STUDY OF THE NON-PERFORMING ASSETS OF COMMERCIAL BANKS IN NEPAL

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RECOMMENDATION

This to certify that the thesis

Submitted by:
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Entitled:

A STUDY OF THE NON-PERFORMING ASSETS OF

COMMERCIAL BANKS IN NEPAL

(With reference to Himalayan Bank Limited and Bank of Kathmandu Limited)

has been prepared as approved by this department in the prescribed format

of the faculty of management. This thesis is forwarded for examination.

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VIVA-VOCE SHEET

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Submitted by
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Entitled:

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COMMERCIAL BANKS IN NEPAL

(With reference to Himalayan Bank Limited and Bank of Kathmandu Limited**)**

And found the thesis to be the original work of the student and written

according to the prescribed format. We recommend the thesis to be accepted

as partial fulfillment of the requirement for

Master Degree of business studies (M.B.S.)

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DECLARATION

I hereby declare that the work reported in this thesis entitled **"A Study of the Non-Performing Assets of Commercial Banks in Nepal (With reference to Himalayan Bank Limited and Bank of Kathmandu Limited)"** submitted to office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the master's degree in business study (MBS) under the supervisor of Mr. Achyut Raj Bhattarai and Mr. Dhruba Subedi of Shanker Dev Campus.

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The thesis report on the A study of on non-performing assets of Commercial banks in Nepal (with reference to Himalayan Bank Limited and Bank of Kathmandu Limited) has been prepared in partial fulfillment of the requirements of the degree of master of business studies. On the journey of reaching this final step of my work. I would like thank all those who have directly and indirectly helped and supported me in many ways. In other word, I will not be able to justify my work without acknowledging those who have significantly contributed to my thesis work, so I want to express my heartfelt thanks to all of them. It has been a matter of great pleasure for me to complete this thesis under the supervision of Mr. Achyut Raj Bhattarai and Mr. Dhruba Subedi of Shanker Dev Campus, I appreciate his kind guidance, valuable supervision, constructive comments and inspiration during the preparation of this thesis. I am also thankful to all staffs of administration of Shanker Dev Campus and the library members.

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Finally, I would not want to state that this thesis is perfect but may have various limitations and shortcomings; nevertheless, I have tried my best.

Narad Kumar Luitel

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ABBREVIATIONS

a/c	Account
A/d	After Date
AMC	Asset management Company
BOK	Bank of Kathmandu
CBSL	Central Bank of Sirlanka
DFIs	Development Finance Institutions
F/Y	Fiscal Year
FCBs	Foreign Commercial Banks
HBL	Himalayan Bank Limited
i.e.	That is
IBRA	Indonesia Bank Restriction Agency
IMF	International Monitory Fund
LLP	loan loss provision
Ltd.	Limited
NBL	Nepal Bank Limited
NCBs	Nationalized Commercial Banks
NPAs	Non Performing Assets
NPLs	Non Performing Loans
NRB	Nepal Rastra Bank

PA	Performing Assets
PCBs	Private Commercial Banks
PE	Probable Error
R	Correlation Coefficient
RBB	Rastriya Banijya Bank
ROA	Return of Total Assets
ROE	Return on shareholders Equality
Rs	Rupees
SE	Standard Error
TA	Total Assets
TD	Total Deposit
TL	Total Lending
WTO	World Treat Origination

CHAPTER-I

INTRODUCTION

1.1   General Background of the Study

Least developed country like a Nepal is very low cultivate lands, high population, low per capital income, poorest economy and low rate of capital formation as well as limited resources. The various factors that are responsible for the slow peace development of the nation are obstruction by land locked position, poor resource endowment, institution weakness and lack of appropriate economic policies due to political instability as well as lack of political commitment. The development of any country largely depends upon its economic development. Thus the primary goal of any nation is trying to embark upon the path of economic development by economic growth rate and developing all sectors of economy. The process of economy development depends upon capital formation and its proper utilization plays paramount role.

The increase in capitals has always been a sort of prime move in the process materials growth and the rate of capital formation has been principal variable in setting the overall pace of economic development. In the modern day business world, the scope of bank has become so wide that it covers all the financial activities from the issue of money to the performance of agency service to its costumers. In this sense, a bank may be defined as a financial institution which accepts the deposit for the purpose of lending or investment from the public, repayable on demand through cheque, draft or otherwise and also performs a number agency service to its client on instruction. So banking sector is the bone of the economy of a country. Commercial banks exist to mobilize the financial resource by investing the same in a profitable manner. The competency of any commercial bank is

referred as to utilization of the resource on optimum way. Hence the profit here should be adequate to meet its cost of funds as well as there should be some margin left over as the reward for risk bearing. The financial institutions are supported to be contributor for the overall economy reforms in the country. Through their activities are guided by some social obligations, some profits are always desirable for their continuous survival.

Commercial banks mobilize a big chunk of resources are being utilized on loan and advance. The return from loan floatation is higher than the return from any other activities. Commercial banks activities are focus for management of loan and advance. By venture of principal for higher risk and return and vice versa. The burgeoning growth of bank has led them towards cutthroat. On the other hand the economic condition of the country is not booming, while on the other hand no any new investment alternative being explored. The competition among the banks just shares the small and same size of market.

The marginal opportunity for getting avenues for loan flotation has compelled the banks to finance without being choosy. Quality of loan and advance cannot be maintained to the desirable level if there is no choice whether to finance or not. The resource cannot be considered, utilized properly when the loans provided to the client cannot be regular and if there is cumulative overdue outstanding. Once, there is given it is supposed that the repayment of investment or principal shall have to be served without any implement. There are many reason behind the loan turn irregular from regular. The main reason may be political situation of the country. The smooth operation of the commercial bank is possible after well economy of the country which is badly affected by political instability. The pre- request of the financial sector is satisfactory level of return. Other contributing factor is that turn good loan into bad are the attitude of the borrower, types and quality of collateral taken and legal complication created by the

borrower during loan recovery process. Once the disbursed loan is not paid timely by client and became overdue, it is called to be non performing assets (NPA). NPA is a major problem for every commercial bank. NPA management management is top priority for commercial banks. Government owned banks (NBL & RBB) have also nearly 50% NPA (Sources NRB banking & financial statistics mid Jan 2006).

The banking institution has operated by government rules and regulation, central banks rules and regulation. Likewise intervention industry norms, relevant act, memorandum of association and article of association. Similarly the exception of the stake holder should also be taken into consideration. All the banking institutions are supposed to confine their activities within the started frame work.

1.2   Statement of Problem

Nepal's financial system faces a number of problem and challenges that have constrained growth of efficient financial market. A host of challenge and complexities that comfort the financial system of Nepal could be categorized as the weak financial position of most the government owned financial institution as reflected higher proportion of NPA. It is estimated the size of the NPA in the Commercial banking system is as higher as 20% with such ratio in the two largest bank(RBR & NBL) exceeding 50%. (Sources NRB banking & financial statistics mid Jan 2006)

Nepalese commercial banks have not formulated their Proper/appropriate investment policy. Their implementation policy also not effective. The credit extended by the commercial bank to industry and agriculture sector is not satisfactory to meet present growing need. Unnecessary political pressure could also effect the sound investment decision of the commercial banks. Guarantying loan against insufficient deposit, land & building mortgage

overvaluation of pledge. Negligence in loan recovery of overdue loan one of the major problem faced by the commercial banks.

Most of commercial bank invest is going to lower production sector due to lack of supervision and unhealthy competition whither they have utilized their loan in proper sector or not and lack of long term policy formulation and absence of strong commitment toward its proper implementation. The rules and regulations are only tool of NRB to supervise and monitor the financial institution.

Through loans and advances in the largest items of the bank in the asset side, but negligence in administering this asset could be the main cause of a liquidity crisis in the bank and one of the main reasons of bank failure. It can be clearly seen on two largest government owned banks, Nepal bank limited (NBL) and Rastriya Banijya Bank (RBB). Nowadays, in most of the national daily newspaper not only they two banks, but also other commercial banks and financial institutions are publishing names of borrows who defaulted in making payment of banks loans. In recent days, not only government owned banks but some of the banks under private ownership are also suffering form NPA burden. It is a matte of debate amongst the entire banking sector regarding the real cause of NPA increment through private sector bank has less nonperforming assets in comparison to NBL and RBB. Below report shows that he Naples commercial banks have more or less some non performing loan.

Non-performing assets in Nepalese banking sector

The NRB report show that NPL to gross loan 18.9% in 2005, 14.22% in 2006 and 9.65% in 2007. The following table no. 1 shows the non-performing loan to total gross loan status of individual commercial banks.

Table 1.1

Non-performing assets in Nepalese banking sector

SN	Banks	Mid-July 2005 (%)	Mid-July 2006(%)	Mid-July 2007(%)
1.	Nepal Bank Limited	49.664	25.11	14.60
2.	Rastriya Banijya bank	52.99	45.34	26.43
3.	Nabil Bank Limited	1.32	1.25	1.12
4.	Nepal Investment Bank Limited	2.69	2.30	2.12
5.	Standard Chartered Bank Nepal Ltd.	2.69	2.12	1.83
6.	Himalayan Bank Limited	7.44	6.14	3.53
7.	Nepal SBI Bank Limited	6.54	6.32	0.46
8.	Nepal Bangladesh Bank Limited	19.4	12.27	35.13
9.	Everest Bank Limited	1.63	1.20	0.76
10.	Bank of Kathmandu Limited	4.99	2.52	2.20
11.	NCC Bank Limited	8.64	11.09	30.63
12.	Lumbine Bank Limited	15.23	31.97	19.85
13.	NIC Bank Limited	3.78	2.60	1.10
14.	Machhapuchhre Bank Limited	0.39	0.28	1.12
15.	Kumari Bank Limited	0.95	0.90	0.73
16.	Laxmi Bank Limited	1.63	0.65	0.35
17.	Siddhartha Bank Limited	2.58	1.34	0.34
18.	Global Bank Ltd.			0.00
19.	Agriculture Development Bank Ltd.		21.23	16.50
20.	Citizens Bank International Ltd.			
	Total	18.94	14.22	9.65

Source: www.nrb.org.np/banking and financial statistic of NRB

The NPL to total gross loan of the slected banks for study are as follows:

Table 1.2

The NPL Gross Loan of Selected Banks

SN	Banks	Mid-July 2005 (%)	Mid-July 2006(%)	Mid-July 2007(%)
1.	Himalayan Bank Limited	7.44	6.14	3.53
2.	Bank of Kathmandu Limited	4.99	2.52	2.20

As per international standard only 5% NPL is allowed but in the context of Nepal 10% NPL to total gross loan is acceptable. While studying data presented in the above table, each and every commercial bank has more to less some percentage of NPL to total loan. The old and government owed banks are facing the high level of NPL where as the new established banks have managed to put the NPL below the standard point.

It is a great nation burring issue and becoming difficult to mange day by day. Nepalese baking industry can not get rid from this problem. They are confronting with increasing non-performing loan. So this study has identified the following research questions regarding to NPA with special reference to Himalayan bank Ltd. And Bank of Kathmandu Ltd.

What is the status and trend of non-perfuming loan of selected commercial banks?

a. What are the factors leading to accumulate of non perfuming assets?

b. What percentage of total assets and total lending is occupying by NPA of selected Nepalese commercial bank?

c. What percentage of total assets and total lending is occupying by NPA of selected Nepalese commercial bank?

d. What is the relationship between loan and loan loss prevision in the selected commercial banks?

e. What are the guidelines and provision pertaining to loan classification and loan loss prevision and are Nepalese commercial banks practicing Nepal Rastra Bank regulation/ directives regarding loan loss provision for non performing loan or not?

f. What is the overall effect of NPA on the profitability of the banks under study?

NPA is one of the major problems faced by the commercial banks due to instability of political situation, insecurity of industry sector, etc. Therefore the appropriate investment policy is basic need of commercial policy and strong commitment for government to recover non performing loan from creditors. The main focus of the problem is the related to comparative analysis of NPA of commercial banks.

1.3 Objective of Study

1) To identify the effects of Non-Performing Assets on ROA and ROE.

2) To identify whether NRB guidelines are actually being implemented in the case of Non-Performing loans or not.

3) To find out the factors behind the accumulation of NPA .

4) To recommend to overcome the difficulties in managing NPA.

1.4   Significance of the Study

Commercial bank is the deal deals in exchange currency, accept deposit, giving loan and doing much more financial traction. Therefore commercial bank is pool between lenders, creditors, investors and depositors. It means

commercial bank collect fund from depositors and gives loan to the user or invests in different investment alternatives such as shares, debentures and government bond etc. The success and prosperity of the bank heavily depends upon the the successful implementation and investment of collected resources, which develops the economic of the country. Good investment is positive impact on the economic development of the country. To success of any bank depends upon the amount of performing loan/assets. Performing assets are those loans that repay principal and interest to the bank from the cash flow it generates.

It is well known fact that bank and financial institution in Nepal has been facing the problem of swelling non-performing assets and issue is becoming more and more unmanageable. Unfortunately nowadays banks have been becoming victims of high level of NPA. Non-Performing assets are those loans, which neither pay interest nor repay principal from the cash flow it generates. So NPA has been becoming subject of headache to the banking sectors. Likewise Nepalese banking sector can't escape from such truth. Some of the direct beneficiaries of the study could be named as lenders, creditors, investors, depositors of the bank. This study would provide clear picture of the commercial bank how they invest its collected fund. This study also helps on investment practice that would help the bank to further improve the investment policy.

1.5   Limitation of Study

1) This study is concerned only with Non-Performing assets Of Himalayan Bank Limited and Bank Of Kathmandu Limited. It doesn't consider other banks.

2) This study is focused on HBL & BOK only. Hence the findings may be not applicable to other Development Bank & Finance Companies.

3) This study is mainly based on secondary data such as annual report of the selected banks, other related journals, previous thesis, magazines, books, library, and internet will also be used.

4) This study covers five year period from mid-July 2003 to mid- July 2007

1.6   Organization of the Study

The study consists of five chapters:

Chapter one   : Introduction

Chapter two   : Review of literature

Chapter three   : Research Methodology

Chapter Four   : Presentation and Analysis of Data

Chapter Five   : Summary, Conclusion and Recommendation

Chapter I: Introduction

Under this chapter, introduction deals with the background of the study, evolution, statement of the problems, scope and limitation of the study.

Chapter II: Review of Literatures

Review of literatures mainly focuses on the NPA analysis of HBL & BOK. It also tries to find out previous research works done about same topic with reference to its past and present action to be carried out.

Chapter III: Research Methodology

Research Methodology is the main organ of this study. It is used to achieve the objectives of the study. It includes research design, nature and sources of data, method and tools of data collection, presentation and analysis of data and data processing.

Chapter IV: Presentation and Analysis of Data

The various types of data collection through different sources have been presented in systematic order. The collected data presentation will be analyzed and interpreted using statistical tools.

Chapter V: Summary, Conclusion and Recommendations

Summary and conclusion are drawn on the basis of valuable information given by the experts of that field. Hence, at the analyzing the collections, information and data, conclusion will be drawn and some important recommendation will be presented for future improvement and immediate action in the field of financing of hydropower project in Nepal

CHAPTER–II

REVIEW OF LITERATURE

Review or literature is a basic requirement for any research. Works that have been done regarding the subject matter has to be reviewed thoroughly so that duplication or study and unnecessary time consuming can be reduced. In order to make the thesis precise and fruitful, review or related books, articles published in various Journals, bulletins, yearly published balance sheet of related banks news paper, magazines, websites NRB directives and guidelines, economic surveys , budget speech and previous related thesis on related subjects have been reviewed in details.

This chapter has been divided into the following parts.

2.1   Conceptual Framework

2.2   Review of Related Studies

    2.2.1   Review of Relevant NRB Directives

    2.2.2   Review of Related Articles/ Journal

    2.2.3   Review of Relevant Thesis

2.3   Research Gap

2.1.   Conceptual Framework

This heading focus the meaning and concepts of the term used in the study

2.1.1 Loan and Advances

The main function of the commercial banks is the granting of credit. Banks offer a wide spectrum of financial service, leading has traditionally been their main function. Loan and advance are assets coming form such

activities. The main business of the banking to providing loan and advance to their customers. Such activities are the primary sources of income to the banks. By providing loan and advance, banks have contributed to the growth of their respective community. This loans and advances are also regarded as risky and the least liquid assets of banks. Loans and advances may take different forms are allowed against various types of securities. Loans, overdrafts, discounting of bills of exchange etc. are some of the forms of the bank lending. Lending is an art in the sense that with the available information because if is always carries a certain degree of risk. Loans and advances dominate the assets side of the balance sheet of any bank. Similarly earning from such loans and advances occupy a major space in income statement. Most of the banks failures in the world are due to shrinkage in the value of loan and advances. Hence, loan is known as risky assets (Dahal and Dahal, 2002: 114).

2.1.2 Performing Loans

Loans with interest that have been served in prescribed time frame are categorized as performing loan. Different country may have different policy to classify the performing loans. In the context of Nepal, loans that have fallen under "pass" category are treated as performing loan.

2.1.3 Non- Performing Loans

An asset is classified as non-performing assets (NPAs) if the borrower does not pay the dues in the form of principle and interest in time, the loans are classified as non-performing one. In other words, loan which are not performing as per the prescribed time of the bank are called non-performing loan. The Payment period varies form nation to nation. Some countries show the loans to past due very shortly and some many have little bit relax policy. However a common feature of NPL is past due that have not been served for more than 90 days. In Nepalese context also if the loans are past due since

three months, it should be reported as non-performing loan. In other words loan classified under substandard, doubtful and loss categories are regarded as non-performing loans.

NPLs create problems for the banking sectors balance on the assets side. They also crate a negative impact on the income statement as a result of provisioning for loan losses. Ultimately a riskier loan portfolio combined with lower net income makes new lending more difficult, often resulting in slower credit growth. In the worst scenario, a high level of NPLs in a banking system poses a systemic risk inviting a panic run on deposits and sharply limiting financial intermediation, and subsequently investment and growth in the economic.

It not properly handled, resolution of NPL burdens can also create moral hazard incentives for banks and borrowers a like. Banks can always rely on a centralized assets management company (AMC) to accept transfer of their bad loans, even these resulted from their own recklessness. Borrower, on the other hand, can be made to believe the once their debts go to a government agency that has limited incentive and inadequate legal powers to run after defaulters, then they are essentially freed from their obligation to pay. These moral hazard incentives perpetuate a non-repayment Cultures and non-aversion to risk. Consequently, the cycle of blank collapse and recapitalization, of crisis and restructuring, goes on.

Fiscal cost accounting often fails to incorporate income from recoveries of bad loan assets, which can significantly offset the original fiscal expenses, particularly when the assets were transferred to a government-owned agency. Thus it is difficult to estimate the true cost of the economy of attempting to remedy financial sector instability (www. Indianfoline. Com /legal/ feat/thle.html).

2.1.4 Loan loss provision

Loans loss provision is accumulated fund that is provided as a safe guard to cover possible loss upon classification of risk inherited by individual loans. There is risk inherent in every loan. Hence, provisioning is made as Cushion against possible losses and to reflect the true picture of the bank's assets. Hence, there is practice of showing net loan (total loans-loan loss provision) in financial statement. The amount required for provisioning depends upon the level of NPAs and their quality. High amount of provision is an indication of that bank's credit portfolio needs serious attention. One percent provision of total credit is an ideal position as it the minimum requirement for all good loans. In Nepal, 1%, 25% 50% and 100% provisioning should be made for pass, substandard, doubt full and loss loans respectively.

2.1.5 Causes of NPA

One of the potential factors responsible fro increasing non performing assets of the commercial banks is lending policy of the banks. Similarly ineffective credit policy, weak monitoring, lacking of portfolio analysis , shortfall on security, weak credit concentration,, mismanagement within the banks, inability to identify borrowers bad intention etc are loopholes in the side of banks and economic and industrial recession, insufficient legal provision for the recovery of dues, inconsistency on government policy, lack of monitoring and supervision form central Bank, high and conservation provisioning requirement are some external factors responsible increasing NPA of banks.

There are various causes to increase the NPAs/NPL. It can increases due to:

- Lack of transparent and clear policy to mobilize the assets productivity.

⟩ Lack of effective forecasting or deviation between expectation and actual outcomes of the business.

⟩ Wrong chosen of project and business to lend the fund.

⟩ Lack of supervisors, monitoring and control.

⟩ Lack of information and communication between banks and customer.

⟩ Lack of proper information about the situation and transaction of the customer at the time of rendering loan.

⟩ Wrong valuation of accepted collateral by the bank to the loan

⟩ lack of step towards the decrease or sell the NPAs, which are not useful to the bank.

⟩ Lack of training s and seminars to build the smart human resources.

⟩ Depression of the economy of the country due to the insecurity and instability of the business environment.

⟩ Lack of trainings and seminars to build the smart human resources.

⟩ Depression of the economy of the country due to the insecurity and instability of the business environment.

2.1.6 Effect of NPA on profitability of the bank

Under the circumstances assets that do not earn any income to the bank affect the profits in a number of ways.

Profitability impact:

- The resources locked up in NPA are borrowed at a cost and have to earn a minimum return to service this cost.

- NPA on the one hand do not earn any income but on the other hand drain the profits earned by performing assets through the claim on provisioning requirements.

- Since they do not earn interest they bring down the yield on advances and net interest margin or the spread.

- NPA have a direct impact on return on assets and return on equity, the tow main parameters for measuring profitability of the bank.

- Return on equity is also affected as provisioning eats more and more into profits earned.

- The cost of maintaining these assets include administrative costs, legal cost and cost of procuring the resources locked in.

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

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

- Lower ROE and ROA

- Lower image and rating of bank.

- Disclosure reduces invertors' confidence

- Increases costs/difficulties in raising capital.

- NPA do not generate income.

- They require provisioning

- Borrowing cost of resources locked in

- Opportunity loss due to non recycling of funds

- 100% risk weight on net NPA for CAR

- Capital gets blocked in NPA

- Utilizes capital but does not generate income to sustain the capital that is locked.

- Recapitalization by government comes with string

- Administration and recovery cost of NPA

- Effect on employee morale and decision making

(Source: Ghimire Govinda, 2005: 21)

2.1.7 NPA Management

Banking sectors are the backbone of a country. The motto of the commercial banks is to mobilize the resources by investing the same in a profitable manner.

The resources may include capital funds consisting the shareholder equity, money deposited by the people, borrowing and profit capitalization. Though the activities of them are guided by some social obligation s but some profit has always been desirable for existence.

Big chunks of sources are being utilized on and advanced by commercial banks. They follow the principle of higher return higher risk. On one hand the mushrooming growth of banks has led them towards cut=throat competition on the next hand economic condition of the country is more or less stagnate. Result is no new area could be colored. The competition among bank is just to share the small size of the cake on the other hand

quality of the loans and advances could not be maintained result is increased on non-performing assets of bank. Increasing NPA has the direct effect to banks, investors and customer.

Internal effect: Due to NPA the banks have to make loan loss provision from their profit and other sources. That's why the profit of the banks decreases or may occur losses. As a result share capital also becomes capital erosion and capital inadequacy. If the provision for doubtful debts crosses 5% of the total loan amount, the bank have to pay income tax as profit. So, it has direct effect to the cash flow of bank. As a result the profit of the bank has affected.

External effect: When banks accept deposits from the public and provide loan to the operation of business and other purposes. When the loan does not return with its interest, it becomes non-performing assets and banks will not able to return the deposited amount to their customers. It the banks unable to return the deposited amount the banks are loosed public supports and faiths. Not only that much but also, the banks have to take loan at a higher rate to pay deposit, which directly affects the profitability of the banks was which lead the bank bankruptcy and dissolved.

Likewise, NPA adversely effect profitability and the reputation of the banks hence they concentrate on management of loan and advances. Classification of loan and advances, loan rescheduling and restructuring. Loan loss provision are measures of NPA management. Nepal Rastra Bank has been issuing directives for the NPA management of commercial Banks to cope up with the increasing level of NPA.

Loan classification is basis for loan loss provisioning . loan classification is based in aging factor of loan. Sometime for the maintenance of the commercial relation and going through the viability of project or by evaluating the borrowers financial viability often back up by additional

personal and corporate guarantee or additional collateral security loans are restructured or rescheduled. Restructure and rescheduled loan on its aging factor and interest and principal payment criteria is again classified under performing and non performing loan. Loan loss provisioning is done to curb up the financial so that occurred due to non-performing loan. Inefficiently in part of bank and country's economical and political instability, prevailing cut-throat competition among bank are some actor responsible for increasing NPA of banks. Banks deal in public money so they must be responsible to the general public. In this regard bank has to do loan loss provisioning for out of operating profit it made every year. Loan loss provisioning is made to safeguard the interest of stakeholders of bank. loan loss provisioning stet aside for performing loan is defined as 'general loan loss provision " and loan loss provisioning set aside for non performing loan is defined as Specific Loan Loss Provision". For restructured and rescheduled loan additional loan loss provisioning is made. In this regard it has to follow NRB directives. NPA management aims for redacting of the risk aroused through NPA by classifying the loan and advances on the basis of again factor. There by making loan loss provisioning every year out of operating profit so when loan finally turns into loss loan there is no heavy financial burden at that time. Hence, mitigating the risk by dong proper planning of loan loss provisioning(Ghimire Neetu, 2008 :19).   .

2.1.8   Global Development of NPAs

The core banking business is of mobilizing the deposit and utilizing it for lending to industry. Lending business is generally encourage 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 a future obligation.

A question that is how risk cans a bank affords to take? Recent happening in the business world Enron, World 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 institution also reveals the fact that the biggest banking failures were due to credit risk.

Due to this, banks are restricting their lending operation to secured avenues only with adequate collateral on which of fall back upon in a situation of default.

(Sources: http://www.indianinfoline.com/lega/feat/thle,html).

2.1.9 Non Performing Assets/Loans in South Asia

2.1.9.1 India

More authentic information about the volume of Non-Performing Assets (NPAs) of Indian Bank is available from 1997 onwards and therefore the growth of Non-Performing Assets (NPAs) since 1997 is presented here. Non-performing Assets (NPAs) contains of the aggregate of sub standard, Doubtful and loss assets. (Table-2) In the case of Indian public sector banks, the percentage of NPAs to total advances (comprising 5.1 percent of 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 1997 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 2002.

Table: 2.1

Percentage of different categories of loan assets to total advances of scheduled commercial banks in India

	Standard	Sub-Standard	Doubtful	Loss	NPAs
1997	82.2	5.1	10.7	2.1	17.8
1998	84.0	5.1	9.1	1.9	16.0
1999	84.1	4.9	9.0	2.0	15.9
2000	86.0	4.3	8.0	1.7	14.0
2001	87.6	3.3	7.6	1.5	12.4
2002	88.9	3.1	6.6	1.4	11.1
Old private sector banks					
1997	89.3	5.5	4.1	1.1	10.7
1998	89.1	5.5	4.2	1.3	10.9
1999	86.9	6.6	5.0	1.4	13.1
2000	88.2	4.5	5.8	1.0	11.2
2001	88.7	4.1	6.2	1.0	11.3
2002	89.0	4.2	6.1	0.8	11.0
New private sector banks					
1997	97.4	2.1	0.0	0.5	2.6
1998	96.5	3.3	0.1	0.2	3.5
1999	93.8	5.2	0.9	0.0	6.2
2000	95.9	2.5	1.3	0.4	4.1
2001	94.9	3.1	2.0	0.0	5.1
2002	91.1	3.8	5.0	0.1	8.9
Foreign Banks in India					
1997	95.9	2.4	0.9	0.9	4.3
1998	93.6	3.9	0.8	1.7	6.4
1999	93.0	4.0	1.6	2.0	7.6
2000	95.9	2.9	2.1	1.9	7.0
2001	93.1	1.9	2.6	2.3	6.9
2002	94.5	1.7	2.0	1.8	5.5

(Source: Trend and Progress of Banking in India, B.S. Sreekantaradhya 2004: 116)

In the case of old private sector Banks, the percentage of NPAs to total advances increased from 10.7 percent (comprising 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 1997 to 11.0 percent (comprising 4.2 percent of sub-standard assets, 6 percent of Doubtful assets and 0.8 percent of loss assets) as at of March 2002. 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 1997 to 8.9 percent (comprising 3.8 percent of Sub-standard assets, 5 percent of Doubtful assets and 0.1 percentofloss assets) as at end of March 2002. 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 1997 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 2002. 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.

2.1.9.2 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 1 and 2 capital adequacies. 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: 2.2

Non-Performing Loan Ratio in Bangladesh

Types of Banks	Gross Non-performing loan ratio				
	2000	2001	2002	2003	2004
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
FCBs	3.4	33.0	2.6	2.7	1.5

Types of Banks	Net Non-performing loan ratio				
	2000	2001	2002	2003	2004
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
FCBs	-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 1998, which came down to 31.5 percent in December 2001. 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 2004. 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 during 2001-2004. PCBs' gross Non-performing Loans position has improved 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 2004. The improvement in the Non-Performing Loans of banks is positive has been remarkable.

(Sources: Milestone, Golden Jubilee Publication of Nepal Rastra Bank 2005, by Fakhruddin Ahmed, Governor, Bangladesh Bank)

2.1.9.3 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 90 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

2.1.10 Non Performing Assets/Loan in East Asia

2.1.10.1 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 some what 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, including Non-Performing Loan (NPLs) problem in the finance and corporate sectors, have not progressed sufficiently. This paper looks into the issues that beset 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 has 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 Countires 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 Indonesia 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.

2.1.10.2 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 to 11.2 percent by February 2000. Danamodal, the organization for the infusion of public funds, has pumped 6.4 billion Ringget (equivalent to U$$2 billion) into 10 banks so far, and already six of them have repaid their debt amounting to U$$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 U$$9.5 billion. All debt restructurings are scheduled on is settled by September 2000, including 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.

2.1.10.3 Thailand

The process of settlement of NPLs is delayed in Thailand, primarily because the government's response has been rather weak. It did not adopt a centralize 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 depreciate 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 U$$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 pubic 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 334.3 billion bhat were reduce 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.

2.1.10.4 Indonesia

Among the four nations cited 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 nationalize) 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 politics, and there was scarily and progress in the resolution to NPLs in 1999.

The Jakarta initiative, in charge of out-court settlement, was set up in January1998. 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 U$$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 Initiative Task force.

(Sources: admin@iima.or.jp)

2.2   Review of Related Studies

2.2.1   Review of Relevant NRB Directives

Streamlining the pervious directives and to have more effective control mechanism for overall financial sector, recently, on August 2005, NRB has issued consolidated new directive for all financial institution i.e. commercial banks, development banks, finance companies and micro finance institutions. Before this directive, commercial banks, development banks, finance companies and micro finance institutions are guided by separate directives. As per this new directive also, loan classification and provisioning of loans of financial institutions are mentioned on E. Pra. Directive No. 2/061/062 this directive is dealt in detail and follows:

1. Classification of Loans and Advances

a. Pass

Loans and advances whose principal amount are not past due and past due for period up to three months shall be included in this category.

b. Substandard

Loans and advances whose principal are past due for a period of 3 months to 6 months shall be included in the category.

c. Doubtful

Loans and advances whose principal are past due for a period of 6 months to 1 (one) year shall be included in this category.

d. Loss

Loans and advances whose principal are past due for a period of more that 1 (one year shall be included in this category.

Loans and advances which are categorized into pass loan are defined as performing loan. Similarly, loans and advances failing in the category of substandard, doubtful, and loss are defined as non- performing loan.

2. Additional Arrangement in Respect of Pass Loan

loans and advances that are fully secured by gold, silver, fixed deposit receipts and HMG securities shall include under 'Pass' category/ However, where collateral f fixed deposit receipt or HMG securities or NRB Bonds is placed as security ageist loan for other purposes, such loan has to be classified on the basis of ageing.

3. Additional Arrangements in Respect of loss Loan

Even if the loan is not past due, loans having ay or all of the following discrepancies shall be classified as 'Loan'.

> a. Insuffient security/ collateral.

> b. The borrower has been declared bankrupt.

> c. The borrower is absconding or cannot be found.

d. Purchase d or discounted bills are not realized within 80 days from the due date.

d. Misused to loans.

f. Owing to non-recovery, initiatin as to auctioning of the collateral has passed six months and if the recovery process I sunder litigation.

g. Loans provided to the borrowers which is include in the blacklist of credit information Bureau.

4. Additional Arrangement Regarding of Term Loan

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

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

6. Letter of Credit and Guarantees

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

7. Rescheduling and Restructuring of Loan

1. Financial institutions may reschedule or restructure loans and advances upon receipt of written plan of action from the borrower citing the following reason:

a. Evidence fro adequate collateral and documentation regarding loans.

b. Financial institutions have confidence that loans can be recover after rescheduling

Note: rescheduling means to ext6end the loan payment period that have been borrowing by the customer.

Restructuring means to huge the loan type and conditions and including change in loan payment period.

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

8. Loan Loss Provisioning

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

Provisioning Rate if classified loan and advances as per NRB directives

Classified of loans and advances	Loan Loss Provision(%)
Pass	1
Substantial	25
Doubtful	50
Loss	100

Loan loss provision set aside fir performing loan is defined as "general loan loss provision" and loan loss provision set aside for non-performing loan is defined as "specific loan loss provision"

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

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

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

c. If interest and principal of rescheduled / rescheduled loans have been served regularly since two years, such loans can be converted in to 'Pass' loan.

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

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

Additional Provisioning Rate of Guaranteed Loan And Loss Provision

Classified of loans and advances	Loan Loss Provision(%)
Pass	21
Substantial	45
Doubtful	70
Loss	100

2.2.2 Review of Relevant Articles/ Journals

In today's world, economic development is the key to all sectors of the world. Competitive financial sector can only assure the development of any country. Most of the under developing countries find way behind the developed countries to become a successful tread partner and to achieve economic development, management of NPA in necessary.

In an article *Challenges of Non-Performing Loan Management in Nepal* Uma Karki has mentioned the causes of increasing trend of non- performing loan. Author identifies the major causes such as "poor loan Analysis" guarantees oriented loan system, deprecation on value assets, misuses of loan, lack of regular supervision of loan. (Karki, 2059 Nepal Rastra Bank Samachars, Vol-4, p. 87)

Deependra Bd. Chhetri (2057) stated in his article title *Non-Performing Assets: A Need for Rationalization* that to provide connation of the NPA and its potential sources, implication of NPA in financial sector in the south Asian resign. He has also given possible measure to contain NPA. "Loan and advances of financial institutes are meant to be serviced either part of principle of the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan settlement. Since the date becomes past dues, the loans becomes non-performing asset. The book of the account with lending institution should be effectively operative by means of real transaction effected on the part of the debtor in order to remain loan performing." (Chhetri, 2057:17)

As per his opinion, the definition of NPA differs from country to country. In some of the developing countries of Asia pacific economic cooperation (APEC) forum a loan is classified as non-performing only after it has been arrear for at least 6 months. Similarly, it is after three months in India. Loans thus defaulted are classified into different categories having their differing

implication on the assets management of financial institution. He also stated that NPAs are classified according to international practice into three categories namely substandard, doubtful and loss depending upon the temporal position of loan default. "thus the degree of NPA assets depends solely on the length of time the assets has been in the form of none obliged by the loanee. The more time it has elapsed the worsted condition of assets is being perceived and such assets are treated according."

As per Mr. Chhetri's view, failure of business for which loan was used, deceptive and below standard credit appraisal system, credit program sponsored by government, slowdown in economy/recession diversion of fund are some of the lending to accumulation of NPAs.

He said that there is serous implication of NPAs on financial institution. He further added that the liability of credit institution dose not limit to the amount declared as NPA but extend to extra amount that requires by regulation of supervisory authority in the form of provisioning as the amount required for provisioning depends upon the level of NPAs and their quality. As per his view rising level of NPAs create a psyche of worse environment especially in the financial institution like waiving interest, rescheduling the loan, writing off the loan, appointing private recovery agent, taking help of tribunals and law of land etc NPAs can be reduced.

Finally he concluded that financial institutions are beset with the burden of mounting level of NPAs in developing countries. "Such assets debar the income flow of the finical institution while claiming additional resources in the form of provisioning thereby hindering gainful investment. Rising level of NPAs cannot b taken as stimulus but the vigilance demanded to solve the problem like this, eventually will greater vigor to gear up the banking and financial activities in more active way contributing to energizing growth.

Bishwambher Pyakuryal (2001) has stated I his articles entitled. *Our Economy is in a Volatile Stage* that the banks have not able to collect their overdue due to the increasing cumulative NPAs in Nepalese commercial banks. There is no additional demand of the investments due to the higher risk and present uncertainly.

He said, revenue collection is negative and regular expenditure is higher than the avenue. This indicates volatility of the economy. Even before the declaration of emergency, the government did not have surplus revenue to pay for the remuneration and benefits of retired civil servants. The year 2002 is going to be difficult a major bans are going to mature. Debt servicing will also demand a significant share of the budget. Up to 65 percent of our development expenditure (through our revenue), it will be very difficult for us to convince the donor community. This could push our society towards what is called a 'mass unrest society'.

He also ads "the government is about to seatbacks an assets management company to take over the non-performing assets (NPAs) of the government-owned banks. On the other hand it looks like the government's entire concentration has been on tow commercial banks only (Nepal Bank Ltd. And Rstriya Banijya Bank). Due to cumulative growth of the NPAs the banks haven't risks, there is virtually on demand for new investments. That's why many banks are concentrating on conventional areas. We haven't been able to explore potential areas of competitive advantage in the regional context," (Pyakuryal, 2001:3).

After 1990, we have seen the macroeconomic stability could not ensure the reduction of poverty. If the present rte of economic growth and population growth continues. It will take at least 20 years to double our per capital income. It has been proved that macroeconomic stability alone can't ensure economic development in a country like Nepal. At the same time, the low-

level of inflation at present may not reflect future prospects for Nepalese economy.

Mr. Pradhan (2058) in his article *NPA: Some Suggestion to Tackle them* says that unless the growth of NPA is kept in control, it has the potential to cause systematic crises. He has mentioned that a dream of globalization leg to huge investment, which unfortunately could not be utilized properly due to hesitant liberalization policies.

Large corporate misused the credits delayed payments and contributed indirectly for enhancing NPA ratio. He further argue that lack of vision in appraisal of proposal which loan sanction, reviewing credit limits, absences of risk management policy of financial, concentration of credit in few group, lack of co-ordination among other financier group, lack of action against defaulters, indecision on existing out of bad loans for fear of investigating agencies like special policy, CIAA, public, accounts committee of the parliament has also contributed in whatever measure to the worsening situation of NPA. His further point out must crucial reason for the increased in the NPA is the shabby and defaulter friendly legal system. Suggestion the remedy of NPA he adds that administrative system should be formed (Pradhan, S. M. 2058, Baisakh, Mirmire, vo1-1, p.28).

Mr. Him Prasad Neupane (2060) in his article titles *Bad Loans of Banking Sector Challenges and Efforts to Resolve it,* has thrown some views regarding bad loans of banking sector. As mentioned by him there was various types of risk inherent in the credit. One, who manages risk, earns profit. He further added that the recent financial crisis in banking sector is due to weak accounting procedures defect in loan classification, lack of transparency, loss control measures etc.

Like the other writers, Mr. Neupane has also stated that NPL is the indicator of financial crisis and the factors leading to NPL is economic slowdown,

recession, bad international of the borrower, lack of credit policy, increase in interest rate etc. NPL increases resource mobilization cost and reduce profit-earning capacity of the bank. He has also mentioned that the international standard of acceptable NPA is 4% but there is about 26% NPL in Nepalese banking sector which is due to high level of NPL are banks cannot return depositors money on demand and it limits lending capacity of the bank. The writer has suggested internal and external measures for reducing NPL and its effect. Internal measure comprises classification of loans and ad advances and providing provisions for probable loss and external measures comprises of help from credit information Bureau (CIB), appointment of asset management company (AMC) and debt recovery tribunal (DRT).

He concludes, Banks must give priority for reducing NPA. He has also mentioned that many countries are adopting various measures for reducing loan loss. Recently the president of Philippines has announced tax rebate system for reducing NPA. Now it is high time to improve bad debts of banking sector with firm determination (Neupane, Nepal Rastra Bank Samachar, 2060, p. 141`)

2.2.3 Review of Relevant Thesis

Mr. Santosh Pandey (2002) has conducted his study entitled *Rastra bank directives implementation and impact on the commercial bank* the main objective to his research is to find out the normal and standards laid down by NRB relating to the loan classification and provisions, single borrower limit and capital adequacy of bank. The directive, if not properly addressed, has potential to weak the financial systems of the country, as they are any tools of the NRB supervise and monitor the financial intuitions. The directives in themselves are not that important unless properly implemented. The importation part depends on the commercial banks. So it is felt that there is need to find out if the directions are being followed. In case the commercial banks are making such huge profit with full compliance of the directives,

then the commercial banks would deserve votes of praise because they world then be instrumental in the economic development of the country. From the study he concluded that the new directives required banks to re-categories the loans into four different categories on the basis of aging. The period of past due period for the loans has been changed. Accordingly, the percentage of provision needs to be made by the banks for each category of loans. The limits for the single borrower limit on fund based loan and non-fund based loan have come down. This is mainly become the previous limit for both types of loan were based on the total capital fund while the present limits are based only on the core capital which is less then the total capital fund of the bank.

He furthers concluded that all the foreside result lead to one direction, the bank would be financially healthy and strongly in the future. HBL will be able to withstand tougher economic situation in the future with adequate capital and provision for losses. The tough time through which the bank is undergoing at present will prevail any for a couple of years. But in the long run, it will be strong enough to attract more deposit and expose itself to more risks with capital cushion behind it. Ultimately the changes in direction will bring prosperity not only to the shareholders but also to the depositors, the employees and the economy of the country as a whole.

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

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

Mr. Dinesh Kumar Khadka (2004) in his thesis entitled *non- performing assets of Nepalese commercial Banks*, has explained about the topics in which he had objectives to study and examine the level of NPAs in total assets, total deposits and total lending of commercial banks of the banking industry of Nepal.

He also had studied whether the Nepalese commercial banks have been following the directives of NRB regarding loan loss provision for non-performing loans/ assets or not. He had taken sample banks as Nepal SBI bank limited, Nepal Investment bank limited, Nepal Bangladesh bank limited, Bank of Kathmandu, limited, Nabil bank limited from his studies, it is found that the level of NPA of Nepal Bangladesh bank limited seemed graters then all of the other banks under his study. Similarly, Nepal SBI bank and Bank of Kathmandu stand at second and third position respectively. The position of Nabil bank limited seemed to be quite satisfactory because, the bank has been reducing its, NPA every year. NPA of Nepal Investment Bank stands at minimum then that of all the other banks. From the study it has also been fund that none of the banks have been following the directives of NRB regarding the loan loss provision. Despite of high level of NPA the loan loss provision made by the Nepal Bangladesh Bank seemed to be quite satisfactory than any of others banks. Despite of the outstanding success in managing the NPA the loan loss provision made by

Nepal Investment Bank is not considerable. It meant the loan loss Provision of Nepal Investment Bank is very less than the requirement.

Mr. Govinda Ghimire (2005) in his thesis entitled *Non Performing Assets of Commercial Banks:* caused and effect, in which he had the objectives to evaluate the impact of NPA on the profitability of the commercial banks. He also studied about the internal and external factors that affect the non performing assts to increase from the loan and advances. The internal factors that influence the effective management of the NPA and its increment. The objective of his studies is also to find out the relationship between the non banking assets and the non-performing assets, in which he was able to find out very much important result from the survey. The study was are to find out the internal responsible factors that contributes turning good loan into bad loan, bad intention, week monitoring and miss management are the most responsible factors that contribution turning good loan into bad loan, bad intention, weak monitoring and miss management are the must responsible factors, similar weak legal provision and credit concentration are also found as the least preferred factors in turning good loans in to bad loans. Some factors such as lack of portfolio analysis, not having effective credit policy and shortfall on security were identified as having average effect on NPA growth. In connection to the external factors it has been found that recessing, political and legalisms use are more relevant factors in turning good loans in to bad loans like wise legal provision for recovery as a reason for incensement in NPA in Nepalese banks have been found the factors having less impact. Supervision and monitoring system have been identified as average factors. It is there fore, can be generalized that economic and industrial recession and not having strong legal provision for loan recovery are major external factors that have major contribution for the increment of NPA.

It has also concluded in the study that Nepalese Commercial Banks gave must priority, lending its resources, to trade sectors, at the same time it is found that service sectors are not being given that much emphasis. He had recommended to the sample banks, Nepal Bangladesh Bank ltd. Nepal SBI Bank Ltd. and Bank of Kathmandu Ltd. as on different headings, subject matters such as financial strength, personal integrity and security, monitoring and control system avoidance of credit concentration, strong legal system, assets Management Company, avoidance of undue pressure.

Mrs. Sabitri Shrestha (2003) in her thesis *Impact and implementation of Nepal Rastra Bank Guideline on Commercial Bank*: A study of Nabil Bank limited and SBI Bank limited" has tried to find out the impact of NRB directives on Commercial Banks. She has also find out wherether NRB directives are actually monitoring or not.

She has concluded "All the change in NRB directives made both positive and negative impacts on commercial banks. Even through the study is any two private banks i.e. Nabil Bank and Nepal SBI Bank among entire population, it clears the new directives issued by NRB made good impact more then bad impact on the various aspects of the banks. The increased provisioning amount has decreased the profitability of commercial banks loan exposure has been cut down to customers due to the borrower limits have been brought down by NRB. Therefore, reduction in loan amount results to decrease the interest income from loans, which will decrease the profits of the banks in coming years on the positive sides of new directives; recently the problems of banks are increasing operating cost and decreasing loan amount resulting decrease in profits of the banks. But it shows it is only short-term because the directives are more effective to protect the banks from bad loans, which protect the banks from bankruptcy as well as protection of deposits of depositors. Increase in capital adequacy ratio strengthen the bank's financial position, loan related provision will made

safety of loan except the risk reducing provisions will protect the bank from liquidation. After all, it can be concluded that newly issued directives are more effective then previous one although it has brought some problems towards banks. To decrease the decreasing profits of the banks, they should research the alternatives such like more investments in other business; bank should adopt new technology according to the demand of time and must not depend on only interest income from profit.

2.3   Research Gap

Going through the review of litterateur, it has been found that some research in the related topic and have already been reviewed which helps to this study but no research was found exactly in detail research and analysis of non-performing assets on sample commercial bank. Hence the research had attempted to fill this resrach gap by taking reference fo Himalyayan Bank and Bank of Kathmandu. This study will try to show the present issues, latest information on Bank's NPA and their rations, data and real picture of loan and advance of Nepalese commercial banks.

CHAPTER-III

RESEARCH METHODOLOGY

Research methodology is the process of arriving at a solution of the problem through planned and systematic dealing with the collection, analysis and interpretation of fact figure. It may be understood as a science of studying how research is done scientifically. In this chapter, we study the various steps that are generally adopted by researcher in studying his research problem along with the logic behind them. It refers to the various sequential steps to adopt by a researcher in studying a problem with certain objective in view. It is the guidelines followed by the researcher in order to give the result to his study. In fact, it is the outline of research, which the researcher is going to do. Therefore, research methodology is very important as it represent the method of entire research.

3.1 Research Design

Research design is plan, structure and strategy of investigating conceived so as to obtain answer of research question and to control variance. The plan is the overall scheme of program of research.

Research design is necessary to make well research, which fulfils the objectives of the study. Mainly research design is structure and strategy of investigation conceives to obtain research questions and to find out actual variance. The research is find out the problem and possibility of generating the investment portfolio of commercial banks with reference to selected banks. Regarding the nature of this research, most of the data and information are concerned with past phenomena of the portfolio performance. This study is also based on descriptive as well as analytical research. Descriptive research design describes the general pattern of the banking investment, Nepalese investors, business structure and problem of the portfolio management etc. for analytical purpose; we evaluate the

situation and events occurring at present and past data of selected commercial banks.

3.2 Population and Samples

There are 25 commercial banks in Nepal. Under the study of analysis and management of investment portfolio of commercial banks, the total number of commercial banks operating in Nepal is the population. Only two banks are selected as samples for this study by using judgmental sampling method.

- Himalayan Bank Limited
- Bank of Katmandu Limited.

3.3 Sources of Data

Both primary and secondary data has been used in this study. Bank employees are the primary sources of data and following are the secondary sources of data used in the study.

- Annual report, newsletter, brochure etc. of the selected banks.
- Laws, guidelines and directives regarding the subject matter.
- Text books.
- Articles published in newspaper, journals, magazines and publication
- Websites
- N.R.B published report
- Unpublished Thesis

3.4 Data Processing Procedures and Analysis

The data collection from various sources are recoded systematically and presented in appropriate forms of tables and charts and appropriate mathematical, statistical, financial, graphical tools are applied to analyze the data. And data of four consecutive of the two selected banks are used to meet the objective of the study.

3.4.1 Financial Tools

While adopting financial tools, a ration is used as a benchmark for evaluation the financial position and performance of any firm. "Financial analysis is the process of identifying the financial strength and weakness of the firm by properly establish relationship between the item of the balance sheet and profit and less account (Pandey, 1999, p. 108).

Financial analysis is the use of financial statement to analyze a company's financial position and performance and to assess future financial performance (Wild, 2003, p.13).

3.4.1.1 Ration analysis

Ratio analysis is a tool of scanning the financial statement of the firm. Ti ration is simply one number expressed in terms of another and as such it expresses the numerical or quantitative relationship between two variables. (Pandey I.M. 1999, p. 108).

Loan an advance to total deposit

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

$$\text{Credit to Deposit Ratio} = \frac{Loans\ and\ advances}{Total\ Deposit}$$

Loans and advances to total assets ratio

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

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

Loan loss provision to total loans and advance ratio

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

Loan loss provision ratio $= \dfrac{Loan\, Loss\, \Pr ovision}{Total\, Loans\, Advances}$

Non-performing loans to total loans and advances ratio

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

Non-performing loans to total loans and advances $= \dfrac{Non\, Perfor\min g\, Loans}{Total\, Loans\, Advances}$

Provision held to non-perfuming loan

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

Provision held to non-perfuming loan $= \dfrac{Total\, Loan\, loss\, \Pr ovision}{Non\, perfor\min g\, Loans}$

Return on Loans and Advances

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

Higher the ratio better is the performance of the bank. It is calculated as below:

Return on loans and advances= $\dfrac{Net\ profit}{Total\ Loans\ Advances}$

3.4.2 Statistical Tools

Statistical tools are the mathematical techniques used to analysis and interpretation of numerical data. 'Statistical analysis is one particular language, which describes the data and makes possible to talk about the realties and dereference of the variables (Gupta, 1997, p.21).

3.4.2.1 Correlation Coefficient (r)

Correlation refers to the degree of relationship between two variables. Correlation coefficient determines the association between the dependent variable and independent variable. If between the variable, increase or decrease in one cause increase or decrease in another, then such variable are correlated variables. "Correlation may be defined as the degree of linear relationship existing between two or more variables. Two variables are said to be correlated when the change in the value of one is accompanied by the change of another variable". There are different techniques of calculating correlation coefficient. Among variable technique, we have used Karl Pearson coefficient of correlation. It is calculated as follows:

Correlation Coefficient (r) = $\dfrac{xy}{N\dagger x \dagger y}$

Where,

   x= X- $\overline{X}$

   y= Y- $\overline{Y}$

$†$ x= Standard Deviation of Series X

$†$ y = Standard Deviation of Series Y

N= No. of pairs of observation

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

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 positive relationship between the variables.

r< 0, there is negative relationship between the variables.

r = +1 the relationship is perfect positive.

r = -1 the relationship is perfect negative.

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

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

Where,

N= No. of observation

r= Correlation coefficient

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

R< P.E. then the correlation coefficient is insignificant and there is no evidence of correlation.

3.5 Diagrammatic and Graphical Representation

Diagrams and graphs are visual aid that gives a bird eye view of a given set of numerical data. They represent the data in simple and readily comprehensive from. Hence various bar diagrams pie, charts and graphs have been used for presentation and analysis of data.

CHAPTER-IV

DATA PRESENTATION AND ANALYSIS

In this chapter, raw form of data which are colleted from various scores are processed and changed into an understandable presentation using financial as well as statistical tools supported by diagrams and graphs as motioned in the previous chapter. Similarly, the process of transforming of data is called analysis for the examination and interpretation of the data to draw conclusion. Therefore, this chapter is the heart of the study, as all the findings, conclusions. Therefore, this chapter is the heart of the study, as all the findings, conclusions and recommendation are going to be derived from the calculations and analysis done in this sector for the propose of the study five years data form fiscal year 2059/060 to 2063/064 of all sample banks have been taken into consideration in this chapter descriptive analysis of secondary data is performed.

Descriptive Analysis

Descriptive analysis is carried out to assess the NPA level and its relationship with other key factors in the firms under study. Five years data relating to total asset, total deposit, total loan and advances, provision held, NPL, net profit of the sample banks have been obtained. Using different financial and statistical tools, analysis have been made and drawn the conclusion.

4.1 Data Presentation and Analysis of HBL and BOK

Himalayan Bank

Table 4.1

Performing and Non-Performing Assets in Total Assets, Total Deposit and Total Lending.

S. No.	Particulars	059/060	060/61	061/62	062/63	063/64
1.	Percentage of Performing Assets to Total Assets	41.89	47.44	44.71	49.97	51.17
2.	Percentage of Performing Assets to Total Deposit	46.34	53.48	50.17	55.57	57.08
3.	Percentage of Performing Assets to Total Lending	89.92	91.12	92.56	93.40	96.39
4.	Percentage of NPA to Total Assets	4.69	4.62	3.60	3.53	1.91
5.	Percentage of NPA to Total Deposit	5.19	5.21	4.03	3.93	2.14
6.	Percentage of NPA to Total Lending	10.08	8.88	7.44	6.60	3.61
7.	Percentage of Sub-standard loan in Total NPA	20.53	36.88	6.95	10.30	11.23
8.	Percentage of doubtful loan in Total NPA	34.32	4.75	24.18	21.98	30.39
9.	Percentage loss loan in Total NPA	45.16	58.37	68.87	67.74	58.38

In above Table 4.1 the percentage of performing assets and non-performing assets of Himalayan Bank Limited in its total assets, total deposit and total lending have been presented for five fiscal years.

In fiscal year 059/060, the bank has total landing amount Rs. 10844598988 which was 0.16% increased and reached to Rs.12919630944 at the end of 060/61. Again the bank has total lending amounted Rs. 12,919,630,994 (see Annex) which was 3.95% and reached to Rs.13,451,168,267 at the end of fiscal 061/62. In fiscal year 2062/63, this amount reached Rs. 15,761,976,082 with 14.66% increase in comparison to the previous year. At the end of fiscal year 063/64, it peaks to Rs. 17,793,723,863 with 11.42% increase.

At the end of fiscal year 059/060, the bank had performing assets amount RS. 9751759501 (See annex, 1) which was 41.89 of the total assets, 46.34% of total deposit and 89.92% of total landing. In fiscal year 060/61, the bank had performing assets amounted Rs. 11,772,168,365 (see annex-) which was 47.44% of total assets, 53.48% of total deposit and 91.12% of total lending. In fiscal year 061/62, the amount slightly increased to Rs. 12,449,820,947 which occupies 44.71% of total assets, 50.17% of total deposit and 92.56% of total lending. Similarly, in fiscal year 062/63, the amount reached to Rs. 14,721,218,259 which was 49.97% of total assets, 55.57% of total deposit and 93.40% of total lending. This growth continues in fiscal year 2063/64 amounting Rs. 17,152,108,557 occupying 51.17% of total assets, 57.08% of total deposit and 96.39% of total lending resulting slight increase in performing assets of Himalayan Bank.

The non-performing assets of the bank amounted to Rs.1092839487 recoding 4.69% of total assets 5.19% of total deposit and 10.08% of total landing of the bank during FY 059/060. Again, the non-performing assets of the bank amount Rs.1,147,462,638 recording 4.62% of total assets, 5.21% of total deposit and 8.88% of total lending of the bank during 2060/61. This amount decreased in fiscal year 061/62 and stand at Rs. 1,001,347,320 that occupied 3.60% of total assets, 4.03% of total deposit and 7.44% of total lending of the bank at the end of fiscal year 061/62. This amount further

increase to Rs. 1,040,757,823 in fiscal year 2062/63 resulting 3.53% of total assets, 3.93% of total deposit and 6.60% of total lending. Similarly, fiscal year 063/064 the amount declined to Rs. 641,615,306 occupying 1.91% of total assets, 2.14% of total deposit and 3.61% of total lending of the bank. In this way, the percentage of non-performing assets in total assets, total deposit and total lending as well as amount value has been increase only 062/63 and decrease in 059/060, 060/61, 061/62 and 063/64.

Total non-performing assets 059/060 included 20.53%, 34.32% and 45.16% of sub-standard, doubtful and loss loan respectively. Again, in fiscal year 060/61 included 36.88%, 4.75% and 58.37% of substandard, doubtful and loss loan respectively. Likewise, the total NPA of Himalayan Bank at the end of fiscal year 2061/62 occupied 6.95%, 24.18%, 68.87% by substandard loan, doubtful loan, and loss loan respectively. In fiscal year 2062/63, out of total NPA of the bank substandard loan, doubtful loan and loss and loss loan stands 10.30%, 21.95%, 67.74%. Whereas in fiscal year 2063/64 it stands 11.23%, 30.39% and 58.38% of substandard doubtful and loss loan of the bank at the end of fiscal year 2063/64.

Following table and figure provide the picture of total assets, total deposit, total lending and non-performing assets of Himalayan Bank Limited.

Table 4.2

Total Assets, Total Deposit, Total Lending and Non-Performing Assets of Himalayan Bank Limited

Fiscal Year	Non-Performing Assets	Total Assets	Total Deposit	Total Lending
059/060	1092839487	23279241304	21045086740	10844598988
060/61	1,147,462,638	24,817,369,870	22010332984	12,919,630,994
061/62	1,001,347,320	27,844,694,655	24814011984	13,451,168,267
062/63	1,040,757,823	29,460,389,672	26490851640	15,761,976,082
063/64	641,615,306	33,519,141,111	30048417756	17,793,723,863

Fig: 1. Total Assets, Total Deposit, Total lending and Non-performing Assets of Himalayan Bank limited.
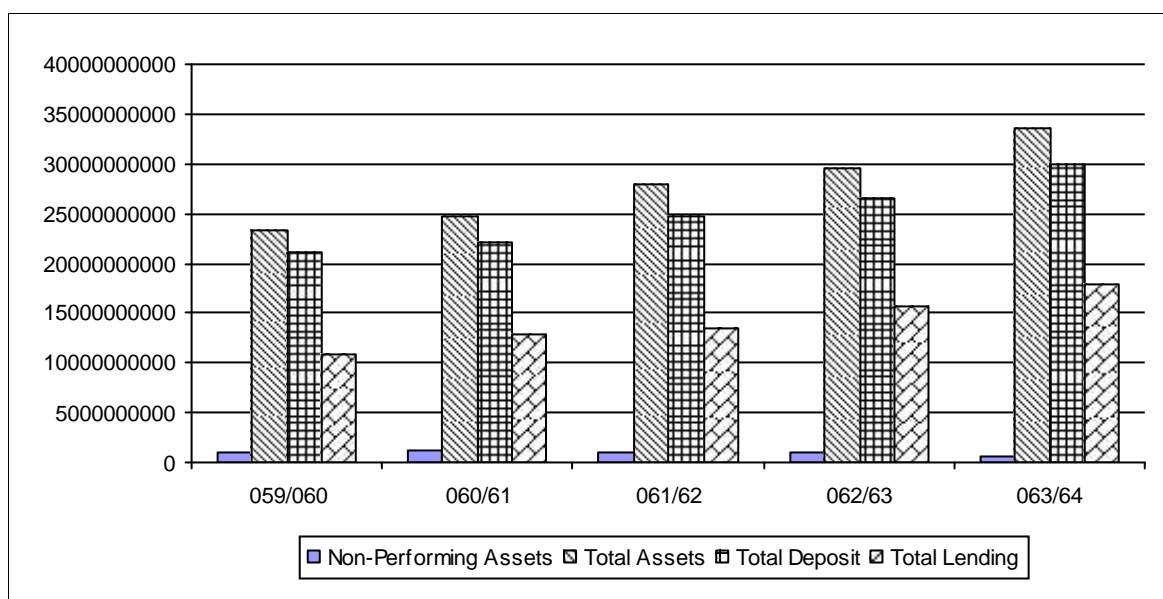
From above figure and table, we can see total assets of the bank increase fiscal year 2060/61 to Rs. 24,817,369870 from Rs. 23279241304 in fiscal year 0590/60. Likewise fiscal year 2061/62 it increases to Rs. 27,844,694,655. In fiscal year 062/063 it increases to Rs. 29,460,389,672 and reached Rs. 33,519,141,111 at the end of 2063/64.

Similarly, in fiscal year 2060/61 total deposit of the bank increase Rs.22010332984 form Rs. 21045086740 F/Y 059/60. In F/Y 061/062 total deposit increase and reach up Rs. 24814011984. Only slight increase has been seen in deposit and reached up to Rs. 30,048,417,756 at the end of fiscal year 063/64. Total lending of the bank gradually increased every fiscal year at reached up to Rs. 17,793,723,863 at the end of fiscal year 2063/64 which was 12,919,630,994 at the end of fiscal year 2060/61.

Above table and figure clearly depicted that the non-performing assets of Himalayan Bank Limited has been decrease in fiscal year 2059/60, 2061/62 but increase in fiscal year 062/63 and also decreased in fiscal year 2063/64. At the end of fiscal year 061/62 the bank has total NPA amounted to 1,001,347,320 that was decreased by 12.73%. At the end of fiscal year 2062/63 it is increased by 3.94% and limited at Rs. 641,615,306 at the end of fiscal year 2063/64.

The regular decrement in non-performing assets of the bank clearly depicts that the bank has been given full attention towards managing non-performing assets of the bank.

Loan Loss Provision of Himalayan Bank

The loan loss provisions maintained by Himalayan Bank Limited for its different typed loan are presented in the following table.

Table 4.3

Loan Loss Provision of Himalayan Bank Limited

Types of Loan	Provision required to be maintained	% loan loss provision				
		059/060	060/61	061/62	062/63	063/64
Pass Loan	1%	1.00	1.00	1.00	1.00	1.00
Sub standard loan	25%	27.92	26.07	60.20	57.78	25.46
Doubtful loan	50%	49.12	50.71	47.23	68.16	50
Loss loan	100%	96.60	97.79	99.54	100.26	99.48

(Source: - Annual Reports of Himalayan Bank Limited)

In above table we can see that loan loss provision maintained by Himalayan Bank Limited for its different class. The bank provisioned 1% for pass loan in fiscal year 059/060, 2060/61, 061/62, 062/63 and 063/64 which are requirements in all years.

Similarly, the bank provisioned 27.92 in F/Y 059/060, 26.07% in fiscal year 2060/61, 60.20% in fiscal year 061/62, 57.78% in fiscal year 062/63 and 25.46% in fiscal year 063/64 for substandard loan. We can see the bank provision fiscal year 059/60 to 063/64. As per requirement bank should maintained at least 25% in this category.

A bank must maintain 50% loan loss provision for doubtful loan but the Himalayan Bank Limited in F/Y 059/060, the bank could provision only 49.12% which is lower the requirement. Again, the bank provision succeeds maintaining more than required level i.e. 50.71% in fiscal year 060/61. Likewise, in fiscal year 061/62, the bank could provision only 47.23% which

is lower the requirement. In fiscal year, 062/63 and 063/64, the bank succeed in maintaining required level i.e. 68.16% and 50%.

Likewise, 100% loan loss provision is required for bad loan of a commercial bank. Himalayan Bank Limited provision 96.60% in F/Y 059/60, 97.79% in fiscal year 060/61, 99.54% in fiscal year 061/62, 100.26% in fiscal year 062/63 and 99.48% in fiscal year 063/64.

Above result clearly indicated that the bank has not completely to follow maintain loan loss provision from years as per N.R.B. directives.

Table 4.4

Non-Performing Assets and Net Profit of Himalayan Bank Limited

Fiscal Year	Non-Performing Assets	Net Profit
059/060	1,09,28,39,487	21,21,28,485
060/61	1,147,462,638	263,053,495
061/62	1,001,347,320	308,275,171
062/63	1,040,757,823	457,457,696
063/64	641,615,306	491,822,905

(Source: - Annual Reports of Himalayan Bank Limited)

Fig. 2. Non-Performing Assets and Net Profit of Himalayan Bank
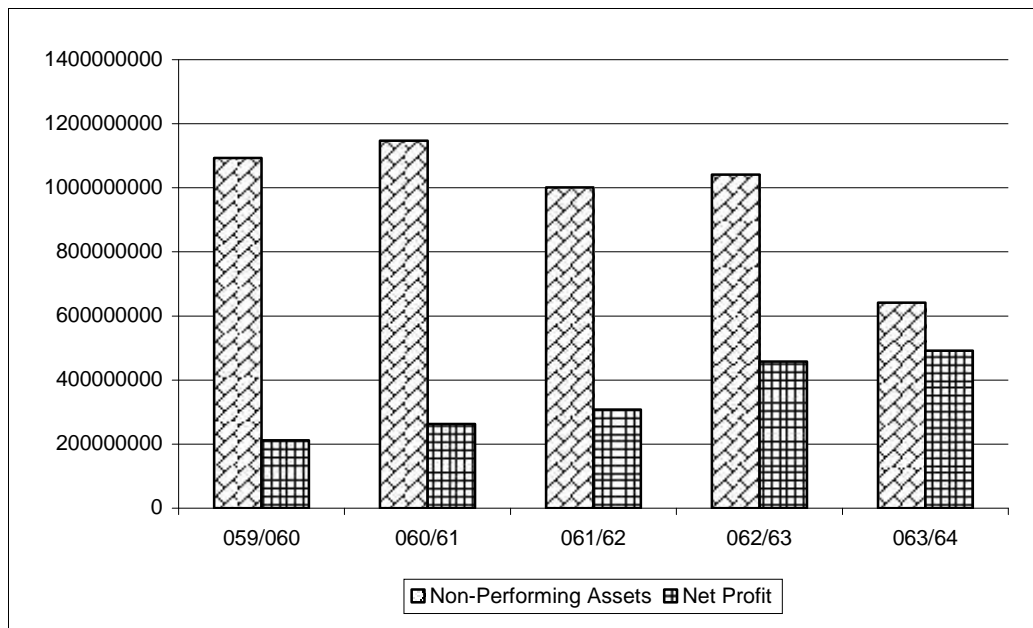
In the above table and figure, we can see Non-performing assets and net profit of Himalayan Bank Limited. In fiscal year 059/60, N.P.A. of the bank was 10928394987 and net profit Rs. 212128485. In fiscal year 060/61, N.P.A. of the bank was 1,147,462,638 and net profit of Rs 263,053,495. In fiscal year 061/62, the N.P.A. decreased by 12.73% but net profit increased by 17.19% then previous year profit during the year. In fiscal year 062/63 N.P.A. increased by 3.94% but net profit increased by 48.39%. Likewise, in fiscal year 063/64 the N.P.A. decrease 38.35% and net profit was also increased by 7.51%.

Bank of Kathmandu Ltd

Table 4.5

Performing and Non-Performing Assets in its Total Assets, Total Deposit and Total Lending of Bank of Kathmandu Limited

S. No.	Particulars	059/060	060/61	061/62	062/63	063/64
1.	Percentage of Performing Assets to Total Assets	59.57	59.06	59.59	59.33	64.86
2.	Percentage of Performing Assets to Total Deposit	71.87	72.44	65.68	69.48	76.28
3.	Percentage of Performing Assets to Total Lending	91.33	93.34	95.00	97.28	97.49
4.	Percentage of NPA to Total Assets	5.65	4.21	3.13	1.66	1.67
5.	Percentage of NPA to Total Deposit	6.82	5.17	3.45	1.94	1.96
6.	Percentage of NPA to Total Lending	8.67	6.66	5.00	2.72	2.51
7.	Percentage of Sub-standard loan in Total NPA	42.74	27.28	28.66	35.17	16.38
8.	Percentage of doubtful loan in Total NPA	3.26	17.14	29.11	4.32	15.03
9.	Percentage loss loan in Total NPA	54.00	55.58	42.23	60.51	68.58

In above table, the percentage of performing assets and non-performing assets in its total assets, total deposit and total lending have been presented for five fiscal years.

In fiscal year 059/60, the bank has total lending amount Rs. 4856032840 which was increased by   . And reached to Rs. 6008311890 at the end of F/Y 060/61. Likewise, F/Y 060/61 the bank has total lending amount Rs. 6,008,311,890 (Annex- 2), which was increased by 2.89% and reached to RS. 6,182,045,019 at the end of fiscal year 061/62. In fiscal year 062/63, this amount reached Rs. 7,488,700,923 with 21.14% increased in comparison to the previous year. At the end of 063/64, it peaks to Rs. 9,694,101,954 with 29.45% increase.

At the end of fiscal year 059/060 the bank has performing assets amount Rs. 4435158764 which was 59.57% of total assets, 71.87% of total deposit and 91.33% of total landing of the bank. Again at the end of FY 060/61, the bank has performing assets amounted Rs. 5,608,374,713 (see Annex-) which was 59.06% of total assets 72.44% of total deposit and 93.34% of total lending of the bank. In fiscal year 061/62, the amount slightly increased to Rs. 5,873,538,981 which occupies 59.59% of the total assets, 65.68% of total deposit and 95.00% of total loan. Similarly, in fiscal year 062/63, the amount reached to Rs. 7,285,076,453 which was 59.33% of total assets, 69.48% of total deposit and 97.28% of total lending. This growth continues in fiscal year 063/64 amounting Rs. 9,450,805,704 occupying 64.86% of total assets, 76.28% of total deposit and 97.49% of total lending resulting slight increase in performing assets of Bank of Kathmandu Limited.

The non-performing assets of bank amounted to Rs. 420874076 recording 5.65% of Total assets, 6.82% of total deposit, 8.67 of total landing of the bank during F/Y 059/60. Again, the non-performing assets of the bank amounted to Rs. 399,937,177 recording 4.21% of total assets, 5.17% of total deposit and 6.66 of total lending of the bank, during fiscal year 060/61. This amount decrease in fiscal year 061/62, and stand at Rs. 308,506,039 that occupied 3.13% or total assets, 3.45% of total deposit and 5.00% of total lending of the bank at the end of 061/62. This amount decreased to Rs.

203,624,470 in fiscal year 062/63 resulting, 1.66% of total assets, 1.94% of total deposit and 2.72% of total lending. Similarly, the amount further increased to Rs 243,296,250 occupying 1.67% of total assets, 1.96% of total deposit and 2.51% of total lending of the bank. In this way, the percentage of non-performing assets in total assets, total deposit and total lending as well as amount value has been gradually increasing in recent year.

Total non-performing assets in fiscal year 059/060 in clouded 42.74% 3.26% and 54% of sub standard, doubtful and loss loan respectively. Again, total non-performing assets in fiscal year 060/61 included 27.28%, 17.14% and 55.58% of substandard, doubtful and loss respectively. Likewise, the total N.P.A. of Bank of Kathmandu at the end of the fiscal year 061/62 occupied 28.66%, 29.11% and 42.23% by substandard loan, doubtful loan and loss loan respectively. In fiscal year 062/63, out of total N.P.A. of the bank substandard, doubtful and loss loan stands 35.17%, 4.32% and 60.51%. Where as, in fiscal year 063/64, substandard loan, doubtful loan and loss loan stands 16.38% 15.03% and 68.58%.

Following table and figure provide the picture of total assets, total deposit, total lending and non-performing assets of Bank of Katmandu limited.

Table 4.6
Total Assets, Total Deposit, Total Lending and N.P.A. of Bank of Kathmandu Limited

Fiscal Year	Non-Performing Assets	Total Assets	Total Deposit	Total Lending
059/60	420,874,076	7,444,816,949	617,071,157	4,856,032,840
060/61	399,937,177	9,496,344,672	7,741,645,424	6,008,311,890
061/62	308,506,039	9,857,130,464	8,942,748,598	6,182,045,019
062/63	203,624,470	12,278,329,302	10,485,359,239	7,488,700,923
063/64	243,296,250	14,570,098,804	12,388,927,294	9,694,101,954

(Source: - Annual Report of Bank of Kathmandu Limited)

Fig. No. 3 Total Assets, Total Deposit, Total Lending and N.P.A. of Bank of Kathmandu Limited
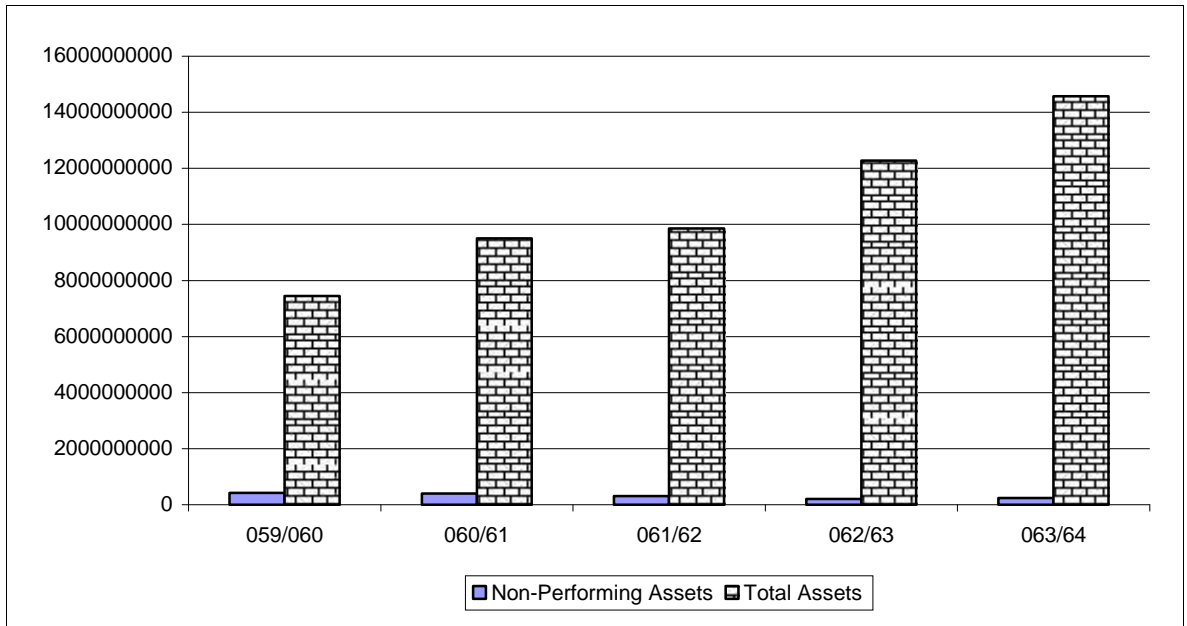
From the above table and figure, we can see total assets or the bank increased in Fiscal Year 060/61 to Rs. 9496344672 from 7444816949 in f/y 059/60. In F/Y 061/62 to Rs. 9,857,130,464 from 9,496,344,672 in Fiscal Year 060/61. In fiscal year 062/63 it increased to Rs. 12,278,329,302 and also increased to Rs. 14,570,098,804 at the end of fiscal year 063/64.

Similarly, in fiscal year 060/61 total deposit of the bank increased to Rs. 7741645424 from Rs. 6170711570.In F/Y 061/62 total deposit of the bank increased to Rs. 8,942,748,598 from Rs. 7,741,645,424. In fiscal year 062/63, total deposit has been recorded to Rs. 10,485,359,239. Likewise, total deposit has been seen decreased and reached to Rs. 12,388,927,294 at the end of fiscal year 063/64. The lending of the bank gradually increased every fiscal year at reached up to Rs. 9,694,101,954 at the end of fiscal year 063/64 which was Rs. 6,008,311,890 t the end of fiscal year 060/61.

Above table and figure clearly depicted that the non-performing assets of Bank of Kathmandu has been decreased by.049% and limited to Rs. 399937177 in F/Y 060/61.Similarly the non-performing assets of Bank of Kathmandu has been decreased by 22.86% and limited to Rs. 308,506,039 in fiscal year 061/62 amounting Rs. 399,937,177 in fiscal year 060/61. Likewise, the amount of non-performing assets seems to be decreased in fiscal year 062/63 by 34.00% amounting Rs. 203,624,470. At the end of fiscal year 2063/64 it increased by 19.48% and limited to Rs. 243,296,250.

From the above result we can find that the bank has gradually increased its lending amount. However, the fluctuation in non-performing assets of the bank predicts that the bank is lacking its regular attention towards managing non-performing assets of the bank and need to maintain this fluctuation with full attention.

Loan Loss Provision of Bank of Kathmandu Limited

The loss provisions maintained by Bank of Kathmandu Limited for its different typed loan are presented in the following table.

Table 4.7

Loan Loss Provision of Bank of Kathmandu Limited

Types of Loan	Provision required to be maintained	% loan loss provision				
		059/60	060/061	061/62	062/63	063/64
Pass Loan	1%	0.97	0.98	0.99	1.00	1.00
Sub standard loan	25%	20.06	25.00	49.48	25.00	25.00
Doubtful loan	50%	50.00	50.00	46.90	50.00	50.00
Loss loan	100%	100	100	99.67	94.35	96.00

(Source: - Annual Reports of Bank of Kathmandu Limited)

In above table, we can see the loan loss provision maintained by Bank of Kathmandu for its different class loan. The bank provisioned 0.97%, 0.98%, 0.99%, 1.00% and 1.00% in the fiscal year 059/060, 060/61, 061/62, 062/63 and 063/64 respectively. For pass loan which is not maintained in fiscal year 059/060, 060/61 and 061/62 but fiscal year 062/63 and 063/64, which is an per requirements (i.e. 1.00%) in all years.

Similarly, the bank provisioned 20.06% in F/Y 059/06, 25% in fiscal year 060/61, 49.48% in fiscal year 061/62, 25% in fiscal year 062/63 and 25% in fiscal year 063/64 for substandard loan. As per requirement bank should maintain at least 25% in this category which Bank of Kathmandu has been able to maintain in F/Y 059/060, 060/061 to 063/064 but not maintained in F/Y 059/060.

Again, the bank provisioned 50% in fiscal year 059/060, 50% in F/Y 060/61, 46.90% in fiscal year 061/62, 50% in fiscal year 062/63 and 50% in fiscal year 063/64 for doubtful loan. As per requirement bank should maintain at least 50% in this category which Bank of Katmandu has been nearly able to meet whereas in fiscal year 061/62 lower maintained for doubtful loan.

Likewise, 100% loan loss is required for bad loan of a commercial bank. Bank of Kathmandu has not maintained its loan loss provision in fiscal year 061/62, 062/63 and 063/64. Only fiscal year 059/060, 060/61, the bank maintained requirement of loan loss provision.

Above result clearly indicated that the bank has not been able to follow and maintain loan loss provision form years as per N.R.B. directives.

Table 4.8

Non-Performing Assets and Net Profit of Bank of Kathmandu Limited

Fiscal Year	Non-Performing Assets	Net Profit
059/060	420,874,076	82,127,662
060/61	399,937,177	127,473,189
061/62	308,506,039	139,529,721
062/63	203,624,470	202,440,627
063/64	243,296,250	262,386,980

(Source: - Annual Reports of Bank of Kathmandu Limited)

Fig. 4. Non-Performing Assets and Net Profit of Bank of Kathmandu Limited
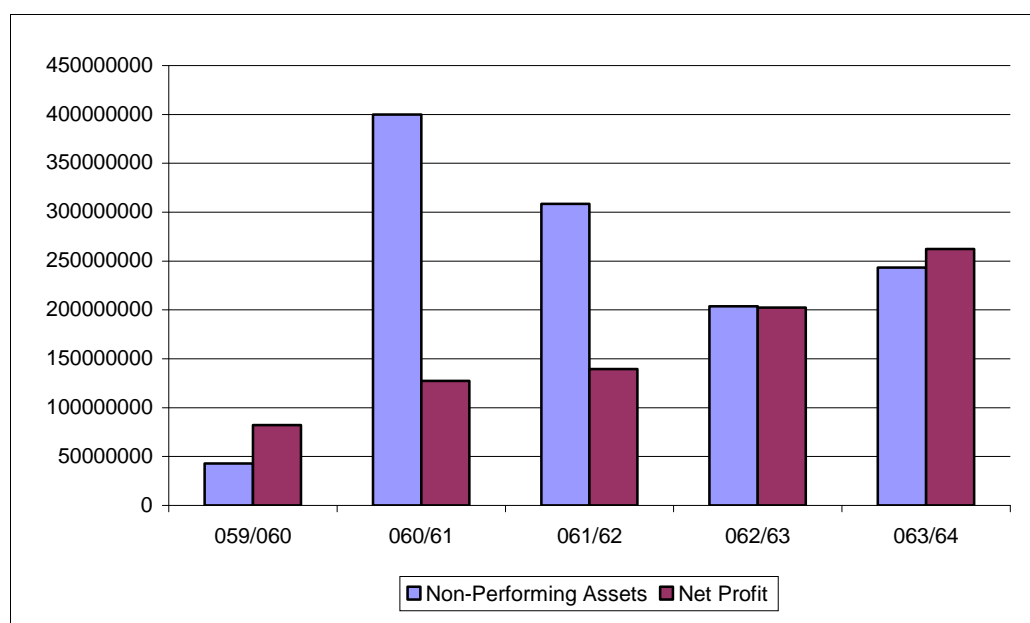
In above table and figure, we can see the non-performing assets and net profit of Bank of Kathmandu. In fiscal year 059/06 non performing assets of the bank was Rs. 420874076 and profit Rs. 82127622. Again F/Y 060/61, N.P.A. decrease by 4.97% i.e. Rs 399,937,177 but net profit increased by 55.21% i.e. Rs. 127,473,189. In fiscal year 061/62, the N.P.A. decreased by 22.86% i.e. Rs 308,506,039 but net profit increased by 9.46% i.e. Rs.

139,529,721 than previous year profit during the year. Likewise, N.P.A. of Bank of Kathmandu decreased by 34.00% amounting Rs. 203,624,470 in fiscal year 062/63 but net profit increased by 45.09% i.e. Rs. 202,440,627 than previous year most during the year. However, N.P.A. of Bank of Kathmandu increased 19.48% amounting Rs. 243,296,250 in fiscal year 063/64 and 29.61% increased in net profit amounting as Rs. 262,386,980 was seen.

There are many factors, which affect the net profit of the banks. Non-performing assets of such factors. Therefore, the bank should keep level of N.P.A. as minimum to earn more profit. Non-performing assets play a key role in increasing and decreasing the profitability of the banks. It is one of the major tools in measuring the status of the bank. Therefore, the bank should keep the level of N.P.A. at minimum to earn more profit. Therefore, the banks effort should be directed towards minimizing the level o N.P.A.

4.2   Comparative study of performing and Non-Performing Assets of Himalayan Bank and Bank of Kathmandu

Percentage of performing assets and non-performing assets in total assets, total deposit and total lending of the bank represent the quality of assets of a particular bank. Higher percentage of performing assets lower percentage of non-performing assets indicates the higher quality and vice-versa. Therefore, under this comparative study effort has made to compare performing assets and non-performing assets of the two selected banks.

Table 4.9

Performing and Non-Performing Assets of Himalayan Bank Ltd. and BOK Ltd.

S. No.	PARTI CULA RS	Himalayan Bank Limited					Bank of Kathmandu Limited				
		059/60	060/61	061/62	062/63	063/64	059/060	060/61	061/62	062/63	063/64
1.	% of P.A. to T.A.	41.89	47.44	44.71	49.97	51.17	59.57	59.06	59.59	59.33	64.86
2.	% of P.A. to T.D	46.34	53.48	50.17	55.57	57.08	71.87	72.44	65.68	69.48	76.28
3.	% of P.A. to T.L.	89.92	91.12	92.56	93.40	96.39	91.33	93.34	95.00	97.28	97.49
4.	% of N.P.A. to T.A.	4.69	4.62	3.60	3.53	1.91	5.65	4.21	3.13	1.66	1.67
5.	% of N.P.A. to T.D.	5.19	5.21	4.03	3.93	2.14	6.82	5.17	3.45	1.94	1.96
6.	% of N.P.A. to T.L.	10.08	8.88	7.44	6.60	3.61	8.67	6.66	5.00	2.72	2.51

(Source: - Annual Reports of Concerned Banks)

The above table exhibits the ratio of performing and non-performing assets of Himalayan Bank Limited and Bank of Kathmandu Limited of consecutive years.

Percentage performing assets to total assets of Bank of Kathmandu is to be in increasing trend than of Himalayan Bank Limited. The ratio stands 59.57%, 59.06%, 59.59%, 59.33% and 64.86% in fiscal year 059/60, 060/61,

061/62, 062/63 and 063/64 respectively of the Bank of Kathmandu, whereas, Himalayan Banks ratio stands,41.89%, 47.44%, 44.71%, 49.97% and 51.17% in fiscal year 059/60, 060/61, 061/62, 062/63 and 063/64 respectively.

Performing assets to total deposit of Himalayan Bank seems to be decrease in fiscal year 061/62 than fiscal year 059/60 and 060/61. Thereafter, it increase in fiscal year 062/63 and 063/64 and reached 55.57% form 57.08% whereas in case of Bank of Kathmandu FY 060/061 it increase 71.87% to 72.44% in FY 059/60 and FY 061/062 to 063/064 it slightly increased and reached 65.68% to 76.28%.

Performing assets to total loan both Himalayan Bank and Bank of Kathmandu is increasing trend, however the ratio of Himalayan Bank was lower than Bank of Kathmandu in fiscal year 059/60, 060/61, 061/62 and 062/63 and in fiscal year 063/64 the ratio of Himalayan Bank is 96.39% which is higher than Bank of Kathmandu i.e. 97.49%.

Likewise, percentage non-performing assets to total assets of Bank of Kathmandu seem to be in quite comfortable position than Himalayan. In fiscal year 059/60 it was 5.65%. In fiscal year 060/61 it was 4.21% and keeps on decreasing gradually and reached to 1.67% in fiscal year 063/64 of Bank of Kathmandu, whereas, Himalayan Bank is also decreasing trend. In fiscal year 059/60 the ratio was 4.69% and with slight decrement each year it reached to 1.91% in fiscal year 063/64 which still is little higher in comparison with that of Bank of Kathmandu.

Percentage non-performing assets to total deposit of Bank of Kathmandu is in decreasing trend. Himalayan control this ratio and could make it to 2.14% by fiscal year 063/64 which as 5.19% in fiscal year 059/60. Bank of Kathmandu could make the ratio from 6.82% in fiscal year 059/60 to 1.94% in fiscal year 062/63. But in fiscal year 063/64, the Bank of Kathmandu has increased and reached 1.96%.

Percentage of non-performing assets to total loan of Himalayan Bank seems to be very progressive. The ratio was 10.08% in fiscal year 059/60 which was quite alarming at that time but Himalayan Bank succeed in reducing the ratio up to 3.61% in fiscal year 063/64 which is quite moderate. Bank of Kathmandu in other hand keeps maintaining its ratio 8.67% in fiscal year 059/60 to 2.51% in fiscal year 063/64 which is little lower than that of Himalayan Bank.

From the above comparison, amongst two banks, Bank of Kathmandu has the least deviation in ratio but little higher ratio than Himalayan Bank. Since, N.P.A. is one of the causes of banking crisis; both banks should give serious attention towards this matter.

4.3   Loan Loss Provision of two banks

Table 4.10

Loan Loss Provision of Himalayan Bank and Bank of Kathmandu

S. No.	Particulars	Himalayan Bank Limited					Bank of Kathmandu Limited				
		059/60	060/61	061/62	062/63	063/64	059/60	060/61	061/62	062/63	063/64
1.	Pass Loan	1.0	1.00	1.00	1.00	1.00	0.97	0.98	0.99	1	1
2.	Sub-standard Loan	27.92	26.07	60.20	57.78	25.46	20.06	25	49.98	25	25
3.	Doubtful Loan	49.12	50.71	47.23	68.16	50	50.0	50	46.90	50	50
4.	Loss Loan	96.60	97.79	99.54	100.26	99.48	100	100	99.67	94.35	96.10

(Source: - Annual Reports of Concerned Banks)

Nepal Rastra Bank has made provision that every bank is required to be made loan loss provision as per NRB's directives for commercial banks. Loan loss provision of 1%, 25%, 50% and 100% of respectively loan

amount is required to be maintained for pass loan, substandard loan, doubtful loan and bad loan respectively.

Himalayan Bank maintained provision as per NRB's directive for pass loan but Bank of Kathmandu had maintained only fiscal year 062/63 and 063/64.

Regarding substandard loan, Himalayan Bank but Bank of Kathmandu not maintained in F/Y 059/60 provision as per NRB directive. In case of doubtful loan Himalayan Bank Ltd. has been not able to fulfill in f/y 059/60 and 061/62 but bank of Kathmandu both is not be maintained in f/y 0061/62. Similarly, Himalayan Bank has been able to fulfill the provision requirement of NRB. For loss loan in fiscal year 062/63 and Bank of Kathmandu also able to fulfill the provision requirement for loss loan in fiscal year 059/60.

We can say that, banks are not following NRB's directives regarding loan loss provision. Such result raised a question, whether NRB fails to implement its directives or not? Therefore, regular supervision and control over the commercial banks is lacking somewhere form NRB's part.

4.4   Correlation Analysis

The correlation analysis generally used to describe the degree to which one variable is related to another, in statistics is used in order to depict the co-variance between two or more variables. In other words, it helps in studying the co-variance of two or more variable. It helps to determine whether.

I)   A positive or negative relation exists

ii)   The relation is significant or insignificant

iii)   Establish cause and effect relation if any

The statistical tool, correlation analysis, is preferred in this study to identify relationship between N.P.A. and ROA, ROE and whether the relationship is

significant or not. Here, N.P.A. denotes for the percentage. Non-performing assets in total lending's of banks which also is knows as level of N.P.A.

Probable Error (P.E.) of Correlation Coefficient

The P.E. of the correlation coefficient is applicable for the measurement of reliability of the computed value to the correlation coefficient (r), it helps to come following conclusion.

If r < P.E., the value of "r" is not significant no matter how high is the value of r is, i.e. there is no evidence of correlation between the variables.

If r > P.E., the value of "r" is significant, i.e. correlation is significant.

Correlation between N.P.A. and ROA of Himalayan Bank and Bank of Kathmandu

Table 4.11

Correlation between N.P.A. and ROA of Himalayan Bank and Bank of Kathmandu

Name of Bank	Coefficient of correlation (r)	Relationship	Coefficient of determination (r2)	Probable Error (P.E.)	Sig./ Insig
Himalayan Bank	-0.85	Negative	0.723	0.084	Significant
Bank of Kathmandu	-0.97	Negative	0.94	0.018	Significant

The correlation coefficient is used to measure the relationship between two or more variables. It helps to identify the cause and effect between the variables. Here in Table 4.11 the correlation coefficient between N.P.A. and ROA of Himalayan Bank shows negative relationship i.e. r = -0.85. It indicates that there is negative relationship between N.P.A. and ROA. If

N.P.A. increases ROA will decrease or if N.P.A. decrease ROA will increase.

Again, probable error (P.E.) or correlation coefficient is applicable for the measurement of reliability of the computed value of the correlation coefficient. The P.E. or Himalayan Bank is 0.084 which is more than r so it identify that it is not significant i.e. if r < P.E., the value of "r" is not significant no matter now high is the value of r, i.e., there is no evidence of correlation between the variables N.P.A. and ROA.

Correlation coefficient of N.P.A. and ROA of Bank of Kathmandu shows negative correlation i.e. r = -0.97 which indicates that there is negative relationship between NPA and ROA of Bank of Kathmandu, i.e. if NPA increases ROA will decrease and vise-versa. The P.E. of Bank of Kathmandu on correlation of NPA and ROA is P.E. = 0.018, which is greater than r that indicates the value of r is not significant no matter how high the value of r is. That means there is no evidence of correlation between the NPA and ROA of Bank of Kathmandu.

Correlation between NPA and ROE of Himalayan Bank and Bank of Kathmandu

Table 4.12

Correlation between NPA and ROE of Himalayan Bank and Bank of Kathmandu

Name of Bank	Coefficient of correlation (r)	Relationship	Coefficient of determination (r2)	Probable Error (P.E.)	Sig./ Insig
Himalayan Bank	-0.81	Negative	0.656	0.104	Significant
Bank of Kathmandu	-0.31	Negative	0.096	0.272	Significant

The alternative area for the analysis also includes the correlation coefficient between NPA and ROE. It shows negative correlation between NPA and ROE of Himalayan Bank. The value of r = -0.81 which indicates that there is negative relationship between NPA and ROE that means if NPA increases ROE decreases and vise-versa. The P.E. of the NPA and ROE of Himalayan shows 0.104 that is significant, which means there is an evidence of correlation between the variable NPA and ROE. The Correlation between NPA and ROE of Bank of Kathmandu shows also negative correlation r = -0.31. Causes behind positive correction between NPA and ROE are explained below.

) NPA has been decreased to great extent, which results in increment in profit by approximately 17% which further results in positive correlation between NPA and ROE.

) High percentage in ROE is also another cause for positive correlation between ROE and NPA.

) Total Assets have been nominally decreased where as NPA is highly increased which is also another cause for positive correlation between NPA.

) Decrease in doubtful assets is a sign of recovery of lots and increase in income and creates positively correlation between NPA and ROE.

) Ratio of decrement of NPA is much higher than increment the total assets which contribute of lot to increase profit so the positive correlation between NPA and ROE appears.

4.5   Major Findings of the Study

1. The analysis of NPA to total loan revealed that NPA of HBL and BOK is 3.61% and 2.51 of total loan reactively in the year 063/64 which was 10.08% and 8.67% respectively in the year 059/60. However, in recent years HBL and BOK both show significant decrement in NPA, which is the result of bank's effective credit management and its efforts in recovering bad debts through establishment of recovery cell.

2. From the study it has been revealed that out of total NPA and the ratio of loss loan seems lower in HBL i.e. 58.38%. But BOK, loss loan seems higher i.e. 68.58% in year 063/64, which falls in the category to be provisioned 100% as per NRB directives.

3. The higher degree of negative correlation of both the banks between NPA and ROA indicates towards the inverse relation between NPA and ROA and negative correlation between NPA and ROE of HBL and BOK. It means the level of NPA effect the return on assets and return on shareholder's equality. Therefore, banks should reduce their level of NPA to increase the ROE and ROA. As the level of NPA increases profit of the bank decreases.

4. From the analysis we can easily found that no-one bank has been following as appropriately as NRB's directives regarding loan loss provision. It means no one bank has maintained loan loss provision perfectly as per requirement of NRB's directives up to fiscal year 063/64. It bank continue this trend the bank may have face different legal hassle regarding its lending in future. The main reason may the over provision crate inadequacy of capital less provision crate legal hassle to the bank. It is observed that sampled banks has maintained higher than requirement for one type of loan category where as make lower for another type of loan class.

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

Finally this chapter including the summary conclusion and recommendation based on the result of the analysis of the data.

5.1   Summary

Banks plays an important role in the economic development of the country as the issue of development always reset upon the mobilization of resources. Banks deals in the process of chanellising the available resources to the needy sector causing overall economic development. This research is aimed at studying the non-performing loan and N.R.B. directives regarding loans loss provisioning of commercial banks. For this purpose, descriptive cum analytical research design was adopted. Out of the total population of 20 commercial banks, two major join venture banks Himalayan Bank Limited and Bank of Kathmandu Limited were taken as sample using judgmental sampling methods. Secondary data has been used in the study. Data has been collected through annual reports, telephonic conversation and other publication. The data collected from various sources are recorded systematically and presented in appropriate mathematical, statistical, financial, graphical tools have been applied to analyze the data. The data of five consecutive years of the two selected banks have been analyzed to meet the objectives of the study.

Loan and advance are the most profitable of all the assets of a bank. These assets constitute primary source of income to the bank. Despite of being loan and advance more profitable than other assets, it creates risk of non-repayment for the bank. Such risk is knows as credit risk or default risk.

The high degree of negative correlation of different commercial banks between NPA and ROA and NPA and ROE indicates towards the inverse

relation between NPA and ROA and NPA and ROE. It means the level of NPA effect the return on assets and return on shareholder's equity. Therefore, banks should reduce their level of NPA to increase the ROE and ROA. If the level of NPA decreases then profit of the banks increases.

As per the latest loan classification and provisioning directives loans and advances have to be categorized into four types namely pass, substandard, doubtful and loss with respective provisioning of 1%, 25%, 50% and 100%. The loan falling under pass category is regarded as performing loan and that which falls under remaining three categories is regarded as non-performing loan. Himalayan Bank Limited and Bank of Kathmandu Limited have higher proportion of doubtful loan in the total non-performing loan followed by loss and then substandard loan.

Escalating level of NPA is becoming great problem in banking business in the world. In the context Nepal cannot be run off from such situation. The level of NPA in Nepalese banking business is very alarming. Today's banking industry is severely affected by the problem of NPA. Improper credit appraisal system, ineffective credit monitoring and supervision system, economic slowdown, borrower's misconduct and overvaluation of collateral, political pressures to lend to uncreditworthy parties etc are the major factors lending to non-performing assets. Setting up recovery cell, hiring assets Management Company etc. are some of the measure to resolve the problem of NPA. Loan classification and loan loss provision also help to conform the problems thus created due to non-performing loans. The latest directive regarding loan classification and loan provisioning is vary important for maintaining sound financial health of the banks. The new provisioning directives lead to increment in provision amount of the banks leading to decrement in profitability of the bank this is only for a short run. Last but not the least, it would not be wrong to say that NPA should be reduced to maintain should financial health of the bank.

5.2 Conclusion

Banks are in the business of accessing deposits for the purpose of lending. They act as financial intermediaries between depositors with surplus funds and borrowers who are in need of fund. Banks occupy a pivotal place in the payment system for the government, business and households. Thus, they play a vital role in the economic and financial life of the country. They are therefore accountable to the government, NRB as well as to the public who are keeping their funds with the banks by reposing trust in the ability of the bank that they will not put the depositor's interest to jeopardy. As in other business the risk of business loss is equally associated with the lending activities. A loan assets becomes non-performing (NPA) when it causes to generate income i.e. interest, fees, commission etc. to the bank which effects on profitability, ROA, productivity and even image of the bank. In order to cover the risk inherent in the lending portfolio, banks have to make loans provision by categorizing the loan into different category as per the NRB directives. Increasing non-performing loans is the serious problems of the banking sectors in Nepal. Non-performing assets debar the income flow of the bank while claming additional resources in the form of provisioning and hinder further gainful investments.

From the study it has been reveled that even the two prominent private sector bank like Himalayan Bank and Bank of Kathmandu has non-performing loan and accordingly provision for such loan. Himalayan Bank average proportion on non-performing loan before a year seems to be high which was very alarming. However, in recent years the level of NPA decreases significantly which is more than acceptable. Himalayan Bank seems to be very continuous in lower level of NPA.

Bank of Kathmandu also seems to be able to control the level of NPA in recent years. Overall, from the study it was found that non-performing loan has shown significant decrement and accordingly provision has also

decreased. But Himalayan Bank and Bank of Kathmandu fail to maintain the required provisioning for loss loan, which is not good for the health of the bank. This raised a question whether N.R.B. fail to regulated and supervise the banks to implement its rules and regulations?

In conclusion it can be said that ineffective credit policy, political pressure to lend to uncreditworthy borrower, overvaluation or collateral are the major cause of mounting non-performing assets of the banks. Other factors lending to accumulation of NPA is weak loan sanctioning process, ineffective credit monitoring & supervision system, economic slowdown, borrower's misconduct etc. continual review and classification of loan enables banks to monitor quality of their loan portfolio and to take remedial action to counter deterioration in credit quality. In addition to this establishing recovery cell, hiring Assets Management Company are also measures to resolve the problem of NPL. The present loan classification and provisioning directive seems more stringent than previous one. As a result more provision has to be apportioned lending to lesser profitability but this kind of negative impact is only for short period. Adequate provisioning strengthens the financial health of the banks and makes them able to face any kind of future contingencies.

5.3   Recommendations

Nepal is undergoing a tremendous political turmoil which have been affecting every sector of economy whether it be tourism, manufacturing industries, agriculture, trading, education etc. Naturally, banking sector cannot be remained untouched. The sum effect of all other sectors rest on bank. The banking sector is the backbone of any economy as the majority of funds are being channelized for any economic activity through this sector. So, in this context banks should be very cautious while lending and thus to reduce NPA of the banks. Here are some recommendations.

The main factors which leads to non-performing loans are improper credit appraisal system, ineffective credit monitoring and supervision system etc. Beside this negligence in taking information form credit information bureau may also lead to bad debts. While disbursing loans, there should be strong practice in commercial banks to float loans on the basis of the business position, scope, viability and need. Further proper workout should be done to access the security offered on the distress situation so that loan can be easily recovered. Hence, all the banks are recommended to be more cautious and realistic while granting loan and advances.

After advancing loans 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. Therefore, it is recommended to create separate departments like,

Credit Appraisal Department: To receive application and gather necessary information and give approval for lending.

Credit Administrative Department: To disburse loan, transact the repayment of principal and interest and proved information regularly to the executive level.

Legal Department: To properly execute the necessary legal documents for the safe guard of bank. Update the documents and its validity; publish notices regarding the auctioning and repayment of loan.

Credit Control Department (Recovery Cell): To regularly follow up the borrowers about their installment dues and remind them their due dates in case of defaulters. Timely give information to executive level about chronic cases in course of follow ups.

It is recommendation for banks to initiate training and development programme for the employee to make them efficient and professional in credit appraisal, monitoring and proper risk management.

Following the directives of NRB and acting upon it also reduces many of the credit risk. Beside there is penalty implication in non-compliance of the directives. Hence all the banks are recommended to adhere the directives and they are also suggested to come up with a stronger internal audit department to ensure that directives are properly implemented.

Concentrating a single sector of economy may create higher of risk. So, the flotation of loans should be as per the need of specific sector as well as per the economic and political situation of the country so that recession in any specific sector may no effect the profitability of the bank.

Bank and financial institutions loan loss recovery act 2058 should also be revised while implying the act of provision into practice according to the present scenario of the country.

It is often said, "Prevention is better than cure". Hence, it is recommended for all the banks to take preventive measures before the loan goes to default. All the banks are recommended to have an information system to gather all the possible information and activities about its borrowers so that necessary precautions can be taken in time.

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Calculation of Himalayan Bank Limited

1. Calculation of percentage performing loan in total assets, total deposit and total lending
(Rs.)

Fiscal Year	Performing Assets	Total Assets	Total Deposit	Total Lending	% PA to TA	% PA to TD	% PA to TL
059/60	9,751,759,501	23,279,341,304	21,045,086,740	1,844,598,988	41.89	46.34	89.9
060/61	11,772,168,356	24,817,369,870	22,010,332,984	12,919,630,994	47.44	53.48	91.
061/62	12,449,820,947	27,844,694,655	24,814,011,984	13,451,168,267	44.71	50.17	92.
062/63	14,721,218,259	29,460,389,672	26,490,851,640	15,761,976,082	49.97	55.57	93.
063/64	17,152,108,557	33,519,141,111	30,048,417,756	17,793,723,863	51.17	57.08	96.

2. Calculation of Non-performing loan / Assets in total assets, total deposit and total lending (Rs.)

Fiscal Year	Non-Performing Assets	Total Assets	Total Deposit	Total Lending	% NPA to TA	% NPA to TD	% NPA to TL
059/60	1,092,839,487	23,279,241,304	21,045,086,740	10,844,598,988	4.69	5.19	10.08
060/61	1,147,462,638	24,817,369,870	22,010,332,984	12,919,630,994	4.62	5.21	8.88
061/62	1,001,347,320	27,844,694,655	24,814,011,984	13,451,168,267	3.60	4.03	7.44
062/63	1,040,757,823	29,460,389,672	26,490,851,640	15,761,976,082	3.53	3.93	6.60
063/64	641,615,306	33,519,141,111	30,048,417,756	17,793,723,863	1.91	2.14	3.61

3. Calculation of percentage of substandard, doubtful and loss loan in total NPA (Rs.)

Fiscal Year	Non-Performing Assets	Sub-Standard	Doubtful Loan	Loss Loan	% SSL to NPA	% DL to NPA	% LL to NPA
059/60	1,092,839,487	224,318,058	375,017,864	493,503,565	20.53	34.32	45.16
060/61	1,147,462,638	423,163,354	54,474,884	669,824,400	36.88	4.75	58.37
061/62	1,001,347,320	69,549,651	242,116,379	689,681,290	6.95	24.18	68.87
062/63	1,040,757,823	107,227,888	228,498,188	705,031,747	10.30	21.95	67.74
063/64	641,615,306	72,076,059	194,976,256	374,562,991	11.23	30.39	58.38

4. Calculation of percentage loan loss provision by Himalayan Bank Limited for its different types of loan (Rs.)

For Fiscal year 059/60

S. No.	Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
1	Pass Loan	9,566,445,731	96,016,810	1.00
2	Substandard loan	224,318,058	62,628,890	27.92
3	Doubtful loan	375,017,864	184,229,769	49.12
4	Loss loan	493,503,565	476,711,113	96.60

For Fiscal year 060/61

S. No.	Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
1	Pass Loan	11,275,992,182	112,782,502	1.00
2	Substandard loan	423,163,354	110,338,076	26.07
3	Doubtful loan	54,474,884	27,624,508	50.71
4	Loss loan	669,824,400	654,994,536	97.79

For Fiscal year 061/62

Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
Pass Loan	11,821,694,843	117,648,411	1.00
Substandard loan	69,549,651	41,866,119	60.20
Doubtful loan	242,116,379	114,358,189	47.23
Loss loan	689,681,290	686,498,503	99.54

For Fiscal year 062/63

Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
Pass Loan	14,055,103,815	141,354,553	1.00
Substandard loan	107,227,888	61,953,985	57.78
Doubtful loan	228,498,188	155,755,034	68.16
Loss loan	705,031,747	706,896,393	100.26

For Fiscal year 063/64

Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
Pass Loan	16,697,714,159	167,225,322	1.00
Substandard loan	72,076,059	18,349,848	25.46
Doubtful loan	194,976,256	97,488,128	50.00
Loss loan	374,562,991	372,599,028	99.48

5. Calculation of Return of Assets (ROA) and Return on Equity (ROE)

Fiscal Year (1)	Total Assets (2)	Equity (3)	Net Profit (4)	ROA (4/2 x 100)	ROE (4/3 x 100)
059/60	23279241304	429000000	21,21,28,485	0.91	49.45
060/61	24,817,369,870	536250000	263,053,495	1.06	49.99
061/62	27,844,694,655	643500000	308,275,171	1.11	47.91
062/63	29,460,389,672	772200000	457,457,696	1.55	59.24
063/64	33,519,141,111	810810000	491,822,905	1.47	60.66

6. Calculation of correlation coefficient between NPA and ROA

Where,

x denotes level of NPA and y denotes ROA

Year	x	y	xy	x2	y2
059/060	10.08	0.91	9.17	101.61	0.83
060/61	8.88	1.06	9.41	78.86	1.12
061/62	7.44	1.11	8.26	55.35	1.23
062/63	6.60	1.55	10.23	43.56	2.40
063/64	3.61	1.47	5.31	13.03	2.16
Total	**36.61**	**6.10**	**42.38**	**292.41**	**7.74**

7. Calculation of correlation coefficient between NPA and ROE

where,

x denotes level of NPA and y denotes ROE

Fiscal Year	x	y	xy	x2	y2
059/060	10.08	49.45	498.46	101.61	2445.30
060/61	8.88	49.99	443.91	78.86	2499.00
061/62	7.44	47.91	356.45	55.35	2295.37
062/63	6.60	59.24	390.98	43.56	3509.38
063/64	3.61	60.66	218.98	13.03	3679.64
Total	**36.61**	**267.25**	**1908.78**	**292.41**	**14428.69**

Himalayan Bank Limited

Calculation of correlation coefficient between NPA and ROA

$$R_{xy} = \frac{N\sum xy - \sum x \sum y}{\sqrt{\sum x^2 \cdot f - \bar{x}^2}\sqrt{N\sum y^2 \cdot f - \bar{y}^2}}$$

$$= \frac{5 \times 42.38 - 36.61 \times 6.10}{\sqrt{5 \times 292.41 - (36.61)^2}\sqrt{5 \times 7.74 - (6.10)^2}}$$

$$= \frac{211.9 - 223.32}{\sqrt{1462.05 - 1340.39}\sqrt{38.70 - 37.21}}$$

$$= \frac{-11.42}{11.03 \times 1.22} \times \frac{-11.42}{13.46}$$

$$= -0.85$$

$r_2 = (-0.85)^2 = 0.723$

$$S.E. = \frac{1 - r^2}{\sqrt{n}}$$

$$= \frac{1 - 0.723}{\sqrt{5}} = \frac{0.277}{2.24} \times 0.124$$

P.E = 0.6745 x S.E (r)

$$= 0.6745 \times 0.124$$

$$= 0.084$$

Calculation of correlation coefficient between NPA and ROE

$$R_{xy} = \frac{N \sum xy - \sum x \sum y}{\sqrt{\sum x^2 - (\sum x)^2}\sqrt{N \sum y^2 - (\sum y)^2}}$$

$$= \frac{5 \mid 1908.76 - 36.61 \mid 267.25}{\sqrt{5 \mid 292.41 - (36.61)^2}\sqrt{5 \mid 14428.69 - (267.25)^2}}$$

$$= \frac{9543.80 - 9784.02}{\sqrt{1462.05 - 1340.29}\sqrt{72143.45 - 71422.56}}$$

$$= \frac{-240.22}{11.03 \mid 26.85} X \frac{-240.22}{296.16}$$

$$= -0.81$$

$$r_2 = (-0.81)^2 = 0.656$$

$$S.E. = \frac{1 - r^2}{\sqrt{n}}$$

$$= \frac{1 - 0.656}{\sqrt{5}} = \frac{0.344}{2.24} X 0.154$$

P.E = 0.6745 x S.E (r)

$$= 0.6745 \ x0.154$$

$$= 0.104$$

Calculation of Bank of Kathmandu

1. Calculation of percentage performing loan in total assets, total deposit and total lending
(Rs.)

Fiscal Year	Performing Assets	Total Assets	Total Deposit	Total Lending	% PA to TA	% PA to TD	% PA to TL
059/60	4,435,158,764	7,444,816,949	6,170,711,570	4,856,032,840	59.57	71.87	91.33
060/61	5,608,374,713	9,496,344,672	7,741,645,424	6,008,311,890	59.06	72.44	93.39
061/62	5,873,538,981	9,857,130,464	8,942,748,598	6,182,045,019	59.59	65.68	95.00
062/63	7,285,076,453	12,278,329,302	10,485,359,239	7,488,700,923	59.33	69.48	97.28
063/64	9,450,805,704	14,570,098,804	12,388,927,294	9,694,101,954	64.86	76.28	97.49

2. Calculation of Percentage Non-Performing Loan / Assets in Total Assets, Total Deposit
and Total Lending (Rs.)

Fiscal Year	Non-Performing Assets	Total Assets	Total Deposit	Total Lending	% NPA to TA	% NPA to TD	% NPA to TL
059/60	420,874,076	7,444,816,949	6,170,711,570	4,856,032,840	5.65	6.82	8.67
060/61	399,937,177	9,496,344,672	7,741,645,424	6,008,311,890	4.21	5.17	6.66
061/62	308,506,039	9,857,130,464	8,942,748,598	6,182,045,019	3.13	3.45	5.00
062/63	203,624,470	12,278,329,302	10,485,359,239	7,488,700,923	1.66	1.94	2.72
063/64	243,296,250	14,570,098,804	12,388,927,294	9,694,101,954	1.67	1.96	2.51

3. Calculation of percentage of sub-standard doubtful and loss loan in Total NPA (Rs.)

Fiscal Year	Non-Performing Assets	Sub-Standard	Doubtful	Loss Loan	% SSL to NPA	% DL to NPA	% LL to NPA
059/60	420,874,076	179,870,104	13,702,127	227,301,845	42.74	3.26	54.00
060/61	399,937,177	109,099,868	68,530,408	222,306,901	27.28	17.14	55.58
061/62	308,506,039	88,423,249	89,806,458	130,276,331	28.66	29.11	42.23
062/63	203,624,470	71,610,921	8,804,237	123,209,312	35.17	4.32	60.51
063/64	243,296,250	39,863,342	36,576,083	166,856,825	16.38	15.03	68.58

4. Calculation of percentage loan loss provision by Bank of Kathmandu for its different types of loan (Rs.)

For fiscal year 059/60

Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
Pass Loan	4,435,158,764	43,091,821	0.97
Substandard loan	179,870,104	36,087,908	20.06
Doubtful loan	13,702,127	6,851,063	50.00
Loss loan	22,730,1845	227,301,845	1.00

For Fiscal year 060/61

Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
Pass Loan	5,411,596,890	53,169,147	0.98
Substandard loan	109,099,868	27,274,967	25.00
Doubtful loan	68,530,408	34,265,204	50.00
Loss loan	222,306,901	222,306,901	100.00

For Fiscal year 061/62

Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
Pass Loan	5,723,971,845	56,712,104	0.99
Substandard loan	88,423,249	22,086,406	49.98
Doubtful loan	89,806,458	42,119,735	46.90
Loss loan	130,276,331	129,851,409	99.67

For Fiscal year 062/63

Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
Pass Loan	7,123,200,804	70,834,087	1.00
Substandard loan	71,610,921	17,902,730	25.00
Doubtful loan	8,804,237	4,402,118	50.00
Loss loan	123,209,312	116,244,952	94.35

For Fiscal year 063/064

Types of Loan	Amount	Loan Loss Provision	% Loan Loss Provision
Pass Loan	9,346,807,209	93,163,590	1.00
Substandard loan	39,863,342	9,965,836	25.00
Doubtful loan	36,576,083	18,288,042	50.00
Loss loan	166,856,825	160,357,057	96.10

5. Calculation of Return of Assets (ROA) and Return on Equity (ROE)

Fiscal Year (1)	Total Assets (2)	Equity (3)	Net Profit (4)	ROA (4/2 x 100)	ROE (4/3 x 100)
059/60	7,444,816,949	463,580,900	82,127,662	1.10	17.72
060/61	9,496,344,672	463,580,900	127,473,189	1.34	27.50
061/62	9,857,130,464	463,580,900	139,529,721	1.42	30.10
062/63	12,278,329,302	463,580,900	202,440,627	1.65	43.67
063/64	14,570,098,804	603,141,300	262,386,980	1.80	43.50

6. Calculation of correlation coefficient between NPA and ROA

where, x denotes level of NPA and y denotes ROA

Year	x	y	xy	x2	y2
059/60	8.67	1.10	9.54	75.17	1.21
060/61	6.66	1.34	8.92	44.35	1.80
061/62	5.00	1.42	7.10	25.00	2.02
062/63	2.72	1.65	4.49	7.40	2.72
063/64	2.51	1.80	4.52	6.30	3.24
Total	**25.56**	**7.31**	**34.57**	**158.22**	**10.99**

7. Calculation of correlation coefficient between NPA and ROE

where

x denotes level of NPA and y denotes ROE

Fiscal Year	x	y	xy	x2	y2
059/60	8.67	17.72	153.63	75.17	314.00
060/61	6.66	27.50	183.15	44.36	756.25
061/62	5.00	30.10	150.50	25.00	906.01
062/63	2.72	43.67	118.78	7.40	1907.07
063/64	2.51	43.50	109.19	6.30	1892.25
Total	**25.56**	**162.49**	**715.25**	**158.23**	**5775.58**

Bank of Kathmandu Limited

Calculation of correlation coefficient between NPA and ROA

$$R_{xy} = \frac{N \sum xy - \sum x \sum y}{\sqrt{\sum x^2 - (\sum x)^2}\sqrt{N \sum y^2 - (\sum y)^2}}$$

$$= \frac{5|34.57 \times 25.56|7.31}{\sqrt{5|158.22 - (25.56)^2}\sqrt{5|10.99 - (7.31)^2}}$$

$$= \frac{172.85 - 186.84}{\sqrt{791.10 - 653.31}\sqrt{54.95 - 53.43}}$$

$$= \frac{-13.99}{11.74|1.23} \times \frac{-13.99}{14.44}$$

$$= -0.97$$

$r_2 = (-0.97)^2 = 0.94$

$$S.E. = \frac{1 - r^2}{\sqrt{n}}$$

$$= \frac{1 - 0.94}{\sqrt{5}} = \frac{0.06}{2.236} \times 0.027$$

P.E= 0.6745 x S.E (r)

$$= 0.6745 \times 0.027$$

$$= 0.018$$

Calculation of correlation coefficient between NPA and ROE

$$R_{xy} = \frac{N \quad xy\, \text{Z} \quad x \quad y}{\sqrt{x^2 \,\text{Z}f \quad x\text{\AA}}\sqrt{N \quad y^2 \,\text{Z}f \quad y\text{\AA}}}$$

$$= \frac{5\mid 715.25\,\text{Z}25.56\mid 162.49}{\sqrt{5\mid 158.23\,\text{Z}(25.56)^2}\,\sqrt{5\mid 5775.58\,\text{Z}(162.49)^2}}$$

$$= \frac{3576.25\,\text{Z}4153.24}{\sqrt{791.10\,\text{Z}653.31}\sqrt{28877.90\,\text{Z}26403}}$$

$$= \frac{\text{Z}576.99}{1174\mid 157.32}\text{X}\frac{\text{Z}576.99}{1846.94}$$

$$= -0.31$$

$r_2 = (-0.31)^2 = 0.096$

$$S.E. = \frac{1\,\text{Z}r^2}{\sqrt{n}}$$

$$= \frac{1\,\text{Z}0.096}{\sqrt{5}} = \frac{0.904}{2.24}\text{X}0.403$$

P.E= 0.6745 x S.E (r)

$$= 0.6745 \times 0403$$

$$= 0.272$$