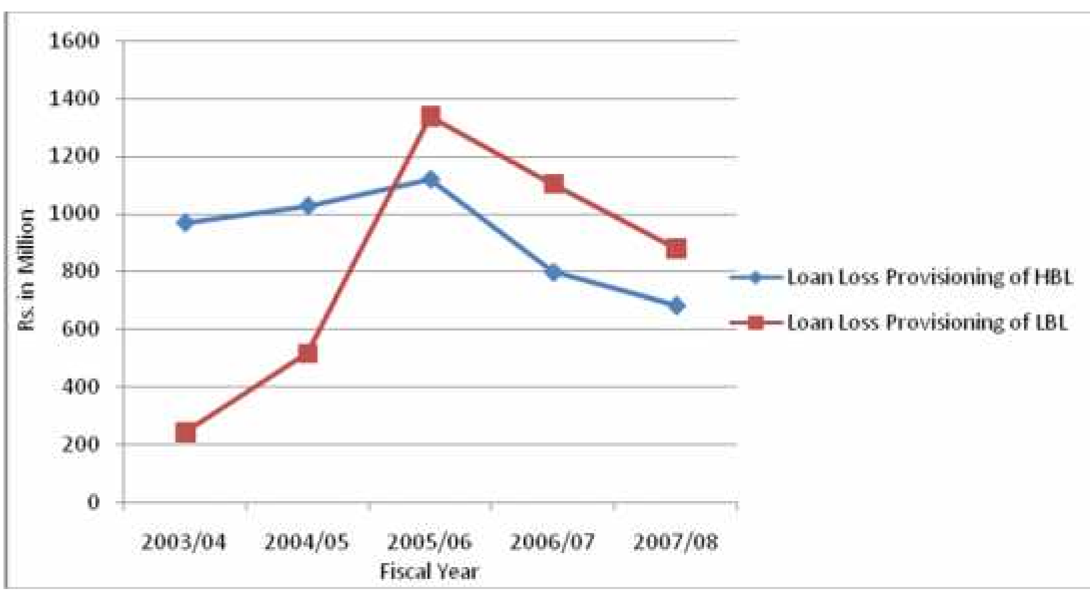
(Rs. in Million)

Fiscal Year		2003/04	2004/05	2005/06	2006/07	2007/08
HBL	Loan Loss Provisioning	968	1027	1119	796	682
	Index number	100	106.09	115.61	82.23	70.45
LBL	Loan Loss Provisioning	242	517	1338	1104	878
	Index number	100	213.64	552.89	456.21	362.81

Source: Security Board of Nepal

Figure 4.5

Trend of Loan Loss Provisioning



From the above table and figure it is found that HBL's loan loss provisioning is in fluctuating trend during the study period. It increases 0.70 times more than its base year 2003/04. In the case of LBL, it is also found in fluctuating trend under study.

4.3 Analysis of Non-Performing Assets and Net Profit

For the analysis of the trend of NPA and Net profit increment level compared to previous year has been computed. Then, trend of NPA is compared to evaluate whether the increment ratio of NPA is similar to increment ratio of net profit. With this comparison, it can be found whether the profitability is affected with the growth of NPA. If the increment ratio of NPA is higher than that of net profit, it can be concluded that significant portion of profit is sacrificed for maintaining required loan loss provisioning and there is reduction on net profit. Likewise, if net profit level is similar even though the NPA level is increased we may conclude that net profit is maintained because banks have been able to boost the profit level and actual profitability is not affected only due to NPA growth.

4.3.1 Analysis of Non-Performing Assets and Net Profit of HBL

Table 4.14

Non-Performing Assets and Net Profit of HBL

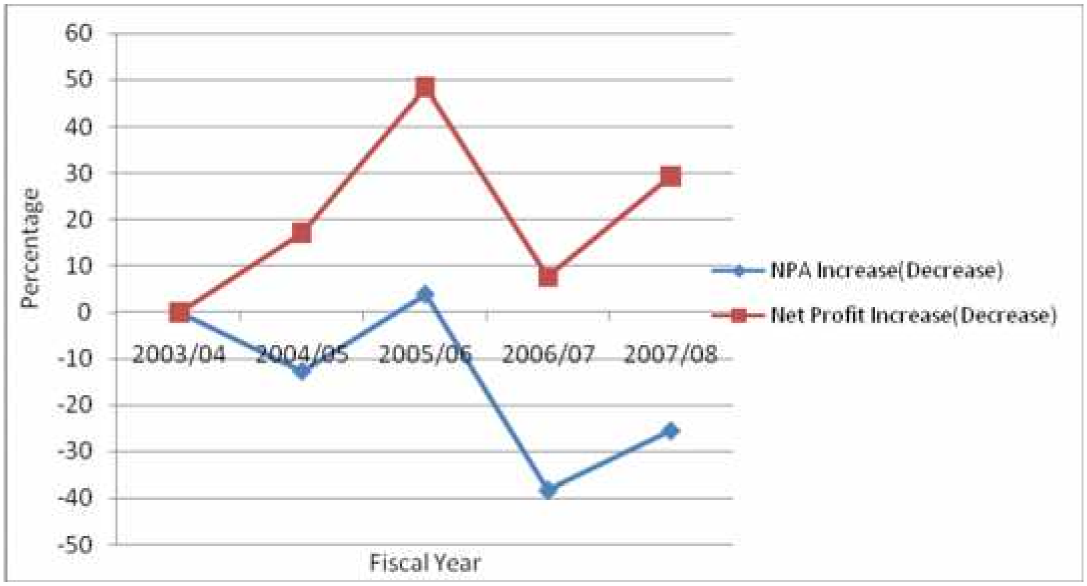
(Rs. in Million)

Fiscal Year	NPA	Increase(Decrease)	Net Profit	Increase(Decrease)
2003/04	1147		263	
2004/05	1001	-12.73	308	17.11
2005/06	1040	3.896	457	48.38
2006/07	641	-38.36	492	7.66
2007/08	477	-25.58	636	29.27

Source: Annual Reports of HBL

Figure 4.6

Non-Performing Assets and Net Profit of HBL



From the above table and figure, we found that non-performing assets of the bank is in fluctuating trend and net profit of the bank is in increasing trend every year in the study period. Percentage increases in net profit is not consistent, it is in fluctuating trend.

4.3.2 Analysis of Non-Performing Assets and Net Profit of LBL

Table 4.15

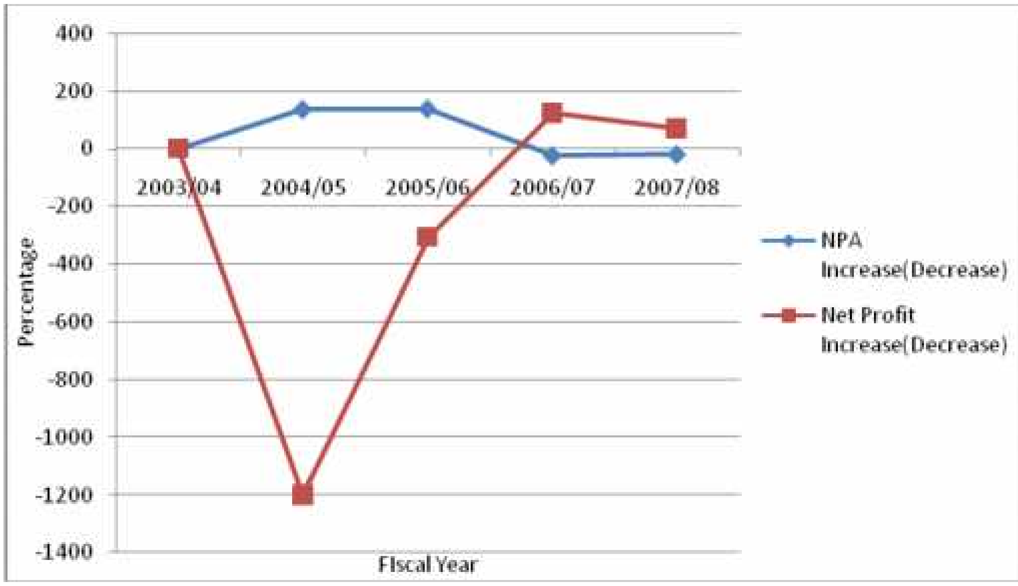
Non-Performing Assets and Net Profit of LBL

(Rs. in Million)

Fiscal Year	NPA	Increase(Decrease)	Net Profit	Increase(Decrease)
2003/04	237		18	
2004/05	561	136.71	-198	-1200
2005/06	1339	138.68	-806	-307.07
2006/07	1007	-24.79	192	123.82
2007/08	801	-20.46	328	70.83

Source: Annual Reports of LBL

Figure 4.7
Non-Performing Assets and Net Profit of LBL



From the above table and figure, we found that non-performing assets of the bank is in fluctuating trend. Similarly, net profit of the bank is in decreasing trend in the first three consecutive years and after that in increasing trend till F/Y 2007/08.

The trend of NPA and Net Profit indicates that net profit somehow depend upon the level of non-performing assets but only non-performing assets is not a cause to increase or decrease of the net profit of the bank.

4.4Recent Situation of Quality of Loan

In this part of the analysis recent situation of the loan and NPA is analyzed. Both the banks are maintaining their loan and NPA level keeping in mind loan and NPA management is a most important task of the banks.

4.4.1 Recent Situation of Quality of Loan of HBL

Recent situation of quality of the loan of the HBL is satisfactory. Its proportion of NPA to total loan is 2.36% which meets the criteria of NRB. In recent year, out of total loan 97.64% is performing loan. In recent year total loan of the bank is Rs. 20180 million out of which Rs.19703 million is performing and Rs.477 million is non-performing. From the following table and figure we can analyze the recent situation more efficiently.

Table 4.16

Recent Situation of Quality of Loan of HBL

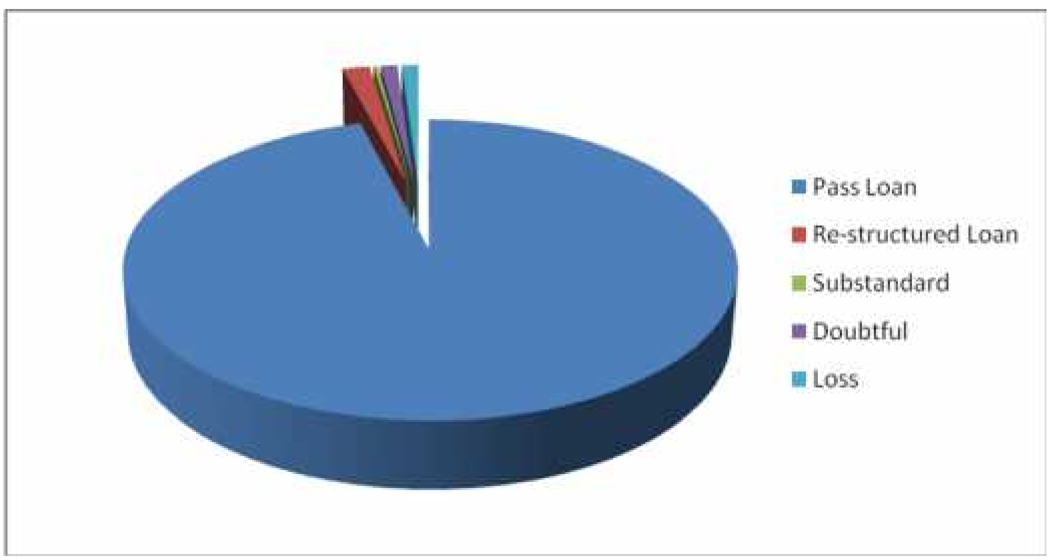
(Rs. in Million)

Loan Classification	F.Y. 2007/2008	NPA	Proportion of NPA
Pass Loan	19358		2.36%
Re-structured Loan	345		
Substandard	54	54	
Doubtful	214	214	
Loss	209	209	
Total	**20180**	**477**	

Source: Annual Report of HBL

Figure 4.8

Recent Situation of Quality of Loan of HBL



Recent Situation of Quality of Loan of LBL

Recent situation of quality of the loan of LBL is in improving trend. Its proportion of NPA to total loan is 14.90%, which does not meet the criteria of NRB. In recent year, out of total loan 85.09 % is performing loan. In recent year, total loan of the bank is Rs 5367 million out of which Rs 4567 million is performing and Rs 800 million is non-performing. From the following table and figure we can analyze the recent situation more efficiently.

Table 4.17

Recent Situation of Quality of Loan of LBL

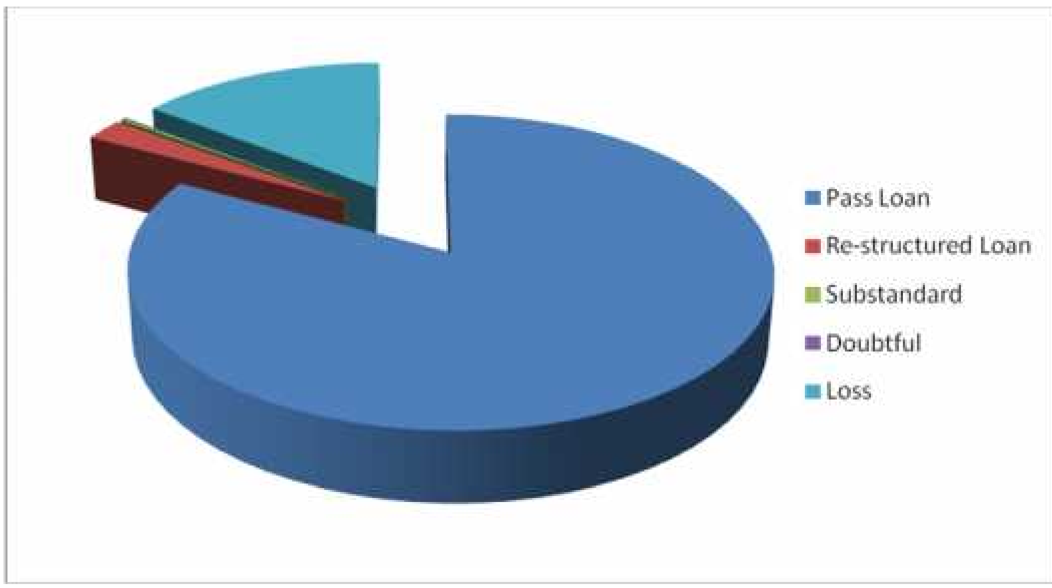
(Rs. in Million)

Loan Classification	F.Y. 2007/2008	NPA	Proportion of NPA
Pass Loan	4442		14.90%
Re-structured Loan	125		
Substandard	12	12	
Doubtful	5	5	
Loss	783	783	
Total	**5367**	**800**	

Source: Security Board of Nepal

Figure 4.9

Recent Situation of Quality of Loan of LBL



From the above table and figure, it is found that the level of NPA of HBL's is meeting the criteria of NRB directives and LBL has exceeded it. HBL's lending procedure is sound. LBL still needs some carefulness in lending procedure.

4.5Analysis of Correlation Coefficient

Correlation coefficient measures the relation between two or more variables. It also measures the extent to which one variable affects the other one. The correlation coefficient lies between +1 and -1. The +1 coefficient indicates that the variables are perfectly positively correlated and -1 coefficient indicates that variables are perfectly negatively correlated and if the correlation coefficient is 0, it means that the variables are not related to each other.

The negative correlation indicates that the increase in value of one variable leads to decrease in the value of the other variables. The positive correlation indicates that the increase in the value of one variable leads to increase in the value of the other variable also. The number indicates the degree of correlation between the variables.

Correlation coefficient of different dependent and independent variables are tried to analyze to find out the relation of these variables in different years. The statistical tool correlation analysis is preferred in this study to identify relationship between NPA and Net profit, NPA and total loan and NPA and loan loss provisioning to find out whether the relationship is significant or not.

4.5.1 Correlation Coefficient Between NPA and Total Loan

As the NPA is the part of loans which is not performing well, it is necessary to analyze the correlation between total loans and NPA's. Positive correlation indicates that non performing assets are simultaneously increases with the increases of loan portfolio. Negative correlation indicates decrease in non performing assets even loan portfolio increases and vice versa.

Table 4.18

Correlation Coefficient between NPA and Total Loan of HBL

(Rs. in Million)

Fiscal Year	NPA	Total Loan
2003/04	1147	11951
2004/05	1001	12424
2005/06	1040	14642
2006/07	641	16997
2007/08	477	19497
Correlation (r)	-0.95	

Source: Annex- 1

From the above table we can conclude that there is negative relationship between credit expansion and NPA level of HBL. It means that when loan portfolio is increased, NPA level is decreased and vice versa. NPA level seems to decrease with the rise in the volume of total loan.

Table 4.19

Correlation Coefficient between NPA and Total Loan of LBL

(Rs. in Million)

Fiscal Year	NPA	Total Loan
2003/04	237	2980
2004/05	561	3168
2005/06	1339	2984
2006/07	1007	3841
2007/08	801	4489
Correlation (r)	0.15	

Source: Annex- 2

From the above table, the correlation coefficient is 0.15 which is highly positive. It indicates that there is positive relationship between NPA and total loan of LBL. It means that when loan portfolio is increased, NPA level of the bank is also increased and vice versa. NPA level seems to rise with the rise in the volume of total loan. It can be concluded that NPA cannot be avoided but they can be reduced and mitigated in order to maintain the quality of loan portfolio.

4.5.2 Correlation Coefficient Between NPA and Net Profit

In this part of analysis, correlation coefficient point out the relationship between NPA and net profit during the study period. During this period what happens and what should be concluded is maintained here.

Table 4.20

Correlation Coefficient between NPA and Net Profit of HBL

(Rs. in Million)

Fiscal Year	NPA	Net Profit
2003/04	1147	263
2004/05	1001	308
2005/06	1040	457
2006/07	641	492
2007/08	477	636
Correlation (r)	-0.89	

Source: Annex -3

Above table depicts that the correlation between NPA and net profit is remained -0.89. It indicates that the NPA and net profit of the bank is negatively related. It means that when NPA level is increased, net profit of the bank is decreased and vice versa. The bank can raise its net profit by decreasing NPA.

Table 4.21

Correlation Coefficient between NPA and Net Profit of LBL

(Rs. in Million)

Fiscal Year	NPA	Net Profit
2003/04	237	18
2004/05	561	-198
2005/06	1339	-806
2006/07	1007	192
2007/08	801	328
Correlation (r)	-0.48	

Source-Annex 4

Above table depicts that the correlation between NPA and net profit is remained -0.48. It indicates that the NPA and net profit of the bank is negatively related. It means that when NPA level is increased, net profit of the bank is decreased and vice versa. The bank can raise its net profit by decreasing NPA.

4.5.3 Correlation Coefficient Between NPA and Loan Loss Provisioning

Loan loss provisioning is the vehicle for adjusting the degradation of quality of loan which could arise from the reduction in quality of loan. In general more NPA means more amount of operating profit to set aside for loan loss provisioning resulting decrease in portion of net income. In other aspects, more loan loss provisioning reflects that adequate cushion is maintained to protect the banks from the loss of degradation of their loans. It is found that there is + or – correlation between NPA and loan loss provisioning under study.

Table 4.22

Correlation Coefficient between NPA and Loan Loss Provisioning of HBL

(Rs. in Million)

Fiscal Year	NPA	Loan Loss Provisioning
2003/04	1147	968
2004/05	1001	1027
2005/06	1040	1119
2006/07	641	796
2007/08	477	682
Correlation (r)	0.90	

Source-Annex 5

Above table depicts that the correlation between NPA and loan loss provisioning is remained +0.90. It indicates that the NPA and loan loss provisioning of the bank is positively related. It means that when NPA level is increased, loan loss provisioning of the bank is also increased and vice versa. The bank can raise its loan loss provisioning by increasing NPA.

Table 4.23

Correlation Coefficient between NPA and Loan Loss Provisioning of LBL

(Rs. in Million)

Fiscal Year	**NPA**	**Loan Loss Provisioning**
2003/04	237	242
2004/05	561	517
2005/06	1339	1338
2006/07	1007	1104
2007/08	801	878
Correlation (r)	0.99	

Source-Annex 6

From the above table, the correlation coefficient is 0.99 which is highly positive. It indicates that there is positive relationship between NPA and loan loss provision of LBL. It means that when NPA level of the bank is increased loan loss provisioning is also increased and vice versa. NPA level seems to rise with the rise in the volume of loan loss provisioning.

4.6Analysis of Primary Data

Option survey is done to explore the various factors contributing in the growth of NPA with their immediate effect, to find out the major problems area in the management of NPA and find out the solution to manage the NPA in banking sector. So, opinion survey is analyzed on following sequential order:

- Analysis of factors contributing to NPA.
- Analysis of problems associated with management of NPA.

4.6.1 Analysis of Factors Contributing to NPA

For facilitation of this study, various contributing factors for NPA are classified into two categories i.e. they are internal and external factors. Respondents are asked to put their views about internal and external factors causing for growth of NPAs. Category wise response on behalf of opinion survey reflects the view of response on behalf of questionnaire relating to contributing factors for NPA.

Table 4.24

Analysis of Factors Contributing NPA

Question No.	Stem	Category "A"	Category "B"	Category "C"	Category "D"	Total
1.	Internal Factors	-	-	3	5	8 (9.09)
	External Factors	10	30	26	14	80 (90.91)
Total	10	30	29	19	88 (100)	
2.	Insufficient Control & monitoring system	2	5	10	8	25 (28.41)
	Lack of corporate governance	3	4	3	3	13 (14.77)
	Credit Policy of the bank	2	12	6	3	23 (26.14)
	Faulty appraisal of loan proposal	2	8	6	3	19 (21.59)
	Poor collateral assessment system	1	1	4	2	8 (9.09)
Total	10	30	29	19	88 (100)	
3	Law and order situation of the country	2	11	10	10	33 (37.5)
	Integrity & bad intension of borrowers	4	6	9	8	27 (30.68)
	Technological advancement	1	1	2	0	4 (4.55)
	Weak loan recovery & cumbersome legal procedure	3	6	4	1	14 (15.90)
	Frequent changes in policy & rules of government	0	6	4	0	10 (11.361)
Total	10	30	29	19	88 (100)	

Note: Figures in brackets reveals the percentage of respondents.

From the above table of primary data, out of the various internal factors presented for analysis through questionnaire. It is found that insufficient control and monitoring system is the most significant factors for conversion of good loans into loss. Among the total respondent, 28% responded this factors most crucial one. While 26.14% and 21.59% of respondents feels that credit policy of the bank and faulty appraisal of loan proposal respectively are responsible in conversion of good loans into loss. Similarly lack of corporate governance and poor collateral assessment system got 14.77% and 9.09% responses respectively.

From the analysis of above table, it is revealed that the external factors are very crucial in the conversion of good loans into bad. Out of the total respondent 90.91% of them state external factors are most responsible in the growth of NPA. While analyzing the individual external factors, causes related with the situation of the country and borrower's behavior are found most contributing with respective weight are of 37.50 and 30.68 respectively.

Among the others factors 15.91% of total respondents think that lost loan recovery law and legal procedure is responsible in conversion of good loans into bad. Similarly, 11.36% and 4.55% of respondent feel that technological advancement and frequent change in government policy respectively responsible in the conversion of good loan into bad.

4.6.2 Analysis of Problem Associated with the Management of NPA

In this part various problems associated with management of NPA are analyzed. Problems which are related to management of NPA are asked to respondent. Following table reveals the clear picture of responses with regards to the various problems associated with the management of NPA.

Table 4.25

Analysis of Problems Associated with Management of NPA

Problems	**Stem**	**Category "A"**	**Category "B"**	**Category "C"**	**Category "D"**	**Total**
Lack of proper documentation	a	3	10	8	4	25(28.41)
	b	2	8	5	2	17(19.32)
	c	5	12	16	13	45(52.27)
Total	10	30	29	19	88(100)	
Lack of assets management company	a	4	18	20	7	49(55.6)
	b	1	2	5	6	14(15.91)
	c	5	10	4	6	25(28.41)
Total	10	30	29	19	88(100)	
Strength of NRB guidelines	a	2	4	8	8	22(25)
	b	2	5	3	7	17(19.32)
	c	6	21	18	4	49(55.68)
Total	10	30	29	19	88(100)	
Difficulties in the execution of court proceedings	a	7	22	19	10	58(65.91)
	b	2	3	4	2	11(12.5)
	c	1	5	6	7	19(21.59)
Total	10	30	29	19	88(100)	
Economic recession and political instability	a	6	15	14	10	45(51.14)
	b	1	7	8	6	22(25)
	c	3	8	7	3	21(23.86)
Total	10	30	29	19	88(100)	

Note: Figure in brackets denotes percentages.

Note: stem a=Yes, b=No, c=Indifference.

From the above table, it reveals that most of the respondents (55.27%) are indifference. They can not provide their views in this question. 28.41% of total respondent considered it is a problem in the management of NPA. While 19.32% of total respondent responses that it is not a problem associated with the management of NPA. About 55.68% of respondent agreed with that lack of assets Management of NPA. While 15.91% of respondents replied negatively on this issue and 28.41% of respondents are in difference. They have no opinion about it.

Moreover 55.68% of respondents consider indifference in strength NRB guidelines as a problem in the management of NPA. While 25% said yes it is a problem and 19.32% said that is not a problem.

Moreover 65.91% of respondents agreed with that difficulties in court proceedings and cumbersome legal procedure is a problem associated with management of NPA. While out of total respondents 12.50% replied negatively and 21.59% in indifference situation regarding this question.

Nearly, 51.14% of total respondents agreed with the question adverse economic and political situation of the country is a problem associated with management of NPA. While nearly, 25% of respondents replied negatively on this issue and remaining 23% of respondents replied negatively on this issue and remaining 23.86% of respondents are in indifference. They can not provide their views concerning this question.

4.7Major Findings

Present study based on the analysis has drawn important results. Findings of present analysis are very important for academician and researchers. Nepalese banking sectors in recent days are facing the several problems with increasing number of NPA. With the level of increasing NPA profitability performance of the bank has badly affected. To find out the cause of increment of NPA in commercial banks basis of loan flotation procedure, it has tried to sort out follow up practice carried out by the bank for the recovery of overdue loan outstanding, internal responsible factor causing NPA growth as well as external factor that has significant impact for NPA growth. As well as external factor that has significant impact for NPA growth.

In this part major findings of the study are presented relying on the data analyzed and presented. Major findings of this study are presented on the following sequential manner.

- Findings of Himalayan Bank Limited.
- Findings of Lumbini Bank Limited

4.7.1 Findings of Himalayan Bank Limited

During the study period, gross NPA with respect to total assets of HBL are ranges from 4.63% to 1.32% with average, standard deviation and C.V. of 3.00, 1.21 & 40.33 respectively. Similarly, gross NPA with respect to total loan of HBL are ranges from 9.60% to 2.45% with average, S.D. & C.V. of 6.20, 2.68 & 43.19 respectively. In conclusion it's found that HBL's average NPA ratio as a % of total loan is 6.20% which is under the criteria of NRB's directives issuing for commercial banks for managing NPA.

From the analysis, part of net NPA out of gross NPA of HBL is ranging from 83.78% to 94.206% during the study period. Average S.D and C.V. are 87.569, 3.56 and 4.06 respectively. This statistical figure suggests us to conclude that in average 87.569% of NPA of HBL is not secured by means of provisioning. Net NPA with respect to total NPA are slightly fluctuating during the study period.

During the study period, amount of loan provisioning over the total NPA of HBL is ranging from 84.394% to 142.98%. Mean, standard deviation and C.V. of loan loss provisioning to NPA is found that 112.35, 19.89 and 17.70 respectively. This statistical figure impels us to conclude that 112.35% of total NPA of HBL is secured by loan loss provisioning.

By analyzing the trend percent of total loan, it is found that among the sample banks trend of HBL's total loan portfolio is increasing. During the study period HBL's total loan portfolio is increases by 1.63 times

While analyzing the trend of NPA of HBL is fluctuating in decreasing trend and its NPA is decreased by 0.41 times during the study period.

From the analysis, it is found that HBL's loan loss provisioning is in decreasing trend during the study period. It increases 0.70 times more than its base year 2003/04.

From analysis, it is found that non-performing assets of the bank is in fluctuating trend and net profit of the bank is increasing trend every year in study period.

From above analysis it is concluded that there is negative relationship between credit expansion, net profit but positive relation with loan loss provisioning an NPA level of HBL. It means that when loan portfolio is increased, NPA level is decreased and vice versa.

Recent situation of quality of the loan is satisfactory of the HBL. Its proportion of NPA to total loan is 2.36% which meets criteria of NRB.

4.7.2 Findings of Lumbini Bank Limited

During the study period gross NPA with respect to total assets of LBL is ranges from 5.43% to 31.44% with average, S.D. and C.V. of 16.07, 8.62 & 53.67 respectively. This statistical figure reflects that gross NPA level with the respect of total assets of LBL high and is in increasing trend initially and then in decreasing trend after that.. Similarly gross NPA with respect to total loan of LBL is ranges 7.95% to 44.87% with average, S.D. and C.V. 22.92, 12.41 and 54.14 respectively. These statistical figures impel to conclude that gross NPA with respect to total loan of LBL is in increasing trend except in F/Y 2006/07 and 2007/08. Average NPA level of LBL is high.

During the study period net NPA ratio of total assets and net NPA ratio of total loans is in increasing trend except in F/Y 2007/08. The position of LBL is not so good. Its average net NPA ratio as % of total loan is 12.91% which is high according to NRB's directives. In recent year it reduces its NPA significantly.

During the study period, amount of loan loss provisioning over the total NPA of LBL are ranging from 92.157% to 109.63%. Mean S.D., and C.V. of loan loss provisioning to NPA is found 102.69, 6.56 and 6.39 respectively. These statistical figures impel to conclude that 102.69% of total NPA of LBL is secured by loan loss provisioning.

Analyzing above data, it's found that part of net NPA out of gross NPA during the study period ranges from 36.07% to 79.40%. Average, S.D. and C.V. of terminology is 61.80, 17.61 and 28.49 respectively. This statistical figure suggests to conclude that in average 61.80% of NPA of LBL is not secured by means of provisioning.

During the study period the trend percent of total loan, in the case of LBL, is in increasing and its loan portfolio is increased by 1.50 times.

During the study period the trend percent of non-performing assets in the case of Lumbini bank limited, is in increasing trend in F\Y 2003/04,2004/05 and 2005/06 but in decreasing trend in F\Y 2006/07 and 2007/08.

During the study period the trend percent of loan loss provisioning in the case of LBL, is found in fluctuating trend and its loan loss provisioning increases to 3.63 times as compared to base year.

From the above analysis found that non-performing assets of the LBL is in fluctuating trend. In other hand, net profit of the bank is also in fluctuating trend.

From the analysis of correlation coefficient there is positive 0.15 correlations between total loan and NPA, negative -0.48 correlation between net profit and NPA and positive 0.99 correlation between loan loss provisioning and NPA of LBL. It indicates that when loan portfolio and loan loss provisioning is increased, NPA level of the bank is also increased and vice versa. But there is negative relationship between net profit and NPA level, it means that when net profit increased, NPA level is decreased and vice versa.

Recent situation of quality of the loan of LBL is in improving trend. Its proportion of NPA to total loan is 14.90% which does not meet the criteria of NRB but in fiscal year 2007/08 it shows positive result in this area.

4.7.3 Findings of Primary Data

Opinion survey was done to analyze factors causing the growth of NPA, impacts of NPA and problems associated with the management of NPA. Most of the respondent indicated that external factors are more responsible than internal factors in the conversion of good loans to bad/loss.

Among the external factors, factors related with political and economic situation of the country and borrower related factors are found most crucial in the conversion of good loan into bad/loss. While looking for the internal factor it is found that insufficient control and monitoring system are the most contributing factors in the growth of NPA's.

Analyzing the problems associated with the management of NPA, most of the respondents revealed that proper documentation and strength NRB guidelines are the problem area to be faced in the management of NPA. Lack of assets management company, execution of the court proceedings and cumbersome legal procedure and economic recession and political instability are the main problems

CHAPTER- V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter is the final chapter of the study which consists of the summary, conclusion and recommendation from earlier analysis. As mentioned in the objectives of the study this chapter summarizes the problems area with regards to management of NPA and various impacts of NPA.

5.1 Summary

This study has undertaken to analyze as well as explore the various factors contributing for NPA and their consequent impact of sample banks, viz.; Lumbini Bank Limited and Himalayan Bank Limited. This is done by the studying various figures and factors related to NPA's in terms of their impact on profitability position, their contribution in the growth of NPA and problem area in their effective management. The financial statement of the last five years FY. 2003/04 to 2007/08 have been examined for the subject analysis. To analysis the impact of NPA's lf the banks various financial data with respect to NPA are sorted, tabulated, interpreted and correlated by using appropriate tools and techniques. Since the study is based on historical as well as primary data the research design designated historical and explanatory of type.

The study has been divided into five chapters; they are Introduction, Review of Literature, Research Methodology, Data presentation and Analysis and finally summary, Conclusion and Recommendation.

In the first chapter, the general introduction of commercial bank and their activity with regards to economic upliftment of the country, Focus of the study, Research Methodology, Limitation of the Study and Plan of the study are highlighted.

In the second chapter conceptual review of banking, various terminologies related to NPA, and review of previous research and study etc. have been defined to facilitate in the analysis part of the study. For this regard, the various banking-related acts, NRB directives, government policies and present scenario in the area of banking are also reviewed.

In the third chapter, the research methodology which is used to analyze the NPA of sample banks under consideration is briefly explained. This chapter consists of research design, sample and population, sources of data, statistical and financial tools etc which are useful to analyze the NPAs of sample banks under study period.

In the fourth chapter, the data required for the study are collected(source of primary as well as secondary data) for the purpose of the study are presented, analyzed and interpreted by using various tools and techniques of financial management, accounts and statistics to present the result.

The fifth and final chapter consists of the summary, conclusion and recommendation of the earlier four chapters.

5.2 Conclusion

This part of the study is based on the result which could be derived from the findings of the study. Major conclusion of findings are cited below to not only leads on the way meet the objectives of the study but also gives the idea to manage NPA's of Nepalese banks.

In conclusion it's found that HBL's average NPA ratio as a % of total loan is 6.20% and gross NPA with respect to total loan of HBL is in decreasing trend. Average NPA level of LBL is high which is not under the criteria of NRB's directives issuing for commercial banks for managing NPA.

This statistical figure suggests us to conclude that in average 87.57% of NPA of HBL is not secured by means of provisioning. Net NPA with respect to total NPA are slightly fluctuating during the study period and the figure of LBL suggests to conclude that in average 61.80% of NPA of LBL is not secured by means of Provisioning.

This statistical figure impels us to conclude that 112.35% of total NPA of HBL and 102.69% of total NPA of LBL is secured by loan loss provisioning. During the study period HBL's total loan portfolio is increased by 1.63 times and LBL's loan portfolio is increased by 1.50 times.

While analyzing the trend percent of non-performing assets, it is found that the trend of NPA of HBL is fluctuating. Its NPA is decreased by 0.41 times and in the case of LBL, it is in fluctuating trend and is 3.37 times during the study period.

From the analysis, it is found that HBL's loan loss provisioning is in fluctuating trend and increases 0.70 times more than its base year 2003/04 and in the case of LBL, it is also found in fluctuating trend and its loan loss provisioning is 3.63 times.

From the analysis, it's found that non-performing assets of the HBL is in fluctuating trend and net profit of the bank is in increasing trend every year and non-performing assets of the LBL is also in fluctuating trend and net profit of the bank is in decreasing trend in the first three consecutive years and after that in increasing trend till F\Y 2007/08.

From above analysis it's concluded that there is negative relationship between credit expansion and NPA, negative relationship between net profit and NPA and positive relation between loan loss provisioning and NPA of HBL and there is positive 0.15 correlations between total loan, negative correlation between loan loss provisioning and positive relation between net profit and NPA of LBL.

Recent situation of quality of the loan is satisfactory of the HBL. Its proportion of NPA to total loan is 2.36% which meets the criteria of NRB and in the case of LBL it is in improving trend. Its proportion of NPA to total loan is 14.90% which does not meet the criteria of NRB directives but in fiscal year 2007/08 it shows positive result in this area.

Opinion survey was done to analyze factors causing for the growth of NPA, impacts of NPA and problems associated with the management of NPA. Most of the respondent indicated that external factors are more responsible than internal factors in the conversion of good loan to bad/loss.

Among the external factors, factors related with political and economics situation of the country and borrower related factors are found most crucial in the conversion of good loan into bad/loss. While looking for the internal factors it is found that insufficient control and monitoring system, credit policy of the bank and faults in credit appraisal system are the most contributing factors in the growth of NPA's.

Analyzing the problems associated with the management of NPA, most of the respondents revealed that proper documentation and strength NRB guidelines are the problem area to be faced in the management of NPA. Lack of assets Management Company, execution of the court proceedings and cumbersome legal procedure and economic recession and political instability are the main problem.

5.3 Recommendations

High level of non-performing assets not only decreases the profitability of the banks but also affects the entire financial as well as operational health of the organization. Based on the major findings of this study, some recommendations have made so as to overcome issues of non-performing assets of the banking sector.

- NRB should tight the supervision and inspection activity towards the commercial banks so that the accounting manipulation can be avoided and net profit of the banks is not decrease and NPA level of banks not increases.
- In the sample, Himalayan Bank Limited has non-performing assets low in comparison with the Lumbini Bank Limited. So, to maintain the loan portfolio is important for LBL.
- Recent situation of quality of the loan is satisfactory for both banks but does not meet the criteria of NRB directives. HBL's situation is much better than LBL and

situation of LBL is improving than previous year. Both banks should pay attention towards this situation.

- Banks should take enough collateral so that bank at least can cover its amount in case of being unable to repay by the borrower.
- Proper financial analysis should be needed before providing the loan to borrower
- Banks should provide necessary training regarding NPA management to the managers and staffs who are involving in managing NPA.
- All Nepalese commercial banks should maintain loan loss provision in accordance to the NRB directives.
- Improvement in corporate governance including elimination of cronyism and transparency of corporate management should be advanced under government initiatives.
- Banks having high level of NPA should take immediate actions towards recovering their bad loan as soon as possible.

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www.sebonp.com

QUESTIONNARE

1) Please tick on the appropriate option out of the following category?

a) Executive

b) Manager

c) Officer

d) Others

2) Mention the factor responsible in the process of the turning good loans into bad giving weight out of 100 to the following two categories

Factors	Weight in percent
Internal Factors	
External Factors	

3) Would you mention the internal reasons that are responsible for turning good loan into bad loan in your organization?

a) Insufficient control & monitoring system in credit

b) Lack of corporate governance in bank

c) Credit policy of the bank

d) Credit analysis of loan proposal

e) Poor system in valuation of collateral

4) Would you mention the external reasons that contributes for turning good loan into bad in your organization?

a) Law and order situation of the country

b) Lack of integrity/ bad intension of the borrower

c) Technological advancement

d) Weak loan recovery law and cumbersome legal procedure

e) Frequent changes in HMG/N policy in tax, tariffs & customs.

5) Do you agree with the following problems associated with the management of NPA in your organization?

a) Lack of proper documentation

i. Agree
ii. Disagree
iii. Moderately agree

b) Lack of Assets Management company

i. Agree
ii. Disagree
iii. Moderately agree

c) Strength in NRB guidelines

i. Agree
ii. Disagree
iii. Moderately agree

d) Difficulties in the execution of court proceedings

i. Agree
ii. Disagree
iii. Moderately agree

e) Economic recession & political instability

i. Agree
ii. Disagree
iii. Moderately agree

____

Signature

Name:

Designation:

Address:

Date:

LETTER OF RESPONDENTS

Date October, 2007

Dear Sir/Madam,

I am concluding a research titled “Comparative Analysis of Non-Performing Assets of Lumbini Bank Ltd. and Himalyan Bank Limited)” as partial fulfillment for the degree of Masters in Business Studies (MBS) from Tribhuvan University. I shall be very grateful for your friendly response to the questionnaire. Information provided will be used only in my study report. Your kind co-operation in this regard will be highly appreciated.

Thanking you.

Yours sincerely,

....

Bikash Maharjan

Cell No. 9851016346

G.P.O Box. 5746

ANNEX – 1
Correlation Coefficient between NPA and Total Loan of HBL

X	Y	X=X-X	X^2	Y=Y-Y	Y^2	XY
1147	11951	285.80	81681.64	-3151.20	9930061.44	-900612.96
1001	12424	139.80	19544.04	-2678.20	7172755.24	-374412.36
1040	14642	178.80	31969.44	-460.20	211784.04	-82283.76
641	16997	-220.20	48488.04	1894.80	3590267.04	-417234.96
477	19497	-384.20	147609.64	4394.80	19314267.04	-1688482.16
		∑X= 0.00	**□329292.80**	**∑Y= 0.00**	**40219134.80**	**□- 3463026.20**

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}} = -0.95$$

ANNEX – 2

Correlation Coefficient between NPA and Total Loan of LBL

X	Y	X=X-X	X^2	Y=Y-Y	Y^2	XY
237	2980	-552.00	304704.00	-512.40	262553.76	282844.80
561	3168	-228.00	51984.00	-324.40	105235.36	73963.20
1339	2984	550.00	302500.00	-508.40	258470.56	-279620.00
1007	3841	218.00	47524.00	348.60	121521.96	75994.80
801	4489	12.00	144.00	996.60	993211.56	11959.20
		∑x =0.00	**706856.00**	**∑y=0.00**	**1740993.20**	**165142.00**

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}} = 0.15$$

ANNEX – 3

Correlation Coefficient between NPA and Net Profit of HBL

X	Y	X=X-X	X^2	Y=Y-Y	Y^2	XY
1147	263	285.80	81681.64	-168.20	28291.24	-48071.56
1001	308	139.80	19544.04	-123.20	15178.24	-17223.36
1040	457	178.80	31969.44	25.80	665.64	4613.04
641	492	-220.20	48488.04	60.80	3696.64	-13388.16
477	636	-384.20	147609.64	204.80	41943.04	-78684.16
		∑x =0.00	**329292.80**	**∑y=0.00**	**89774.80**	**-152754.20**

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}} = -0.89$$

ANNEX – 4

Correlation Coefficient between NPA and Net Profit of LBL

X	Y	X=X-X	X^2	Y=Y-Y	Y^2	XY
237	18	-552.00	304704.00	111.20	12365.44	-61382.40
561	-198	-228.00	51984.00	-104.80	10983.04	23894.40
1339	-806	550.00	302500.00	-712.80	508083.84	-392040.00
1007	192	218.00	47524.00	285.20	81339.04	62173.60
801	328	12.00	144.00	421.20	177409.44	5054.40
		∑x =0.00	**706856.00**	**∑y=0.00**	**790180.80**	**-362300.00**

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}} = -0.48$$

ANNEX – 5
Correlation Coefficient between NPA and Loan Loss Provisioning of HBL

X	Y	X=X-X	X^2	Y=Y-Y	Y^2	XY
1147	968	285.80	81681.64	49.60	2460.16	14175.68
1001	1027	139.80	19544.04	108.60	11793.96	15182.28
1040	1119	178.80	31969.44	200.60	40240.36	35867.28
641	796	-220.20	48488.04	-122.40	14981.76	26952.48
477	682	-384.20	147609.64	-236.40	55884.96	90824.88
		∑x =0.00	**329292.80**	**∑y=0.00**	**125361.20**	**183002.60**

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}} = 0.90$$

ANNEX – 6
Correlation Coefficient between NPA and Loan Loss Provisioning of LBL

X	Y	X=X-X	X^2	Y=Y-Y	Y^2	XY
237	242	-552.00	304704.00	-573.80	329246.44	316737.60
561	517	-228.00	51984.00	-298.80	89281.44	68126.40
1339	1338	550.00	302500.00	522.20	272692.84	287210.00
1007	1104	218.00	47524.00	288.20	83059.24	62827.60
801	878	12.00	144.00	62.20	3868.84	746.40
		∑x=0.00	**706856.00**	**∑y=0.00**	**778148.80**	**735648.00**

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}} = 0.99$$