Credit Risk Management of Commercial Banks in Nepal

(A Case Study of NABIL and NIBL Bank)

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RECOMMENDATION

This is to certify that the Thesis

Submitted by:
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Entitled:

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(With reference to NABIL Bank and Nepal Investment Bank 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

We have conducted the viva –voce examination of the thesis presented by

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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 for the degree of Master Degree of Business Studies (M.B.S.)

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DECLARATION

I hereby declare that the work reported in this thesis entitled "Credit Risk Management Of Commercial Banks in Nepal" submitted to St. Xavier's college is my original work done in the form of partial fulfillment of the requirement for the Masters Degree in Business Studies under the supervision of Mr. Shankar Thapa.

Usha Koirala
Researcher

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ABBREVIATIONS

AMC	**:**	**Assets Management Company**
C.V	**:**	**Coefficient of variation**
CIB	**:**	**Credit Information Bureau**
E.Pra	**:**	**Ejajat Parta**
i.e	**:**	**That is**
LLP	**:**	**Loan Loss Provision**
Ltd	**:**	**Limited**
NCC	**:**	**Nepal Credit and Commerce Bank Limited**
NIBL	**:**	**Nepal Investment Bank Limited**
No.	**:**	**Number**
NPA	**:**	**Non-Performing Asset**
NPL	**:**	**Non-Performing Loan**
NRB	**:**	**Nepal Rastra Bank**
PE	**:**	**Probable Error**
r	**:**	**Correlation Coefficient**
Rs.	**:**	**Rupees**
S.D.	**:**	**Standard Deviation**
S.N	**:**	**Serial Number**
T.U.	**:**	**Tribhuvan University**

CHAPTER-1
INTRODUCTION

1.1 Background

Banks have historically been viewed as playing a special role in financial markets for two reasons. One is that they perform a critical role in facilitating payments. The other is that they have long played an important, although arguably less exclusive, role in channeling credit to households and businesses. Commercial banks, as well as other intermediaries, provide services in screening and monitoring borrowers; and by developing expertise as well as diversifying across many borrowers; banks reduce the costs of supplying credit. Thus, in their role as lenders, banks are often not merely buying someone's debt; rather, they are providing significant financial services associated with extending credit to their customers and investors.

Similarly, Vensel et al (2003) states that banks and other financial institutions are a unique set of business firms whose assets and liabilities, regulatory restrictions, economic functions and operating make them an important subject of research, particularly in the conditions of the emerging financial sectors in the EU accession countries from Central and Eastern Europe (CEE). Banks' performance monitoring, analysis and control needs special analysis in respect to their operation and performance results from the viewpoint of different audiences, like investors/owners, regulators, customers/clients, and management themselves.

Banking industry is an important institution for accelerating the process of development through deposit mobilization. In Nepal, banking industry has been playing significant role for the overall financial and economic development of the country. According to the Nepal Rastra Bank research report, banking and financial institution are contributing around 10% to its national GDP. Our country consists of many rural areas but expansion

of the banking services to rural areas are very limited due to the lack of proper infrastructure and sound policies and directives from the regulatory authority also. (Lamichhane, 2008)

A loan is a debt. Like all debt instruments, a loan entails the redistribution of financial assets over time, between the lender and the borrower. The borrower initially receives an amount of money from the lender, which he pays back, but sometimes not always in regular installments, to the lender. This service is generally provided at a cost, known as interest on the debt. The lender may subject the borrower to certain restrictions known as loan covenants. One of the principal duties of financial institutions is to provide loans, this is typically the source of income to banks, bank loans and credit also constitute one of the ways of increasing money supply in the economy.

Credit analysis is the method by which one calculates the creditworthiness of a business or organization. The audited financial statements of a large company might be analyzed when it issues or has issued bonds. Or, a bank may analyze the financial statements of a small business before making or renewing a commercial loan. The term refers to either case, whether the business is large or small.

Credit analysis involves a wide variety of financial analysis techniques, including ratio and trend analysis as well as the creation of projections and a detailed analysis of cash flows. Credit analysis also includes an examination of collateral and other sources of repayment as well as credit history and management ability.

Before approving a commercial loan, a bank will look at all of these factors with the primary emphasis being the cash flow of the borrower. A typical measurement of repayment ability is the debt service coverage ratio. A credit analyst at a bank will measure the cash generated by a business (before interest expense and excluding depreciation and any other non-cash or extraordinary expenses).

Bank is a financial intermediary that canalizes funds between deposits and entrepreneurs. It is a financial institution that accepts deposits and channels the money into lending activities. In a general sense, banks act as a financial intermediary. Intermediation is between deposits and entrepreneurs. A bank is an institution that deals with money by accepting deposits from the general public, corporate bodies and private organizations and deploys for profitable purpose in the form of loans and advances. Bank by accepting deposits takes up the role of custodian of public money. The transactions in the financial market heavily depend upon the banking system of the country. Without bank, it will be quite impossible for the industrialist and the entrepreneurs to go directly to general public for getting their saving or investments. So, the simplest definition is that, bank takes the savings of the public by providing them with certain rate of interest and loans it to needy customers charging them higher rate of interest and thus, earns some profit by doing these transactions. This is the broadest form of the banking, but at this age of time, their functions have increased manifold. Remitting of money, letter of credit, guarantee, issue of money, controlling monetary activities of country, etc. are also major functions of bank. For better understanding, an in depth study of bank has been conducted. The term bank is mainly related to financial transactions to operate, run and facilitate various monetary activities.

Therefore bank can easily be defined as the custodians of deposits. Bank is an institution which deals with money by accepting various types of deposits, disbursing loans and rendering other financial services. Dhungana (1993) states that a bank is a business organization that receives and holds deposits of funds from other, grants loans or extends credits and transfers funds by written orders of depositors.

1.2 Statement of Problem

This credit creation process exposes the banks to high default risk, which might lead to financial distress including bankruptcy. All the same, beside other services, banks must create credit for their clients to make money, grow and survive stiff competition at the market place. The principal concern of this study is to ascertain to what extent banks can manage their credit risks, what tools or techniques are at their disposal and to what extent their performance can be augmented by proper credit risk management policies and strategies by analyzing the latest data of different commercial banks.

The financial sector, particularly the banking system, could play a very important role in the successful transition and economic recovery of Nepal. Banks and other financial institutions are a unique set of firms whose assets and liabilities, regulatory restrictions, economic functions, and operations establish them as an important subject for study. The bank's performance monitoring, analysis, and supervision need special analysis of their operations and activities from the viewpoint of different audiences such as owners, clients, regulators, and management itself. Different versions of financial ratio analysis are used for a bank's performance analysis using financial statement items as initial data sources. Such analysis is not found in case of Nepalese context with latest information.

1.3 Objective of the Study

The main objective of the study is to have a bigger picture of how banks manage their credit risk. Thus attention is geared towards:

- **Ascertain the scope to which resourceful credit risk management can perk up bank performance**

- Ascertaining why and how banking credit risk exposure is evolving recently.
- To determine relationship between the NPL and Performance of the Bank

1.4 Significance of the Study

The main focus of the study will be to know about the non-performing assets of the selected Nepalese commercial banks and make comparative study of non performing loan of the selected commercial bank. So this research will be able to deliver some of the present issues, latest information and data regarding non-performing loan and loan loss provision. Hence, this study will give the real picture of the current non-performing assets which will be significant to bankers, its shareholders, depositor and all general public who are interested on this current affair of banking industry .Last but not least, it also provides literature to the researchers who want to carry on further research in this field. The study has mainly focused on the:

- **Ascertaining why and how banking credit risk exposure is evolving recently.**
- **Seeing how banks use credit risk evaluation and assessment tools to mitigate their credit risk exposure.**
- **The steps and methodologies used by banks to identify, plan, map out, define framework, develop an analysis and mitigate credit risk (steps in the risk management Process).**
- **Determine the relationship between the theories, concepts and models of credit risk management and what goes on practically in the banking world.**
- **Making suitable suggestion and recommendation to the organization based on the study.**

- **To find out other relevant information based on the empirical evidence.**
- **To evaluate the proportion of non-performing loan and the level of NPAs in total assets, total deposit and total lending in selected commercial banks.**
- **To analyze the relationship between loan and loan loss provision in the commercial banks.**
- **To study the trend line of the non-performing assets, loan and advances, loan loss provision of selected commercial banks**
- **To examine whether Nepalese commercial banks are fulfilling the NRB directives regarding loan loss provision for non performing assets or not.**
- **To find the impact of non-performing loan on performance of selected commercial banks and provide suggestion and recommendations for the further important.**

1.5 Limitation of the Study

The study will be limited in following areas, which are as follows:

1. **This study is concerned only the issue of non-performing loan in Nepalese commercial banks. It does not consider other aspects of the banks.**
2. **Only Nepalese commercial banks have been considered for the study and two banks have been selected as samples for the study. Hence, the finding may not be applicable to other banks (i.e. Development Banks, Finance Companies and other companies of Nepal).**
3. **The whole study is based on secondary data, annual reports, and publication of respective bank and also articles and journals of the respective topic, which may or may not provide exact vision of the field. So reliability of this research will highly depend upon the**

accuracy of information. If available data are not accurate, the whole finding of the study will be meaningless.

4. **The period of study is limited from fiscal year 2003/04 to 2004/08.**

1.6 Organization of Study

The study has been organized into five chapters, each devoted to some aspects of the study of bank performance and credit risk management. The titles of each of these parts are as follows:

Chapter One: Introduction

Chapter Two: Review of Literature

Chapter Three: Research and Methodology

Chapter Four: Analysis and Interpretation

Chapter Five: Summary, Conclusion and Recommendation.

The rationale behind this kind of study of organization is to follow a simple research methodology approach. The contents of each of the parts of this study are briefly mentioned here.

Chapter one deals with major issues to be investigated along with background of the study, statement of the problem and objective and scope of the study.

Chapter two is devoted to theoretical analysis and brief review of related literature which has been organized into four sections. Section one describes the conceptual framework which is basically concerned with the concept and theories of bank. Section two presents the review of empirical works on capital structure and section three is concerned with review of Nepalese studies on credit risk management. And finally section four is devoted to concluding remarks.

Chapter three describes the research methodology employed in the study. This chapter deals with research design, nature and sources of data, selection of enterprises, methods of data analysis, specification of variables as well as limitation of the study.

Chapter four consists of presentation and analysis of data which deal with empirical analysis of the study. Section one presents the result of secondary data. Finally, last section presents the result of primary data analysis.

Lastly, Chapter five comprises the summary, conclusions and recommendations of the study. This chapter presents the major findings of the study.

Chapter: 2

Review of Literature

Review of literature is an integral and mandatory process in any research work. Its means reviewing research studies or other relevant propositions in the related area of the study so that all the past studies, their conclusions and deficiencies may be known and further research can be conducted. The main reason for the full review of research in the past is to know the outcomes of those investigations in areas where similar concept and methodologies had been used successfully, and to avoid investigating problems that have already been definitely answered.

This chapter is related to examine and review of some related books, article, published and unpublished different economic journals, bulletins, magazines, newspapers, yearly published balance sheet of respective banks, NRB directives and guidelines, economic survey, previous thesis on related subject and subject related website search.

This chapter has been divided into the following parts:

- **2.1 Thematic Review**
- **2.2 Review of Empirical studies**
- **2.3 Review of Nepalese Studies**
- **2.4 Reviews of Contemporary Studies**
  - **2.4.1 Review of relevant NRB directives**
  - **2.4.2 Review of related Article**
  - **2.4.3 Review of Contemporary Dissertations**

2.1 Thematic Review

This heading focus the meaning and concept of the term used in the study-

2.1.1 Loan and Advances

Commercial banks collect deposit from depository customer and provide this money as loan to borrowing customers charging some additional interest. In other words, bank play intermediately role in the economy. Bank does so to convert its liability into assets. Thus loans and advances are the assets of the bank. Interest income on such loans is the primary source of income of commercial banks. To spread the depositors fund to the borrowers, banks should have to take in consideration safeties of loan and advances at time of lending but not only on profitability .They have to analyze properly and take adequate collateral for the safety purpose as providing loan is a risky business. Banks have to mange the proper portfolio so that the impact of market failure of any sector will affect least. Loans may be of different types such as: Personal loan, home loan, auto loan overdraft, import loan, term loan etc.

Loan and advances dominates the asset side of the balance sheet of any bank. Similarly, earning from such loans and advances occupy a major space in income statement of the bank. Lending can be said to be the raison d' etre of a bank. However, it is very important to be shrinkage in the value of loan and advances. Hence, loan is known as risky assets. Risk of non-repayment of loan is known as credit risk or default risk (Dahal and Dahal, 2002:114).

2.1.2 Performing Loan

Performing Loans are those loans that repay principal and interest timely to the bank from the cash flow it generates. In other word, performing

loan are the productive assets that generate the some profits. Loans have the certain time period to return its principal with its interest. If anyone repays loan with its interest on time is known as the 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. It is the most profitable assets of banks. Better performing loan are the symbol of success of banks. But many banks are suffering from the non-repayment of loan amount.

2.1.3 Non-Performing Assets/Loan (NPAs/NPL)

Non-performing Loan (NPL) can be defined as the non-productive assets of the banks. An asset is known as non-performing assets (NPAs) if the borrower does not pay the dues in the form of principal and interest in time. 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 from nation to nation. In some country it is longer period where as in other it is shorter past due period. However a common feature of NPL is past due that have not been served .In Nepalese context, if the loans are past due since three months ,it should be reported an non-performing loans. In other words, loans classified under substandard, doubtful and loss category are regarded as non-performing loans.

Non performing assets can be –non performing loan, on-banking assets, remaining non-performing loan, suspend interest, unutilized assets etc. Generally the loan which does not repay within three months is nonperforming loan. The loan amount that does not cover by the collateral after selling is known as non-banking assets (NBA).Suspend interest is the interest which becomes receivable. Unutilized assets are those which do not generate any cash or incomes to the bank

NPLs create problems for the banking sector's balance sheet in the asset side. They also create a negative impact on the income statement as a result of provisioning for loan losses. Ultimately a riskier 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 economy.

2.1.4 Loan Loss Provision

There is risk associated in every loan. To minimize the risk from possible losses from loan banks have to allocate some fund as loan loss provision. Loan loss provision is the accumulated fund that is provided as a safeguard to cover possible losses. It is the expected accumulated provisioning fund. The amount required for provisioning depends upon the level of NPAs and their quality. The high quality loan requires low loan loss provision, whereas bad loan requires high loan loss provision. One percent provision of total credit is minimum requirement as every pass/good loans have to be provisioned. However, the ratio of provision may differ from nation to nation. In Nepal, NRB has prescribed 1%, 25%, 50% and 100% provision for pass, substandard, doubtful and loss loans respectively. Loan loss provision made for performing loan is called "general loan loss provision" and loan loss provision made for non-performing loan is called "specific loan loss provisioning".

2.1.5 Causes of NPA

One of the potential factors responsible for 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 from Central Bank, high and conservative provisioning requirement are some external factors responsible increasing NPA of banks.

There are various causes to increase the NPAs/NPL. It can increase 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 supervision, 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 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.**
- **Lack of proper policy and act to return the expired loan.**

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:

a. **The resources locked up in NPA are borrowed at a cost and**

have to earn a minimum return to service this cost.

b. **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.**
c. **Since they do not earn interest they bring down the yield on advances and the net interest margin or the spread.**
d. **NPA have a direct impact on return on assets and return on equity, the two main parameters for measuring profitability of the bank.**
e. **Return on assets will be affected because while the total assets include the NPA they do not contribute to profits which are the numerator in the ratio.**
f. **Return on equity is also affected as provisioning eats more and more into profits earned.**
g. **The cost of maintaining these assets include administrative costs, legal costs and cost of procuring the resources locked in.**
h. **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.**

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 Shareholders equity, Money deposited by the people, borrowing and profit capitalization. Though the activities of them are guided by some social obligations but some profit has always been desirable for existence.

Big chunks of resources are being utilized on loan 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 stagnant. Result is no new area could be explored. 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 and 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 loss that occurred due to Non- performing loan. Inefficiency in part of bank and country's economical and political instability, prevailing cut-throat competition among bank are some factor 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 set 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 reduction of the risk aroused through NPA by classifying the loan and advances on the basis of aging 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.

2.1.8 General Principles of Lending

Banker is essentially a dealer in the funds of others and that too funds mostly repayable on demand .Therefore he follows a cautious policy in the matter of lending and is generally governed by the well known general principles of sound lending which are discussed below:

1. Safety

The main business of banking consists in borrowing various types of deposits such as current, saving and fixed and lending such deposits to needy borrowers in the form of advances and discounting of bills. This obviously implies that safety of such funds should be ensured .Otherwise the banker will not be in a position to repay his deposits and once the confidence of the depositors is shaken, he cannot carry on the banking business.

If the banker has to ensure safe lending, he has to look to the three C's of the borrower namely Character, Capacity and Capital. Character of the borrower is important because that determines his willingness to repay the

loan. His capital and capacity to run the business successfully determines his capacity to pay. The safety of the loan depends on both his capacity to repay and willingness to repay.

Normally the banks lend up to 70 to 72 % of their deposits, because a portion of the deposits are required to meet the withdrawals by customers. His endeavor is of course to lend as much of the deposits as possible, without which he will not be in a position to meet his interest obligations and the maintenance of establishment. Therefore, he has to lend with a view to earn interest but lend it safe.

2. Liquidity

By liquidity is meant the readiness with which the bank can convert the assets into cash .As the banker's deposits are subject to the legal obligation of being repayable on demand and at short notice, he must ensure liquidity also while lending, so that in times of needs, he will be able to convert the assets into cash.

There is yet another reason for paying attention to the liquidity factor. The cost of borrowing from Reserve Bank depends on the net liquidity ratio, which is the ratio calculated by taking the proportion of specified net liquidity assets of the borrowing bank, to the bank's aggregate demand and time liabilities.

In fact, if one looks at the banker's balance sheet, he finds the assets arranged in the order of liquidity. Cash is the most liquid assets and it appears as the first item. Banker can ensure high liquidity by keeping all deposits in the form of cash only. In such a case as pointed out earlier, he will not be in a position to meet the interest obligations and expenditure of the establishment. From experience, he has learnt that he can safely lend out a substantial portion of the funds. But while lending he should try to ensure liquidity, i.e., in times of need, he must be able to obtain repayment

of the money within a reasonably short time. Liquidity also implies that the assets can be sold without any loss. Thus the concept of liquidity has twin aspects namely quick saleability or convertibility of the assets and to risk of loss in such conversion.

3. Profitability

Commercial banks have obtained funds from shareholders and naturally if dividend is to be paid on such shares it can only be paid by earning profits. Even in the case of public sector banks although they are service motivated they will have to justify their existence by earning profits. This is not possible unless the funds are employed profitably. From out of the revenue earned the banker has to pay interest on deposits, salary to the staff, meet other establishment expense, build-up reserves and the balance must permit the payment of dividend to shareholders. However, the banker will not give under importance to this aspect because a particular will not give undue importance to this aspect because a particular customer may offer a higher rate of interest but an advance made to him result in a bad debt. Therefore for the sake of profitability, the other two principles, liquidity and safety cannot be sacrificed.

4. The purpose of the Loan

Baker should enquire the purpose for which it was taken. If an advance is given for productive purpose, in all probability, it will be repaid. Thus safety is ensured. If an advance is made for speculative purpose, the banker may come to grief. Similarly advances made for wasteful expenditure on social functions etc. are unproductive in nature and as a rule banks avoid such advances. But it is very difficult for the bank to ensure that the advance has been used for the purpose for which it was taken. A person may take a loan obviously for a productive use, but may spend it on speculation. In recent years there is scrutiny of some of the

account, as a follow-up measure to see that the end, use of credit is not for some other purpose.

4. Diversification of Loans

The familiar saying is 'Do not put all the eggs in the same basket'. Banker should try to diversify loans as far as possible, so that he may minimize his risk in lending. If the banker lends only to one industry or only to few big firms or concentrates in a certain geographical area, the risk is great. He should diversify lending, so that he may not be affected by the failure of one industry, or the few big borrowers. Where lending is done only in one area, it may be affected by political upheaval or natural calamities (Radhaswami & Vasudevan, 1979:205).

2.1.9 Sources of Major Problem in Credit Risk Management

Effective credit risk management allows a bank to reduce risks and potential NPLs. It also offers other benefit. Once banks understand their risk and their costs, they will be able to determine their most profitable business and thus j, credit-risk strategy supported by organizational changes, risk measurement technique and fresh credit process and systems. In the context of Nepal, the sources of major problems in credit risk management are as follows (Ramamurthy, 2004:3-5).

(i) Financial statement (including audited) do not reflected a "true and fair view" of the business entity due to creative accounting. The audited financial statement as submitted by the customers do not reflect details relating to

- Encumbrance's change on the company's current/ fixed assets plus to whom they are changed.

- Details of group company lending/borrowings
- Status of income assessment etc.
- Contingent liabilities.
- Accounting policies.
- Delegation of finding authority is based on seriously and not a complexes of the concerned officials.
- No exchange of credit information/ lack of transparency among the competition banks giving rise to multiple banking (some customers having facilities with different base) complicating to excessive shortfall etc.
- Absence of :

  Risk based pricing methodologies

  Customer risk rating methods

  Facility risk rating models

- Pronounced name lending.
- Collateral based lending instead o need based/ cash flow base lending.
- Over banked center contributing for severe competition and price cutting.
- Lack of corporate governance
- Permissive banking practice including names, lending, multiple banking etc.
- Macro level scenario of political in ability slow growing economy, small domestic market.
- Ineffective judiciary
- Cross border risk disappearance of promoters
- Inadequacy of low to dial with crime like cheating, misfeasance.

2.2 Review of Empirical Studies

A bank is a government regulated, profit making business that operates in competition with other banks and financial institutions to server the saving ant credit needs of its customers. The primary business of banks is accepting deposit and leading money. Banks accepts deposit for customers who want the safety and convenience of deposit service and the opportunity to earn interest on their excess funds (Sapkota, 2001:54).

Bhattacharya in his book," banking strategy, credit appraisal and lending decision has put the recommendation to Tandon committee. He has prepared this report in 1975; however these recommendation stills deserve great significance in the sector of credit appraisal. The system proposed by the committee enjoying upon the banker are as follow:

a) To assess the need based credit of the borrower on a rational basis.
b) To ensure proper and use of bank credit by keeping a closer watch on the borrower business and thus ensure safety of the banks funds.
c) To improve the financial discipline of the borrower and
d) To develop healthy banker borrower relationship.

The committee examined the existing system of lending and recommended the following broad changes in lending system.

a) The credit needs of borrowers are assessed on the basis of their business plans.
b) Bank credit only be supplementary to the borrowers resources and not in replacement of them ,i.e. banks mot to finance one hundred percent of borrowers, requirement,
c) Borrowers are required to old inventory and receivables according to norms prescribed by the reserve bank of India from time to time.
d) Credit may be available in different components only, depending upon the nature of holding of various current's assets.

e) In order to facilitate a close watch on the operations of borrowers, they are required to summit, at regular intervals, data regarding their business and financial operations, both for the past and future period.

The committee including stores and other items uses in the manufacturing process are:

a) Raw material including stores and other items uses in the manufacturing process.
b) Stock in process
c) Finished goods
d) Receivable
e) Spares

"Bank growth and profitability are the result of carefully forecasting funding needs, competitively attracting funds efficiently borrowing funds and effectively investing, funds in safe but profitable earning assets. Depending on a bank's size and location and on local and national economic conditions, a bank may have adequate, relatively stable sources of low cost funds or it may have to compete regularly and aggressively for funds at high market prices for an increasing number of banks, the second situation is becoming the norm as more, the second situation is becoming the norm as more and more banks face increasing pressure to attract adequate funds at reasonable costs (Bhattacharya, 1998:3209).

In the word of S.P Singh and S. Singh, credit policies of banks are condition to great extent by the national policy framework, every banker has to apply his own judgment for arriving at a credit decision, keeping of course, bankers and credit policy also in mind (Singh and Singh, 1983:34).

H.D Gross stated lending is the essence of commercial banking; consequently the formulation and implementation of sound lending policies are among the most important responsibilities of bank directors and management. Dell conceived lending policies are essential in a bank to perform its credit creating function effectively and minimize the risk interest in any intention of credit (Gross, 1963:45).

Shrestha (1995) said that the commercial banks should not concentrated on the specific sector but should fulfill the credit need of various sector of the economy including agriculture, industry , commercial and social sector of the economy service sector. The commercial banks should very effective while providing loans. While providing loans, the bank should think on the maximizing the economic growth of the country as well as the profit from providing the loan for the operation of the country.

2.3 Review of Nepalese Studies

The banking sector is severally affected by the Non- performing loans problem. It is estimated that the NPL of the Nepalese Banking system is around 16 %. Therefore, there is no doubt that it has a serious implication on economic performance of the country (Dhungana, 2058:127).

NRB register the one thousand five hundred and thirty eight borrowers, who have not repaid the loan they received from the fifteen major commercial banks of the country, in 'black list".

The black listed number of borrowers and the amount of different commercial banks are reported as follows.

Table 2.1

Bank Wise Black Listed Borrowers and the Account Due

Banks	No. of Black Listed Borrowers	Amount Due from them (in million)
RBB	546	5526.66
NBL	673	3904.47
HBL	57	383.04
NBBL	45	317.23
NABIL	32	229.3
BOK	17	116.45
NSBIBL	26	102.96
NIBL	17	56.06
NSBI	9	33.89
NCCBL	19	32.38
SCBNL	4	19.13
NICBL	2	7.19
LBL	2	.64

SOURCE: NRB Report, 2063.

The principal loan amount due from these one thousand five hundred and thirty eight borrowers in different banks is totaling Rs. 5731 million 609 thousand. the interest due in total Rs. 5,717 million 8 hundred thousand (Bhatta, 2006:56).

F. Morris (1990) in the discussion paper has concluded that "most of the banks concentrated on compliance with central bank rules on reserve requirements, operating efficiency and soundness of bank investment management has largely been overlooked. The huge loosed now found in the banks portfolio in many developing countries are testimony to the poor quality of this oversight investment function.

He further adds that mismanagement in financial has involved inadequate and over optimistic loan appraisal, tax loan recovery , high risk diversification of landing and investment high risk concentrated, concocted and insider landing, loans mismatching, this has led many banks of developing countries the failure of 1980's "(Morris,1990:81)."

Sunity Shrestha (1995) has presented with objective to make analysis of commercial banks lending to the Gross Domestic product (GDP) of Nepal. She has set hypothesis that there has been positive impact of lending of the commercial banks to the GDP. In research methodology she has considered GDP as the dependent variable and various sectors of lending dependent variable and various sectors of lending visa, agriculture, industrial, commercial service and social sectors as independent variables. A multiple regression techniques have been applied to analyze the contribution.

The multiple analyzes have shown that all the variables except service sector lending has positive impact on GDP. Thus in conclusion, she has accepted the hypothesis i.e. there has been positive impact by the lending of commercial in various sectors of economy, expect service sector investment. (Shrestha, 1995:18).

"A study on deposit and credit of commercial banks in Nepal concluded that the credit deposit ratio would to 51.30%, other things remaining the same. In Nepal that was the lowest under the period of review. Therefore, he had strongly recommended that the joint venture banks should to give more credit entering new fields as far as possible; otherwise, they might not be able to absorb even the total expenses (Shrestha, 1998:15)."

In the same way, **Mr. Dev Lal K.C. (1996),** in his article states, "The changing face of the banking sector and the Nepal Government recent budgetary policy “concludes the following an introduction of he reform in the banking sector as an integrate part of the liberal economic policy, more banks and finance companies have come up as a welcome measure of completion. However because of poor investment policies and lack of internal control the two governments controlled banks, Nepal Bank Ltd and Rastria Banijya Bank has awarded the management contact to foreign companies to improve the condition of non performing assets. The policy of gibing management is professional consultant is a part of the financial sector reform policy of NRB. (K.C. 1996:27-32).

Raja Ram Khadka (1998) in this study entitled “a study in the investment policy of Nepal Arab Band Ltd. In comparison to other joint venture banks of Nepal” has recommended that, the bank should utilize its deposit account as loans and advances to get success in competitive banking investment. Loans and advances are the profitable asset for the banks but ineffective management of the loans and advance’s create the serious. Problems to the banks and the major reason behind the band liquidation and failure could be the weakness of the loan management.

Rawat Bahadur Karki(2000) has summarizes some of the challenge through his article, “ the financial sector is facing major challenges of high NPL of the banking sector, which comes around 18% of the total loan but it the loan classification is made according to least international practice , it is assumed to exceed 30% credit demand is being met largely by non- institutional source i.e. private money lender, merchant trade, individual and land lord at very high rate of interest , which is 2-3 times higher then of institutional source, this shows that the unorganized financial sector is playing a major role in

Nepalese economy . The liquidity has a major role in Nepalese economy. The liquidity position of the banking sector is rated as high as24%, but the productive sector of the economy is starved by credit crunch. This has created a paradoxical situation on banking sector. He has given some suggestions to improve the Nepalese financial sector.

The financial institution especially CBs have to identity new area of investment to increase loans and advances in reducing the liquidity position.

With the rapid growth of the number of banks and financial institution, deposit insurance scheme is a must. The principle reasons for introducing such deposit insurance should be one of the social justice rather than economic justification in order to protect the interest of the small depositors. In this condition, this scheme should be expedited to implement (Karki, 2000:26-30).

A study conducted by **Upendra Shrestha (2000)** regarding the investment practices of joint venture banks in Nepal with special reference to NABIL Bank Limited, Started Charted Bank Nepal Limited and Nepal NSBI Bank Limited has figured out the problem and conclusion as follows.

“Commercial Banks are more emphasized to be making loans on short term basis against movable merchandise. Commercial Banks have a lot of deposit but very little investment opportunity. They are even discouraging people by offering very low interest rate and minimum threshold balances.”

Commercial Banks invests their funds in limited areas to achieve higher amount of profit. This regarded as a very risky step, which may lead to lose in profit as well as principle. The credit extends by commercial Bank to agriculture and industrial sector is not satisfactory to meet the growing need of the present situation.

He has concluded that the liquidity position of NABIL and SCBNL have not found satisfactory, it is therefore, suggested them to improve cash and bank balance to met current obligations SCBNL's loan and advance to total deposit ratio is lower at all, it is recommended to follow liberal lending policy for enhancement of fund mobilization. It is recommended to NSBIBL that is has to invest its fund in share and debenture of other companies. It is suggested to enhance off balance sheet transaction, diversifying their investments, own new branched, play merchant banking role and invest their risky assets and shareholders fund to gain higher risky assets and shareholder fund to gain higher profit margin. NABIL and SCBNL are recommended to increase cash and balance to meet current obligations and loan demand.

The above study shows that Mr. Shrestha has concluded some conflicting statement which is obviously not matching with his statement of problem. His recommendation ignores the industry average and also failed to figure out what is right in the industry like banking along the excess of investment or loans and advances. And he thinks liberal lending policies solve the problem to increase the level of loans and Advances.

But somewhere in his recommendation, he has warned commercial Banks to increase the level of loan and Advances and suggested them to increase the level of investment in government securities or in other safe instrument just to avoid the risk arising from lending. Form this, it can be concluded that Mr. Shrestha has made his entire conclusion absolutely and has not made any relative analysis of the pros and cons of the entire factor affecting his study.

A study conducted by Lila Prasad Ojha (2002) entitled “lending practices: A study on NABIL Bank Limited, Started Charted Bank Limited and Himalayan Bank Limited” has find found out that the measurement of lending strength in relative term has revealed that the total assets to total liability of SCBNL has the highest ratio . However the performance of other two banks has not deviated for from the mean ratio of SCBNL and the combined average. SCBNL tendency to invest in government securities has resulted with the lowest ratio of loans and advances to total assets ratio. The steady and high volume of loans and advances throughout the years has resulted NABIL ratio to be the highest. The ratio of loans and advances and investment to deposit ratio has measured the portion of total deposit that is used to increase the income of the banks irrespective of the profiles of its application. NABIL has deployed the highest proportion of its total deposit in earning activities and this ratio is significantly above the ratio of other two banks. The combined ratio is highly deviated from the mean ratio of NABIL and SCBNL. This is the indicative of that in fund mobilizing activities NABIL is significantly better than SCBNL.

Similarly the absolute measures o lending strength has revealed that the mean volume of net assets and deposit is highest in SCBNL with moderate variation. The volume of net assets of HBL is the least sue to the low share capital, reserve and surplus in its capital mix. But the volume contributed by NABIL in the greatest in the study of period. NABIL has the best contribution in productive as well as industrial sector in economy.

He has further concluded that the overall liquidity strength of SCBNL can be considered the best among the banks. However the liquidity risk arising from interest rate in SCNNL is the most likely. Since the market is highly sensitive towards the interest rate an SCBNL has generally been offering low interest rate as compare to the banks. The analysis of lending strength of HBL in loans and advances in the best however loans and advances, investments to deposit ratio have upgraded the performance of NABIL. If HBL strength succeeded in collecting the less chapter source of strength fund of HBL would push the performance of NABIL and SCBNL for behind in the coming future. Also the contributions made buy HBL in the productive sector of economy is highly appreciable and the best among these the commercial banks. The highest growth rate, proportionately high volume of loans and advances and the best contribution in agriculture and priority sector and the high level of deposit mobilization of HBL has put his level of deposit mobilization of HBL has put this bask in the top positive in the lending function as demand buy national priority , national development . However the better activity ratio of SCBNL has proved this bank then best in managing the lending portfolio according to the demand of profit-oriented business. The high volume of lending activities and high volume of productive sector loan of NABIL has put this bank best thin but in ratio of SCBNL has proved this bank best in managing the lending portfolio according to the demand of profit-oriented business. The high volume of lending activities and high volume of productive sector loan of NABIL has put this bank in the top position in absolute term.

On the basis of findings and conclusion he has recommended for the banks as the liquidity position of all these three banks was found to be high. He has recommended the banks to look upon the new area of lending and investment. The rural economy has always been realizing the credit needs and the dominance of non- organized money lender in this area has been prevailing. To compromise between the liquidity and credit need of rural economy these banks are highly recommended to expand their credit in this area. SCBNL is recommended to give extra priority on productive and priority sector loan. The increasing provision as loan loss and high volume of non-performing assets may have caused due to the failure of industrial and agricultural sector. NABIL's increased non-performing, asset may have caused due to the accumulated bad debts that is kept behind the certain to show the efficiency of management.

He has used different statically tools like standard deviation, correlation, trend analysis and financial tools for the data analysis and presentation. In his study he has also taken sector wise loan- priority sector, productive sector etc, the different sector wise loan classification are presented and analyzed only secondary data has been used for the study, the overview of theoretical aspect of the lending practices of the banks has not been analyzed . He has taken five years data from 1997 to 2001 for study of lending practices of NABIL, SCBNL and HBL (Ojha, 2002:60-68).

Sabitri Shrestha (2003) in her study entitled " impact and implementation of NRB Guidelines (Directive of Commercial Banks – A study of NABIL Bank limited and Nepal NSBI Bank have been fully implantation the NRB's directives. Capital adequacy Ratio of NABIL and Nepal NSBI are 13.40% and 12.86% respectively, which are more than 9%. Banks are following the directives but in same cases such like supplementary capital and balance of NRB there is shortfall. The excurses amount of total deposit in balance of NRB there is shortfall. The banks have categorized the loan amount into four diffident categories as per NRB's directives. The increasing loan loss- providing amount decreased the profit of the banks. The charge in the single borrower limit has brought down the limits of the fund based and non-fund based loans which have resulted to reduced loan exposure to banks.

In her thesis she has recommended that both NABIL and NSBI banks to increase it supplementary capital as it has shortfall in comparison wit NRB guidelines and to meet the supplementary capital adequacy ratio even though it can be compensated by the compensated by the excess amount of core capital . The supplementary capital needs to be increased by Rs. 122.74 million in NABIL Bank and Rs. 125.57 million in Nepal NSBI Bank. She says liquidity and profitability are kike two wheels of one cart so banks cannot run in the absence of any one of them. One can be activated only at the cost of the other. Only liquid banks can attract loan core deposit, which help in reducing interest expanses and gibe loan to good customer at lower rate, which results in requirement of less provision and high net profit. So banks should increase their primary reserve now to maintain the liquidity risk due to scrap out the secondary reserve. On the basis of findings, NABIL Banks has a shortfall of Rs. 140.74 million thus NABIL has to increase its balance at NRB by such amount for better performance even after adding 1% excess amount of cash of total deposit.

Primary data has been used in order to get the view of banks on the directives issued by NRB. Question related to NRB directives 1.5 are used to collect for the study and implementation of directive by commercial bank. Secondary data are also used for the analysis this study the general directives issued in 2001 and 2002 are considered for the study. In issued directives of 2001 and 2002 there are 10 directives but only 5 directives i.e. (1-5) are highlighted and taken in the study.

Ram Prasad Kafle (2005) in his study entitled "Non- performing loans of Nepalese commercial banks. "The researcher's mean objective of the study was to know the problems of the non-performing loans and its effect in the ROA and ROE of the Nepalese commercial banks and to find out whether the Nepalese commercial banks are following the NRB directives regarding loan loss provision for non-performing loan or hot.

Through the research he has found that the no banks have been following NRB's directives regarding the loan loss provision. he also concluded that the return on assets (ROA) and return on equity (ROE)of the bank deposed upon the NPL's should be controlled for this bank should provide necessary training regarding loan management to the manpower's. In order to remove, the NPL's banks should take enough collateral so that banks can recover its loan amount. For the loan loss provision as per the NRB directives and to reduce the NPL, The bank management should be effective and the NRB's monitoring and regulation is necessary.

A study conducted by **Rajan Subedi (2006)** entitled "A Comparative Study of Financial Performance between Himalaya Bank limited and Everest Bank limited" of the period from 200 to 2005 has outlined his major finding and conclusion as follows.

"The mean and total loans and Advances to total saving deposit ratio of NSBI is greater than that of HBL and the coefficient of variation between the ratios of HBL is less than NSBI. It means that the ratio of HBL is less than NSBI is more uniform than NSBI. According to analysis, it fount that NSBI is more employing its saving deposit in term of loans and advances than that of HBL. So, loans and advances to total saving deposit ratio appear better in NSBI than HBL.

The mean total investment to total deposit ratio of NSBI is significantly greater than that of HBL, but the coefficient of variation between the ratio of HBL, but the NSBI. it means that the variability of the ratios of HBL is more consistent than that of NSBI. According to analysis, it if found that NSBI is more successful in utilizing its resources an investment.

However, he failed to give his overall conclusion regarding the superiority of the financial performance of these two banks during the period of the study (1996-2000). He has also put several recommendations out of which few important recommendation are outlined here.

The liquidity of a bank many of affected by external as well as internal factors such as the interest ratio, supply and demand position of loans, saving to investment situation. Central bank requirements and the growth or slackening tending policies management capability. HBL has maintained the ratio of cash and bank balance to total deposit considerably lower than that of NSBI. So, NSBI is recommended to increase cash and balance to meet loan demand.

Mr. Subedi recommended that HBL should increase its cash and bank balance to meet loan demand does not sound logical since no where in his study he has conclude that HBL has failed to meet its demand loans. Being the low level of cash and bank balance as compare to another specific bank dies not necessary conclude the necessity of increasing this asset.

A study conducted by **Prem Krishna Shestha (2007)** in his thesis entitled "profitability Analysis of Standard Chartered Bank Nepal Limited and NABIL Bank Limited" found out the following:

- SCBNL had more consistent operating efficiency ratio than NABIL bank limited during the study period.
- Both of the banks data showed that more than 90% of their total liabilities paid interest. These banks showed that the smaller portion of their interest bearing liabilities paid as interest expenses.
- Both the banks weighted average cost of deposit ratio was found to be at decreasing rate.
- NABIL bank had lower EPS than SCBNL, which indicated that the performance of SCBNL was better than NABIL.
- SCBNL was paying more dividend than NABIL bank limited during the study period. The amount of dividend was almost double for SCBNL than NABIL . it meant that NABIL was in need of fund, so it was

paying fewer dividends and adding more amounts under the head of retained earnings.

- Among the total income, more than 75% of the income came from interest sector. That indicated the main source of income was interest for both the banks.
- The operating expenses ratio over total expenses comprised of more than 40% for both the banks.
- NABIL had fluctuating return on total assets than SCBNL. SXBNL had higher return on equity than NABIL. Return on equity of NABIL was more fluctuating than that of SCBNL. SCBNL had higher return on equity ratio than that of NABIL.
- SCBNL had also higher interest earned to total asset ratio than NABIL.
- The total interest income to total earning assets ratio of both the banks were found decreasing over the years, which indicates a negative sign to the bank's performance.
- NABIL Bank's net profit margin ratio was higher than that of SCNNL. Similarly, net interest margin of NABIL was also higher than that of SCBNL (Shrestha, 2007:76-77).

2.4 Review of Contemporary Studies

2.4.1. Review of Relevant NRB Directives

Streamlining the previous 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 as follows:

1. Classification of Loans and Advances

a. Pass

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

b. Substandard

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

c. Doubtful

Loans and advances whose principles 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 principles 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 Sub-standard, Doubtful, and Loss are defined as Non-Performing Loan.

Note:

a. **If it is appropriate in the views of the bank management, there is not restriction in classifying the loan and advances from low risk category to high-risk category. For instance, loans falling under Sub-standard may be classified into Doubtful or Loss and loans falling under Doubtful may be classified into Loss Category.**

b. **The 'term' loan and Advances also includes Bill Purchased and Discounted.**

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 be included under 'Pass' category. However, where collateral of fixed deposit receipt or HMG securities or NRB Bonds is placed as security against loan for other purposes, such loan has to be classified on the basis of ageing.

3. Additional Arrangement in Respect of Loss Loan

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

a. **Insufficient security/collateral.**
b. **The borrower has been declared bankrupt.**
c. **The borrower is absconding or cannot be found.**
d. **Purchased or discounted bills are not realized within 80 days from the due date.**
e. **Misused to loans.**
f. **Owing to non-recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation.**
g. **Loans provided to the borrowers which is included in the blacklist of credit information Bureau.**
h. **If project/business is in non-operative condition of closed.**
i. **Credit card loan not write off which is dues since 90 days.**

4. Additional Arrangement Regarding of Term Loan

In respect of term loans, the classification 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 Guarantee

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

7. Rescheduling and Restructuring of Loan

1. **Financial institutions may reschedule or restructure loans and advances upon receipt of written plan of action from the borrower citing the following reason:**
   a. **Evidence for adequate collateral and documentation regarding loans.**
   b. **Financial institutions have confidence that loans can be recovered after rescheduling**

Note:

Rescheduling means to extend the loan payment period that have been borrowing by the customer.

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

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

8. Loan Loss Provisioning

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

Provisioning rate of Classified Loan and advances as per NRB Directives

Classification of Loans and Advances	Loan Loss Provision
Pass	**1%**
Substandard	**25%**
Doubtful	**50%**
Loss	**100%**

Loan Loss provision set aside for performing loan is defined as "General Loan Loss Provision" and Loan loss provision set aside for Non-Performing loan is defined as "Specific Loan Loss Provision".

2. **Loan loss provisioning to rescheduled 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 is insured or guaranteed priority sector credit has been rescheduled or restructured, provision should be only 25 percent of above point (a) for such loans. (i.e. 25% of 12.50%)**
   c. **If interest and principle of rescheduled/restructured 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 percentages 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 advances

Classification of Loans and Advances	Provisioning Rate
Pass	21%
Substandard	45%
Doubtful	70%

2.4.2. Review from Related Articles

Binam Raj Ghimire (2003), in his titled "Credit sector reform and NRB" has tried to highlight the effects of change or amendment in NRB directives regarding loan classification and loan loss provisioning." Although the circumstances leading to financial problem or crisis in many Nepali banks differ in many respects, what is common across most of the banks is the increased size of Non Performing Assets (NPAs). To resolve the problem of the losses or likely losses of this nature facing the industry, Nepal Rastra Bank (NRB) has, as the central bank, amended several old directives and issued many new circulars in recent years".

As Opined by him, since the majority of the loans of most of the commercial banks of the country at present falls under sub-standard, doubtful and even loss categories, loan loss provisioning now compared to under the previous arrangement would be dramatically higher. The new classification and provisioning norms are very laudable as they help to strengthen banks financially. But, he added that we also must remember that the old system remained in force from 1991 to 2001 and this was probably the most volatile decade for business operation of the country as

there were frequent boom and bust cycles. He has indicated that total loan loss provisioning as a percentage of total credit as of April 12, 2001 comes to 5.30 %. As of April 13, 2003 it has jumped up to 18.39 %. If only private sector banks are considered then the provision to credit is 2.12% as of April 12, 2001 whereas it is 6.30% as of April 13, 2003.Total increment in loan loss provision in the period is Rs. 11,328.11 million whereas the growth of credit in the period is only 7,976.70 million. He has also stated that tightening provisioning requirements on non-performing loans is essential to ensure that banks remain liquid even during economic downturns.

In the conclusions he has mentioned that in the recent years NRB has worked for the management and reform of credit of the financial institutions more seriously and NRB has adopted reforms aimed not just at dealing with problem banks but also, and which is more important, at strengthening banking supervision to reduce the likelihood of future crises." All prudential directives of NRB in connection to credit sector reform have been made / revised on or after April 2001. To adapt to such a sudden change, there can be some difficulties. For a better and harmonized reform, NRB should continue to be supportive, proactive and also participative to take opinions of bankers for a change in regulation/ policy taking place in the future" (Ghimire, 2003:47).

In the article by Yogendra Regmi, (2062) titled Non-Performing Assets Management" the writer stated about the management of NPAs in the commercial banks. He writes, the NPAs includes the non-performing loan, non-banking assets, remaining non performing loan, suspend interest and unutilized assets. The increasing NPA are the emerging problem in commercial banks, which is the main factor of failure of banks.

He said, NPAs caused by investment of assets in non-performing sectors, lack of future prediction, lack of proper supervision,monitor,control lack of information and failure of recovery of loan and their interest on time. He also added the low quality of collateral of loans, failure of projects and lack of appropriate rules and regulations to punished the bad loan takers. He shows the following NPAs in commercial banks:

NPAs in Commercial Banks

Fiscal Year	Percentage of NPAs
2058 Ashad	30.78
2059 Ashad	30.41
2060 Ashad	28.80
2061 Ashad	29.00

Source: Banking and Financial Statistics of NRB

He added that increasing NPAs directly affects to the banks, investors and human resources. Not only that but also it affects the customer, economy of country and business activities. Increasing NPA has two types of impact on banks: internal impact and external impact. In internal, it affects directly on profitability and human resources and in external, it affects to customers, investors, management and country's economy (Regmi, 2062:75).

He concludes that it is like a cancer of banks. Thus, it is necessary to control this cancer in time; otherwise it becomes a big issue for bankruptcy. NPA have to need microanalysis to protect the banks, investors, customers, human resources and country's economy. For this a clear 'Road Map' is required. To success the laws and policies, all the stakeholders should take responsibilities.

"Asset Management Companies (AMCs) have a mixed outcome everywhere. In many countries AMCs are the vehicle to shift headache from the government to the institutions created by itself or in association with the private sector. Besides, AMCs would be successful if the loan is backed by safe collateral and if the collateral has marketability. No doubt, the transfer of the NPAs from the banks to the AMCs would help restructuring the balance sheets of the banks and make them viable entities. There are threats of monopoly pricing and moral hazards also. Despite this, if the large non-performing loan portfolio of some of the banks in Nepal is to be cleaned, there is no alternative. To ensure that the property of the government (owned by the banks) is not disposed at a throw away price or the asset management company does not exercise undue monopoly power to exploit the banks, government involvement in the process has become essential in Nepal" (Khatiwada Yuba Raj, Executive Director, NRB, and Management Association of Nepal, Giving interview with the New Business Age, November 2002).

"You perhaps unwittingly omitted to mention another measure taken to reduce the NPA - that is the setting up of a special judicial court or Tribunal to hear the loan recovery cases. So, now before filing a case in the regular courts, the first step from the bank will be to file it with the Tribunal. This law was passed after lot of follow up by us bankers. But even after the bank wins the case from the court and takes the collateral into its possession the bank may find it difficult to sell the property, as is the case even today. The buyers simply do not come forward. When they come they are very few and often they join hands and offer a very small amount. There is a sort of a buyers' market here. So, the AMC was proposed. At this moment I cannot say whether this AMC will or will not work well in Nepal. Globally, there are mixed reports. As I have heard, AMCs could not do well in Latin America while they did very well in Thailand, Philippines and Malaysia. Our central bank people have gone there (Thailand, Philippines and Malaysia) and studied how the AMCs functioned there and they are trying to model the proposed AMC of Nepal accordingly. But I think the success of AMC depends on the leadership of the AMC" (Rana Himalaya SJB, Chairman, Himalayan Bank Limited, Giving interview with the New Business Age, December 2003).

2.4.3 Review of Contemporary Dissertations

Kumar Pradhan (2006), has conducted thesis titled "A study of Non-Performing Assets of Commercial Banks of Nepal" with reference to Nepal Bank Limited, Rastriya Banijya Bank, Nepal Bangladesh Bank, Everest Bank and Standard Chartered Bank Nepal Limited. The main objectives of his study are to find out the proportion of non-performing loan and the level of NPAs in total assets total deposit and total lending ,evaluate the relationship between loan and loan loss provision ,present the trend line of the non-performing assets, loan and advances, loan loss provision of selected commercial bank.

Pradhan concludes, "Improper credit policy and credit appraisal system, lack of supervision and monitoring, economic slowdown, overvaluation of collateral, borrower's misconduct, political pressure to lend for un-creditworthy parties, etc are the major causes of occurring NPAs.

He has concluded that that "Nepalese banks have to remain focused in their efforts to recover their spiraling bad loans, or non-performing assets, to sustain the positive trend of improving asset quality. Better risk management techniques, compliance with the core principles for effective banking supervision, skill building and training and transparency in transaction could be the solution. Removal of non-performing loans from the banking system even through government or quasi government funds at times, is essential. But official assistance should be so structures as to avoid moral hazard. To conclude with, till recent past, corporate borrowers even after defaulting continuously never had any real fear of bank taking any action to recover their dues despite the fact that their entire assets were hypothecated to the banks. This is because there was no legal Act framed to safeguard the real interest of banks. While NPA cannot be eliminated, but can only be contained, it has to be done not a

heavy cost of provisioning and increasing the portfolio of credit. Along with recovery fresh inflow of NPA should be brought down at a level much less than the quantum of its exit. If this specific goal is reached, there is an eventual solution for this problem. Good governance is essential for the success in NPA management" (Pradhan, 2006:96-97).

To reduce the level of NPA , he has recommended that, Proper financial analysis should be done before lending to the borrowers, banks should take enough collateral, so that the at least can able to recover its principle and interest amount in case of being unable to repay by the borrower, to Hire Asset Management Company(AMC) to reduce the non-performing assets, to search new investment areas and all banks should provide appropriate training regarding loan management, risk management, credit appraisal etc to the employees.

Dinesh Kumar Khadka (2004), in his thesis titled Non Performing Assets of Nepalese Commercial Banks "With reference to Nabil Bank Ltd, Nepal SBI Bank, Nepal Investment Bank, Nepal Bangladesh Bank and Bank of Kathmandu. His main objectives are to examine the level of non performing loan/asset in total assets, total deposit and total lending of Nepalese commercial banks, effects of non-performing loans to return on assets (ROA) & return on equity (ROE) and following of NRB circulars by commercial banks.

He has pointed out the problems of commercial banks as "Escalating level of NPAs has been becoming great problem in banking business in the world. In this context Nepal can not be run off from such situation. The level of NPA in Nepalese banking business is very alarming. It is well known fact that the bank and financial institution in Nepal have been facing the problem of swelling non-performing assets and the issue is becoming more and more unmanageable day by day. He added from

different financial reports, newspaper and news, it is understood that total NPA in Nepalese banking system is about 35 billion, while it is very worse in case of two largest commercial banks i.e. Rastriya Banijya Bank(RBB) and Nepal Bank Limited(NBL)" (Khadka, 2004:80).

He has concluded that the level of NPA of NBBL seems greater than all other banks. Similarly Nepal SBI Bank and Bank of Kathmandu stands at second and third respectively. The position of NABIL bank Ltd seems quite considerable (satisfactory) because the bank has been reducing its NPA every year .NPA of Nepal Investment Bank stands at minimum than all of other banks. And from his analysis he has concluded that the high degree of negative correlation of different commercial banks between NPA and ROA and between NPA and ROE indicates that there is inverse relation between NPA and ROA as well as between NPA and ROE. It means the level of NPA effect the return on assets and return in shareholder's equity. Therefore, banks should reduce their level of NPA to increase the ROE and ROA.

Finally, to overcome from these findings, he has suggested that proper financial analysis of the borrower should be made before sanctioning the loan, different departments have to be set off for disbursement and control of the loan ,all commercial banks should follow the NRB directives regarding the loan loss provision, efficient management system should be better to decrease NPA, banks should take enough collateral so that bank at least can able to recover its principal and interest amount in case of default situation of the borrower, and training regarding loan management to the managers and staffs who are involving in loan administration.

Shama Bhattarai (2004), has carried out study on "Implementation of directives Issued by Nepal Rastra Bank: A Comparative Study of Nepal

SBI Bank Limited and Nepal Bangladesh Bank Limited. The main objective of the research study is to examine the norms and standard laid down by Nepal Rastra bank relating to capital Adequacy, Loan Classification and Provisioning. The study was undertaken to find out the impact of the changes in the NRB directives on the performance of the commercial banks. And also an effort is made to find out if the directives were implemented or not.

In her study it was found that both (Nepal SBI Bank and Nepal Bangladesh Bank) the bank would fall short in supplementary capital but can maintain its total capital according to the new directives relating to capital adequacy norms. All the changes in NRB directives made impacts in the bank and the results are the following:

- **Increase in the operational procedures of the bank, which increases the operational cost of the bank.**
- **Short terms decrease in profitability, which result to lesser dividends to shareholders and lesser bonus to the employees.**
- **Reduction in the loan exposure of the bank, which decrease in interest income but increase the protection to the money of the depositors' money.**
- **Increase protection to the money of the depositors through increased capital adequacy ratios and more stringent loan related directives.**
- **Increase demand for shareholder's contribution in the banks by foregoing dividends for loan loss provisions and various other reserves to increase the core capital.**

All the aforesaid results lead to one direction; the bank will be financially healthy and stronger in the long run. Both the banks NBBL and NSBL will be able to withstand tough economic situations in the future with adequate capital and provisions for losses. The tough time through which the bank

is under going at present will prevail only for a short period but in the long run, it will be strong enough to attract more deposits and expose itself to more risks with capital cushion behind it. The quality of the assets of the banks will become better as banks will be careful before creating credit. Ultimately, the changes in the directives will bring prosperity not only to the shareholders but also, to the depositors, the employees and the economy of the country as a whole (Bhattarai, 2004:103).

In this chapter relevant study has been made to know the opinion of other researchers and authors related to deposit mobilization of commercial banks in Nepal. Only the relevant literatures have been reviewed. Every possible effort has been made to grasp knowledge and information that is available from libraries and the documents available from relevant literatures and concerned commercial banks have been reviewed. This chapter helps to take adequate feedback to broaden the information base and inputs to my study.

The study of Paudyal (2004) on funds utilization of commercial banks in Nepal has examined that on funds mobilization of the commercial banks and he had concluded that the efficient mobilization of fund is more important than collection of one deposit. Also he said lower is the investment lower will be the capital formation. If there is high ratio of investment of the available fund there will create huge capital formation for which is important to the economic growth of the nation and development of the nation there to. At last, he recommended that the commercial banks should concern their behaviors in the efficient mobilization of the resources to get the profit.

Karmacharya (1978) has stated in his research study on deposit mobilization by the NBL has concluded that commercial banks play a crucial role in accelerating the growth in the country. The bank mobilizes the savings of the people and diverts them into productive channels. The expansion of branches as more as possible to encourage the savings i.e. to increase the savings habits of people and thereby to mobilize the available financial resources efficiently and effectively in

a productive way and concluded that the branch expansion helps to collect more deposits and utilize the available resources. The conclusion is diverted from the analysis of seven years data from 1970 to 1977 A.D. using Karls Pearson's formula, percentage and ratio to meet the objective how far the bank is able to utilize the collected deposits.

Similarly Rayamajhi (2004) in his thesis work, "A study on deposit mobilization of six commercial banks" has concluded that commercial banks play a crucial role in accelerating the growth in the country. The bank mobilizes the savings of the people and diverts them into productive channels. The expansion of braches as more as possible to encourage the savings i.e. to increase the savings habit of people and thereby to mobilize the available financial resources efficiently and effectively in a productive way and concluded that the branch expansion helps to collect more deposits and utilize the available resources.

Joshi (1989) in his thesis work," "A study of financial performance of CBs" concluded that liquidity position of CBs is satisfactory, local CBs have higher deposit equity ratio than joint venture banks. Loans and advances has been the main form of the investment. Assets utilization for earning purpose is two third of total assets. The main source of there banks is interest from loan and advances, it was found that the profitability position of NABIL is stronger than that of other CBs.

Chapter: 3

Research Methodology

Research is a systematic inquiry of any particular topic and methodology is the method of doing research in well manner. Thus Research Methodology is a way to solve the research problem systematically. It is understood as a science of studying how research is done scientifically. It is analysis of specific topic by a proper method.

3.1 Research Design

The main objective of research design is to make analysis in the credit risk management and performance of the commercial banks in Nepal and provide valuable recommendation. In other words, this research is aimed at studying the risk of commercial bank due to credit . This will follow analytical, descriptive and exploratory research design. And it also analyses the composition of trend of non performing assets, loan recovery and profitability condition of commercial banks. The design for this research is made by collection of information from different sources by using various financial statistical tools. Hence, Descriptive cum exploratory designs have been followed to conduct this study.

3.2 Nature and Sources of Data

This study will base on both primary and secondary data. Most of the data related to the financial institutions and will be collected from annual report and official reports of concerned organization. The required information will be supplemented by Ministry of Finance, Department of Industries, Commerce and Supplies, economic survey published by Nepal Government, quarterly economic bulletin published by Nepal Rastra Bank (NRB), National Planning Commission and Security Board of Nepal (SEBON), World Bank Report will be considered.

A field survey based on questionnaire and interview will also be conducted to collect opinions of different respondents in different groups. The respondents selected for the survey will be on the loan takers, account holders and different experts.

3.3 Selection of Enterprises

The study is related to the credit and performance analysis of different financial institution so two Commercial banks are selected. NABIL and Nepal Investment Bank are selected for the study.

3.4 Data Processing Procedures and Analysis

The data collection from various sources are recorded 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 five consecutive of the two selected banks are used to meet the objective of the study.

3.4.1 Financial Tools Analysis

To evaluate the financial position and performance of any firm ratio is used as a key tool of financial analysis. "Financial analysis is the process of identifying the financial strength and weakness of the firm by properly establishing relationship between the items of the balance sheet and profit and loss account" (Pandey, 1999)

3.4.1.1 Ratio Analysis

Ratio analysis is a tool of scanning the financial statement of the firm .It ratio is simply one number expressed in terms of another and as such it express the numerical or quantitative relationship between two variables .Through this, one comes to know that in which areas operation the organization is strong and in which areas it is weak .Ratio analysis is the widely used tool of financial analysis. In financial analysis, a ratio is used as a benchmark for evaluating the financial position of the firm .Ratio analysis reflects the relative strengths and weakness of any organization and also indicates the operating and financial growth of the organization." Ratio help to summarize large quantities of financial data and to make quantitative judgment about the firm's financial performance .The relationship between two accounting figures expressed mathematically is known as financial ratios" (Pandey,1999:108). Even though there are many ratios, only those ratios have been calculated in our study period which is related to the subject matter. Following ratios have been computed and analyzed in this study.

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 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 as follows

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

Loan and Advances to Total Deposit Ratio (Credit Deposit Ratio -CD Ratio)

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.

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

Loan Loss Provision to Total Loans and Advances Ratio

This ratio describes the quality of assets in the form of loans and advances that a bank is holding. Since there is risk inherent in loans and advances, NRB has directed commercial banks to classify its loans into different categories and accordingly to make provision for probable loss. Loan loss provision signifies the 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 loan in volume of total loans and advances .The low ratio signifies the good quality of assets in the volume of loans and advances .It indicates how efficiently it manages loan and advances and makes efforts to cope with probable loan loss. Higher ratio implies, higher portion of NPL in the total loan portfolio. This ratio is calculated as follows:

$$\text{Loan Loss Provision Ratio} = \frac{\text{Loan Loss Provision}}{\text{Total Loans Advances}}$$

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:

$$\text{Non performing loans to Total Loans Advances} = \frac{\text{Non Performing Loans}}{\text{Total Loans Advances}}$$

Provision Held to Non- Performing Loan

This ratio determines the proportion of provision held to non-performing loan of the bank. This ratio measures up to what extent of risk inherent in NPL is covered by the total loan 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 financial strength of the bank. This ratio is calculated as follows:

$$\text{Provision Held to Non} - \text{Performing Loan} = \frac{\text{Total Loan Loss Provision}}{\text{Non performing Loan}}$$

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

$$\text{Return on Loans and Advances} = \frac{\text{Net Profit}}{\text{Total Loans Advances}}$$

3.4.2 Statistical Tools

Statistical tools are the mathematical techniques used to facilitate the analysis and interpretation of numerical data. Following statistical tools have been used in this study

Percentages

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

$$\text{Percentage (P \%)} = \frac{B}{A} \times 100$$

Measures of Central Tendency

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

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

Where, $\sum X$=Sum of the variable 'X' and N= No. of observation

Measure of Dispersion

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

Standard Deviation

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

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

Co-efficient of Variation

The percentage measure of coefficient of standard deviation is called coefficient of variation. The less is the C.V. the more is the uniformity and consistency and vice versa. Standard deviation gives an absolute measure of dispersion. Hence where the mean value of the variable is not equal it is not appropriate to compare two pairs of variables based in S.D. only. The coefficient of variation measures the relative measures of dispersion, hence capable to compare two variables independently in terms of their variability.

$$\text{Coefficient of Variation (C.V.)} = \frac{\sigma}{\bar{X}}$$

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. One variable is treated as dependent

and another variable is treated as independent. In between the variables, increase or decrease in one cause increase or decrease in another, then such variables are correlated variables. "Correlation may be defined as the degree of linear relationship existing between two or more variables. Two variables are said to be correlated if the change in the value of one variable appears to be related or linked with the change in the other variables. It refers to closeness of the relationship between two or more variables. Correlation says just degree of relationship between two or more variables. It does not tell us anything about cause and effect relationship i.e. if there is a high degree of correlation between two variables we cannot say which the cause is and which is the effect" (Sharma and Chaudhary, 2058:405). There are different techniques of calculating correlation coefficient. Among various techniques we have used Karl Pearson coefficient of correlation. The Karl Pearson Coefficient always falls between -1 to +1.The value of correlation of coefficient in -1 signifies the negative correlation and in +1 signified the positive correlation coefficient. It is calculated as follows:

$$\textbf{Correlation Coefficient (r)} = \frac{\sum xy}{N\,\sigma_x \sigma_y}$$

Where,

$x=X-\bar{X}$ $\quad\quad$ $y=Y-\bar{Y}$

σ_x=Standard Deviation of Series X

σ_y= Standard Deviation of Series Y

N= No. of pairs of observation

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

r<0, there is negative relationship between the variables

r>0, there is positive relationship between the variables

r=-1, the relationship is perfectly negative between the variables

r=+1, the relationship is perfectly positive between the variables

The correlation coefficient gives the actual relationship but sometimes it may give the error. The reliability of the correlation coefficient (r) can be checked with the help of probable error (PE).

Probable Error (P.E) of Correlation Coefficient

The probable error is a measurement of ascertaining the reliability of the value of coefficient of correlation. It is used to test whether the calculated value of sample correlation coefficient is significant or not. If r is the calculated correlation coefficient in a sample of n pairs of observations, then its standard error, usually denoted by S.E (r) is given by:

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

Probable error of the coefficient of correlation can be also be calculated from S.E of the coefficient of correlation by the following formula

Probable Error P.E (r) = $0.6745 \times \frac{1-r2}{\sqrt{n}}$

$$PE = \frac{0.6745\,(1-r^2)}{\sqrt{n}}$$

Where, r= correlation coefficient

n= no of observation

A few rules for the interpretation of the significance of correlation coefficient are as follows:

Decision:

i. **If r> 6 PE, then correlation coefficient is significant and reliable.**

ii. **If r< 6 PE, then the correlation coefficient is insignificant and there is no evidence of correlation.(i.e. insignificant).**

iii. **In other situations, nothing can be calculated with certainty.**

3.4.3 Trend Analysis

A series formed from a set of statistical data arranged in accordance with their time of occurrence is said to be a time series. It is one of the statistical tools, which is used to determine the improvement or deterioration of its financial situation. Trend analysis informs about the expected future values of various variables. The way from which the maximum information can be drawn from the figure collected is known as the analysis of time series. The least square root method has been adopted to measure the trend behaviors of the selected banks. This method is widely used in practices. The formula of least square method for the straight line is represented by the following formula.

Y= a+bX

Where Y= Trend Values

a=Y intercept or the computed trend figure of the Y variable, when X=0

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

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

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

ġY=Na+bġX……………………………….(i)

ġXY=aġX+bġX……………………………(ii)

Where=number of years

But for the simplification, if the time variable is measured as a deviation form its mean i.e. mid point is taken as the origin the negative value in the first half of the series balance out the positive values in the second half so

thatǵX=0.The values of constants a and b can easily be determined by using following formula.

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

b=$\frac{\Sigma XY}{\Sigma X^2}$

3.4.5 Diagrammatic and Graphical Representation

Diagrams and graphs are visual aids that give a bird eye view of a given set of numerical data. They represent the data in simple and readily comprehensive form. Hence, bar diagrams, pie charts and graph have been used for presentation and analysis of data. After highlighting the research methodology, the following chapter concentrates on presentation and analysis of the study.

CHAPTER - IV
DATA PRESENTATION AND ANALYSIS

In this chapter, raw form of data which are collected from various sources are processed and changed into an understandable presentation using financial as well as statistical tools supported by diagrams and graphs as mentioned 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 and recommendations are going to be derived from the calculations and analysis done in this section. For the purpose of the study five years data from fiscal year 2003/2004 to 2007/2008 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 year 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.

Firstly, using ratio analyses on related key factors have been computed and described the outcome. After ratio analysis, correlation between two variables like-Loan and advances and total deposit, between loan loss provision and loans and advances and loan loss provision and Non performing loan of selected sample bank have been computed, where one variable is dependent and another is independent variable, which show a unit change in one variable affect how much to another variable. Secondly, it includes the analysis Loan and its loan loss provisioning. Five year data

of four categorized loan and their loan loss provisioning of all sample banks are taken and calculated the percentage of provisioning to respective loan. Finally, comparative analysis has been made to show whether the sample bank are able to maintain required percentage of provisioning for respective loan as NRB directives. High chance of defaulting high provisioning is to be made. Commercial Banks has to follow NRB Directives for the NPA management. Lastly calculate the trend values and lines of related key factors for next five year based on the tendencies of past five years.

4.1 Ratio Analysis

4.1.1 Loan and Advances to Total Asset Ratio

The ratio of loans and advances to total assets measures the volume of loans and advances in the structure of total assets of any commercial bank. Loans and advances of any commercial banks represent the major portion in volume of total assets. High degree of ratio indicates the good performance of the banks in mobilizing its fund by way of lending functions. In other words, interest is the major portion earnings of commercial bank which directly affect the profitability. On the other hand, the high degree of this ratio is representative of low liquidity ratio. Granting loans and advances always carries a certain degree of risk. Thus this asset of banking business is regarded as risky assets. Hence this ratio measures the management attitude towards risky assets. The low ratio is indicative of low productivity and high degree of safety in liquidity and vice versa.

Table 4.1

Loans & Advances to Total Asset Ratio (%)

(In Million)

Year	Nabil Bank			NIBL		
	Loans & Advances	Total Asset	Ratio (%)	Loans & Adv.	Total Asset	Ratio (%)
2004	**10586**	**16745**	**63.22**	**7338**	**13255**	**55.36**
2005	**10947**	**17186**	**63.69**	**10258**	**16274**	**64.23**
2006	**13279**	**22330**	**59.47**	**13178**	**21330**	**61.78**
2007	**15903**	**27253**	**58.35**	**17769**	**27591**	**64.40**
2008	**21759**	**37132**	**58.60**	**27529**	**38873**	**78.82**
Mean			**60.72**	**Mean**		**64.198**
S.D			**2.34**	**S.D**		**7.68**
C.V			**3.85**	**C.V**		**11.83**

(Source: Annual Report and Website of Concerned Banks)

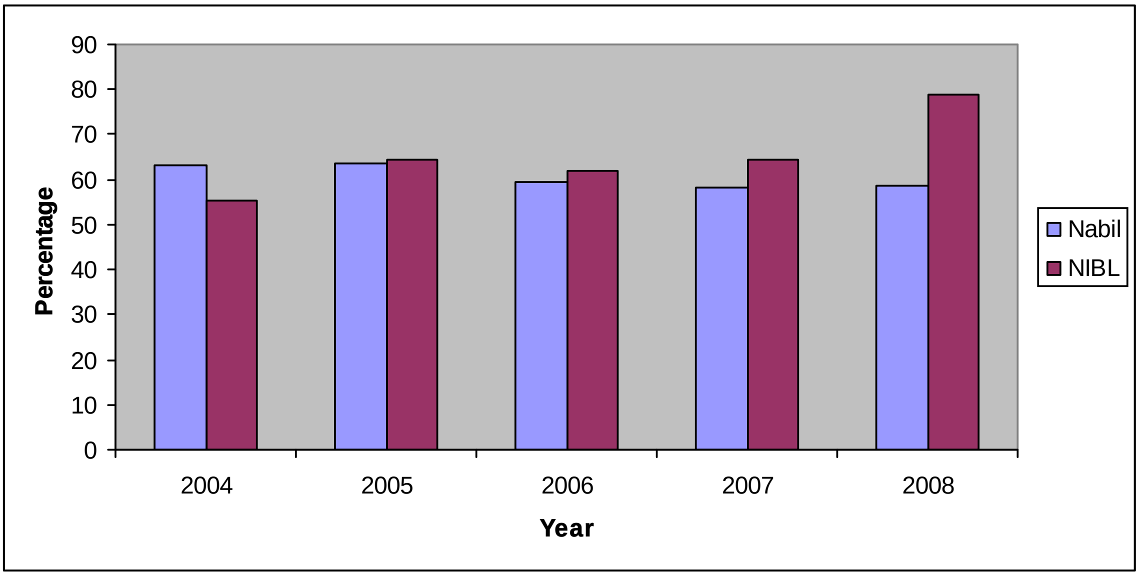
The table (Table 4.1) presented above shows the loan and advances to total assets ratio of two banks for five consecutive years. This ratio shows fluctuating trend in Nabil Bank and increasing trend in NIBL Bank except in year 2006/07.The mean ratio of Nabil, and NIBL is 60.72% and 64.198% respectively. Hence among the two banks NIBL is mobilizing its fund satisfactory than another banks.

The standard deviation of Nabil Bank and NIBL are 2.64 and 7.68 respectively. And Coefficient of variation (CV) of Nabil Bank and NIBL are 3.85% and 11.83% respectively. The NABIL has least standard deviation, it has most consistent ratio during the study period.

From the figure 4.1, it can be interpreted that Nabil has the least loan and advances to total ratio during the period of study. The ratio of NIBL Bank is increasing trend during the period of 2004 to 2008 except in 2006. But at the same time, the ratio of Nabil Bank show fluctuating trend.

Figure 4.1

Loan and Advances to Total Assets Ratio (%)



4.1.2 Loan Loss Provision to Total Loans and Advances Ratio

This ratio describes the quality of assets in the form of loans and advances that a bank is holding. Since there is risk inherent in loans and advances, NRB has directed commercial banks to classify its loans into different categories and accordingly to make provision for probable loss. Loan loss provision signifies the 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 reflected increasing non-performing loan in volume of total loans and advances. The low ratio signifies the good quality of assets in the volume of loans and advances it indicates how efficiently it manages loan and advances and makes efforts to cope with probable loan loss. Higher ratio implies higher portion of Non-performing loan in the total loan portfolio.

Table 4.2

Loan Loss Provision to Total Loans & Advances (%)

(In Million)

Year	Nabil Bank			NIBL		
	LLP	Loans & Adv.	Ratio (%)	Loan loss provision	Loans & Adv.	Ratio (%)
2004	**358**	**10586**	**3.38**	**208**	**7338**	**2.84**
2005	**360**	**10947**	**3.29**	**327**	**10258**	**3.12**
2006	**356**	**13279**	**2.68**	**402**	**13178**	**3.05**
2007	**357**	**15903**	**2.24**	**482**	**17769**	**2.71**
2008	**394**	**21759**	**1.81**	**533**	**27529**	**1.93**
Mean			**2.68**	**Mean**		**2.73**
S.D			**0.6021**	**S.D**		**0.42**
C.V			**22.46**	**C.V**		**15.38**

(Source: Annual Report and Website of Concerned Banks

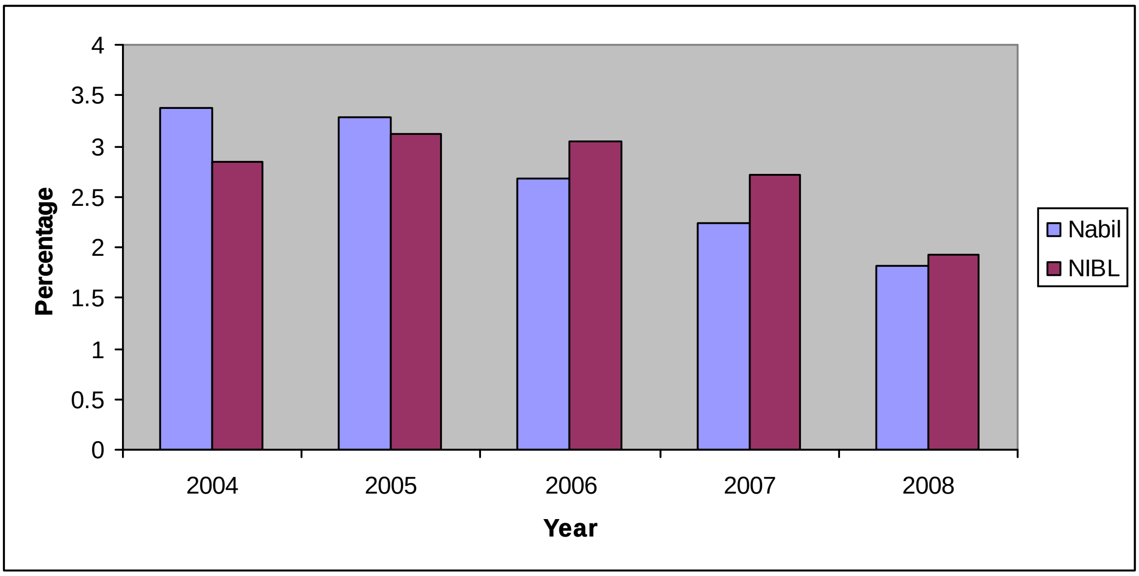
The above table 4.2 exhibits the ratio of loan loss provision to loan and advances of Nabil Bank and NIBL for five consecutive years The ratio of Nabil Bank shows decreasing trend and NIBL shows the fluctuating trend. The mean ratio of Nabil, and NIBL are 2.68% and 2.73% respectively. The overall ratio has been ranged from 2.24% of Nabil in 2007 to 2.71% of NIBL. Higher Loan loss provision is indicative of poor and ineffective credit policy, higher proportion of non-performing asset and poor performance of the economy. NIBL has the least ratio, but fluctuating trend. Decreasing trend of loan loss provision ratio of Nabil explains that Nabil Bank has been successful to reduce its non-performing loan resulting to decreasing Loan loss provision.

The standard deviation of Nabil Bank and NIBL are 0.6021% & 0.4 2% and coefficients of variations are 22.46% & 15.38% respectively. Between the two banks Nabil is moderate in terms of variability and NIBL has the

least variability of ratio during the study period. Since LLP has direct effect in the profit of the banks, both the sampled banks should give serious attention to decrease the level of NPL. The loan loss provision to loan and advances ratio can be presented in bar diagram, which is presented below:

Figure 4.2

Loan Loss Provision to Total Loans & Advances (%)



4.1.3 Non-Performing Loans to Total Loans and Advances Ratio

This ratio determines the proportion of non-performing loans in the total loan and advances portfolio. As per NRB directives the loans falling under category of substandard, doubtful and loss are regarded as non-performing loan. The higher ratio implies the bad quality of assets of banks in the form of loans and advances whereas lower ratio implies the better quality of assets of assets of banks in the form of loan and advances. Hence lower is preferable. As per international standard only 5 % NPL is allowed but in the case of Nepal, maximum 10% NPL is acceptable.

Table 4.3

Non Performing Loan (NPL) to Total Loans & Advances (%)

(In Million)

Year	Nabil Bank			NIBL		
	NPL	Loans & Adv.	Ratio (%)	NPL	Loans & Adv	Ratio (%)
2004	**286**	**10586**	**2.70**	**181**	**7338**	**2.47**
2005	**144**	**10947**	**1.32**	**281**	**10258**	**2.74**
2006	**182**	**13279**	**1.37**	**272**	**13178**	**2.06**
2007	**178**	**15903**	**1.12**	**422**	**17769**	**2.37**
2008	**161**	**21759**	**.740**	**309**	**27529**	**1.12**
Mean			**1.45**	**Mean**		**2.152**
S.D			**.66**	**S.D**		**0.55**
C.V			**45.5**	**C.V**		**22.55**

(Source: Annual Report and Website of Concerned Banks)

The table 4.3 exhibits the ratio of Non-performing loans to loans and advances of Nabil Bank and NIBL for five consecutive years. The figure represented in the above table shows the decreasing trend of Nabil. Nabil's decreasing trend of NPL is the result of effective credit management of bank and its efforts of recovering bad debts through establishment of Recovery cell. The ratio of NIBL shows fluctuating trend . The overall ratio has been ranged from 1.12% of Nabil in 2008 to 2.37% of NIBL in 2008. The mean ratio of Nabil Bank and NIBL are 1.45% and 2.152% respectively. Nabil Bank and NIBL have lesser NPL than the acceptable standard of 10%.So from this ratio it can be said Nabil Bank and NIBL are managing to reduce this ratio in these recent years and maintaining this ratio at minimum level.

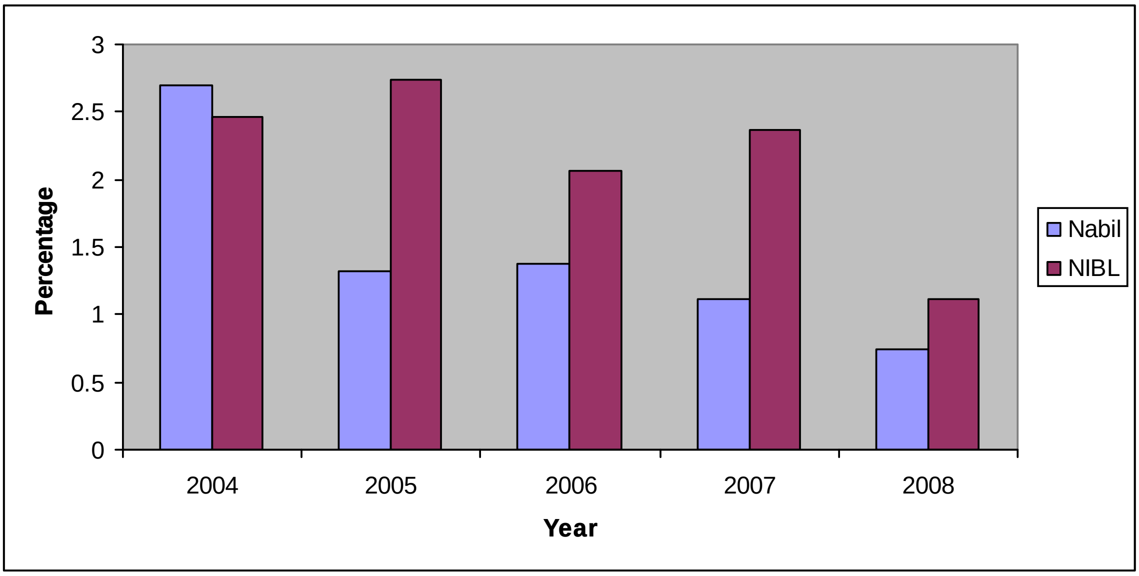
The standard deviation of Nabil and NIB are .66 and 0.55 and coefficients of variation are 45.5% and 22.55% respectively. Thus it signifies that

NIBL has the least deviation and the least coefficient as compared to the NABIL during the study period. Between the two banks, Nabil bank is moderate in term of deviation but has the highest variability of ratio. Since NPL could be one of the causes of banking crisis all the sampled banks .They should give serious attention to this matter and always try to reduce the ratio at least.

The non-performing loan to total loan and advances ratio can be presented in bar diagram also, which is as follows:

Figure 4.3

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



4.1.4 Provision Held to Non Performing Loan

This provision held to non-performing loans ratio shows the proportion of loan loss provision to non-performing loans of the banks. Every bank should have to make provision for the loan to minimize the risk of not recovering the loan from the customer on time. Thus 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 position of the bank.

Table 4.4

Provision Held to Non- Performing Loan (NPL) (%)

(In Million)

Year	Nabil Bank			NIBL		
	LLP	NPL	Ratio (%)	LLP	NPL	Ratio (%)
2004	**358**	**286**	**125.41**	**208**	**181**	**114.91**
2005	**360**	**144**	**250.39**	**327**	**281**	**116.46**
2006	**356**	**182**	**195.60**	**402**	**272**	**147.51**
2007	**357**	**178**	**200.56**	**482**	**422**	**114.38**
2008	**394**	**161**	**244.84**	**533**	**309**	**172.11**
Mean			**203.36**	**Mean**		**133.076**
S.D			**44.89**	**S.D**		**23.18**
C.V			**22.07**	**C.V**		**17.41**

(Source: Annual Report and Website of Concerned Banks)

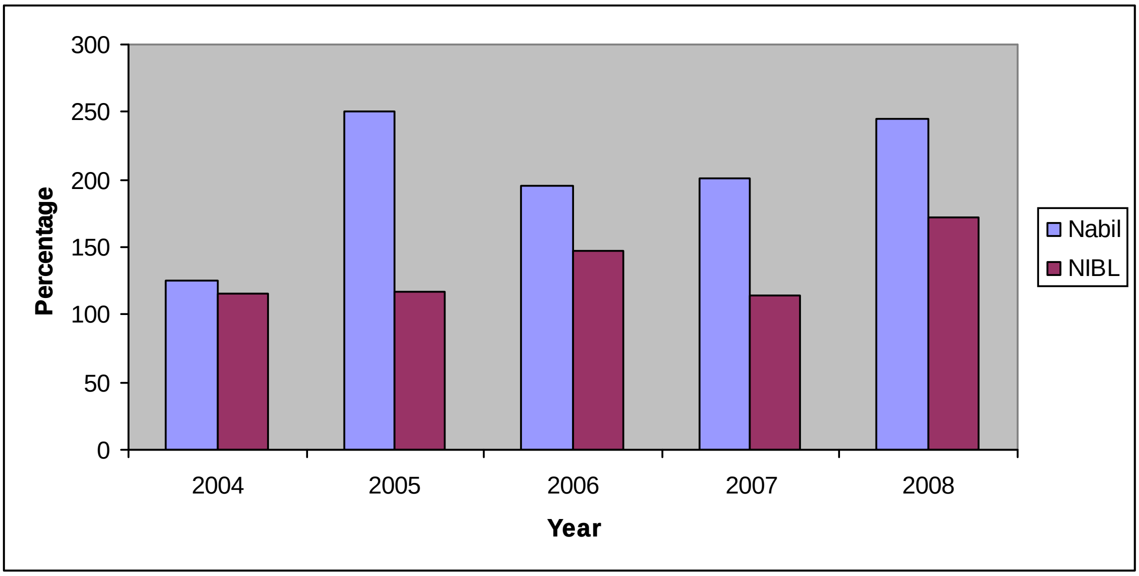
The above table 4.5 exhibits the ratio of provision held to non-performing loan of Nabil bank and NIBL for five consecutive years. The figure represented in the above table shows that Nabil has the highest ratio through out the study period. NIBL has the consistent ratio with higher loan loss provision. The overall ratio has been ranged from 114.38% of NIBL in 2007 to 250% of Nabil in 2005.The mean ratio of Nabil Bank and NIBL are 203.36% and 133.076% respectively. These ratios of both the banks are significantly high which means banks have adequate provision against non-performing loan. Both the Nabil Bank and NIBL have more provision than their non-performing loan, i.e. they have make safeguard or provision for the loan and advances in large amount.

The standard deviations of Nabil and NIBL are 44.89 &23.18 and C.V is 22.07% & 17.41% respectively. Thus it signifies that NIB has the least

deviation and degree of variation in this ratio.Between the two banks, Nabil Bank has the highest deviation and highest in variability compared to that of NIBL. The above provision held to non-performing loan ratio can be presented in bar diagram also, which is as follows:

Figure 4.4

Provision Held to Non-Performing Loan(%)



4.1.5 Return on Loans and Advances

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

Table 4.5

Return on Total Loans & Advances (%)

(In Million)

Year	Nabil Bank			NIBL		
	Net Profit	Loans & Adv.	Ratio (%)	Net Profit	Loans Adv	Ratio (%)

2004	**455**	**10586**	**4.29**	**327**	**7338**	**4.46**
2005	**520**	**10947**	**4.75**	**474**	**10258**	**4.62**
2006	**635**	**13279**	**4.78**	**648**	**13178**	**4.92**
2007	**674**	**15903**	**4.24**	**857**	**17769**	**4.82**
2008	**746**	**21759**	**3.43**	**1013**	**27525**	**3.68**
Mean			**4.29**	**Mean**		**3.5**
S.D			**0.48**	**S.D**		**0.4398**
C.V			**11.19 %**	**C.V**		**10.56 %**

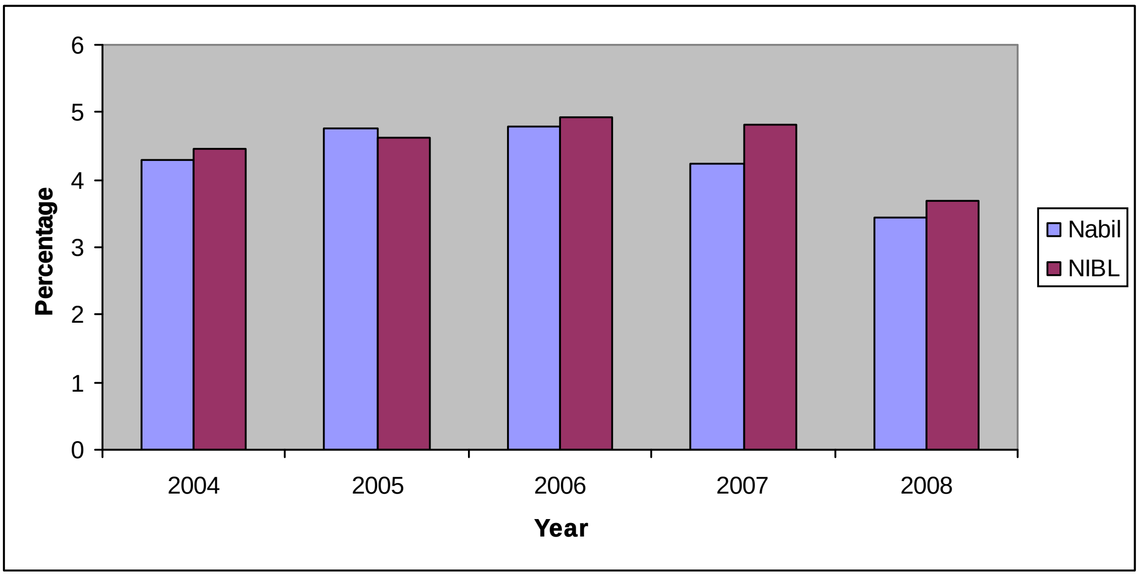
(Source: Annual Report and Website of Concerned Banks)

The above table 4.6 presented above, exhibits the ratio of return on loans and advances of Nabil and NIBL Bank for the five consecutive years .The table represents that Nabil Bank has the highest ratio through the study period. Nabil Bank shows the increasing trend in first three year and fluctuating trend thereafter. .NIB Bank has satisfactory moderate ratio with increasing trend.

The mean ratio of Nabil Bank and NIBL are 4.29% and 3.5% respectively. The mean ratio of Nabil Bank and NIBL Bank is similar. The standard deviations of Nabil and NIBL are 0.48 & 0.4398 and coefficient of variations are 11.19 % & 10.56% respectively. The above return on total loans and advances ratio can be presented in bar diagram also, which is as follows:

Figure 4.5

Return on Total Loans and Advances



4.2 Correlation Analysis

The percentage measure of coefficient of standard deviation is called coefficient of variation. The less is the C.V then more is the uniformity and consistency and vice versa. Standard deviation gives an absolute measure of dispersion. Hence where the mean of the variable is not equal it is not appropriate to compare two pairs of variables based in S.D only. The coefficient of variation measures the relative measures of dispersion, hence capable to compare two variables independently in term of their variability.

4.2.1 Correlation between Loans and Advances and Total Deposit

This correlation between the loans and advances and total deposits describes the degree of relationship between these two variables. Deposit is one of the major items of liability side and loan and advances is the major item of assets side of balance sheet of any commercial banks. Banks disburse loans and advances through the funds received from the depositors. In this case, the deposit is the independent variable and loan and advances is the dependent variable. It shows how a unit increase in

deposit impact in the volume of the loan and advances is exhibited by this correlation coefficient.

Table 4.6

Correlation between Loans and Advances and Total Deposit

Banks	Coefficient of correlation (r)	Relationship	Probable Error (PE)	6*PE	Sig/ Insignificant
Nabil	**0.9671**	**Positive**	**0.0195**	**0.117**	**Significant**
NIBL	**0.9941**	**Positive**	**0.0035**	**0.021**	**Significant**

The above table (Table 4.6) shows the correlation coefficient, PE and 6PE of sample banks. It shows there is high degree of positive correlation between loans and advances and deposit in all the sample bank in study period. The correlation of Nabil and NIBL are 0.9671 and 0.9941 respectively. The PE is 0.0195 and0.0035 and 6PE are 0.117 and 0.021 respectively. The correlation of coefficient of Nabil and NIB, are more than six times the value of P.E and even more than the value of P.E. So, all the banks are highly significant. That means increase in volume of deposit leads to increment in loans and advances. In other word, the loan advances is increase with the increment of total deposit in the banks.

4.2.2 Correlation between Loan Loss Provision and Loans and Advances

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

Table 4.7

Correlation between LLP and Loans and Advances

Banks	Correlation	Relationship	Probable	6*PE	Sig/Insignificant

	Coefficient(r)		Error(P.E)		
Nabil	**-0.4726**	**Negative**	**0.2342**	**1.4052**	**Insignificant**
NIBL	**0.9828**	**Positive**	**0.0103**	**0.0618**	**Significant**

Above table 4.8 explains the relationship between loans and advance and LLP. Here the correlation coefficient of Nabil is -0.4726 and it is less than 6 times the value of its P.E and even less than 6 P.E, the correlation coefficient is insignificant. In other words the total LLP of Nabil is not correlated with the loans and advances during the study period. The correlation coefficient is negative as the loans and advances increases but LLP is also slightly changed due to fluctuating nature. The LLP of Nabil nearly constant through out the study period. The correlation coefficient of NIBL is 0.9828.The value of PE and the value of six times PE is 0.0103 and 0.0618 respectively. The value of correlation coefficient is higher than the value of P.E and six times of P.E. Hence there is positive correlation between LLP and advances of NIBL and its correlation coefficient is significant and reliable.

4.2.3 Correlation between Loan Loss Provision and Non Performing Loan

The correlation between LLP & NPL describes the relationship between them. How a unit increase in NPL effect the LLP is exhibited by this correlation. Here non-performing loan is independent variable and LLP is dependent variable. As earlier mentioned NPL are the loan falling on the category of substandard, Doubtful and Loss Loan and the respective provisioning requirement is 25%, 50% and 100%.Higher the NPL higher will be the provisioning amount.

Table 4.8

Correlation between LLP and Non Performing Loan

Banks	Correlation Coefficient(r)	Relationship	Probable Error	6*P.E	Sig/Insignificant
Nabil	**0.00105**	**Positive**	**0.3016**	**1.809**	**Insignificant**

NIBL	**0.3734**	**Positive**	**0.2595**	**1.557**	**Insignificant**

The table 4.8 explains the relationship between LLP and NPL. Here both banks have positive correlation between NPL and LLP. That means increment in NPL leads to increment in LLP. The correlation coefficient of Nabil is 0.00105 and its P.E and 6 times P.E are 0.3016 and 1.8095.The Correlation coefficient is less than the value of P.E and more less than its 6 P.E. Hence r is less than 6 PE, then the correlation coefficient is insignificant and there is no evidence of correlation. (i.e. insignificant).And NIBL has positive correlation but r is less than its 6 P.E so it is insignificant.

4.3. Trend Analysis

Trend analysis is a statistical tool which helps forecast the future values of different variables on the basis of past tendencies of variable. Trend analysis informs about the expected future values of various variables. Amongst the various methods to determine trend the least square method is widely used in practices. Hence in this study also least square method has been adopted to measure the trend behaviors of these selected banks. However trend analysis is based on the assumption that past tendencies continues in the future. Under this heading the effort has been made to calculate trend values of following variables from mid July 20007/8 to mid July 2011/12.

4.3.1. Trend Analysis of Loan and Advances

The values of average loans and advances (a), rate of change of loans and advances (b) and trend values of loans and advances of two banks for ten years from mid July 2002/03 to Mid July 2011/12 are as follows.

Table 4.9

Trends Values of Loans and Advances

(In Million)

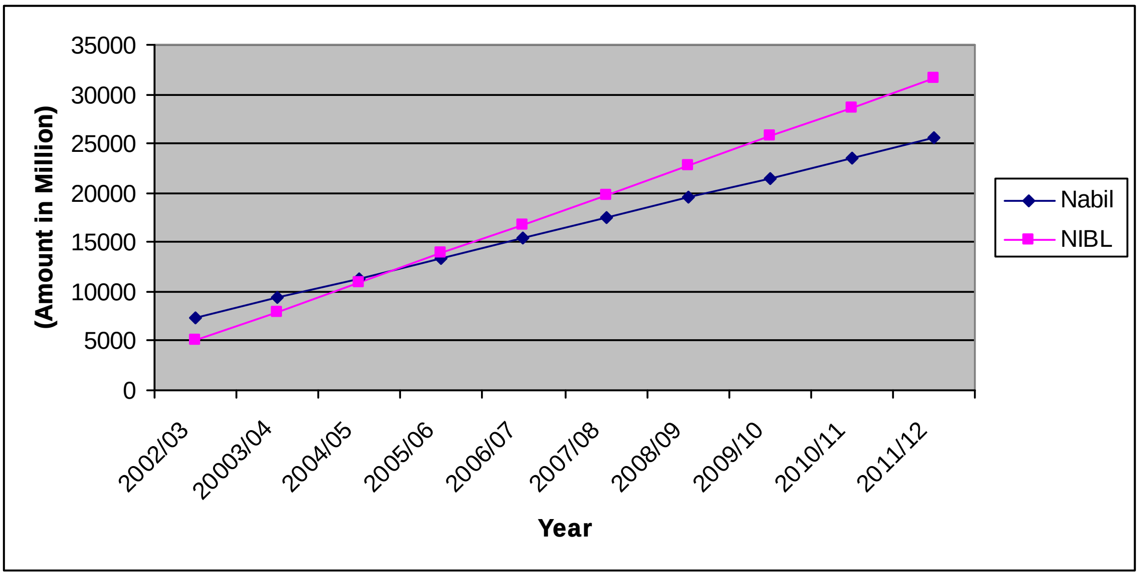
Year (Mid July)	Nabil Bank a =11357.60 b =2031.00	NIBL a =10932 b =2953.40
2002/03	7295.60	5025.20
20003/04	9326.60	7978.60
2004/05	11357.60	10932
2005/06	13388.60	13885.40
2006/07	15419.60	16838.80
2007/08	17450.60	19792.20
2008/09	19481.60	22745.60
2009/10	21512.60	25699
2010/11	23543.60	28652.40
2011/12	25574.60	31605.80

The table 4.9 shows that all sample banks have the increasing trend of loans and advances. The average loans and advances of Nabil Bank is Rs11357.60 million and increasing every year at the rate of Rs 2031.00 million. Hence expected loans and advances of Nabil are supposed to increase from Rs17450.60 Million in 2008 to 25574.60 million in 2012. The average loans and advances of NIBL is Rs 10932 million which increase by Rs 2953.40 million every year. Accordingly loans and advances of NIBL is expected to increase from Rs 19792.20 million in 2008 to Rs.31605.80 million in 2012.

Trend line of loans and advances of these two banks show that the increasing trend in which NIBL has highest rate of increment. It can be concluded that Nabil Bank has policy of low investment in loan and advances than NIBL.

Figure 4.6

Trend of Loan and Advance of Nabil and NIBL



4.3.2. Trend Analysis of Non Performing Loan

The calculated values of average Non Performing Loan (a), rate of change of NPL (b) and trend values of NPL for 10 years from Fiscal Year 2002/03 to 2011/12 of the two banks are as follows:

Table 4.10

Trends values of Non Performing Loan

(In Million)

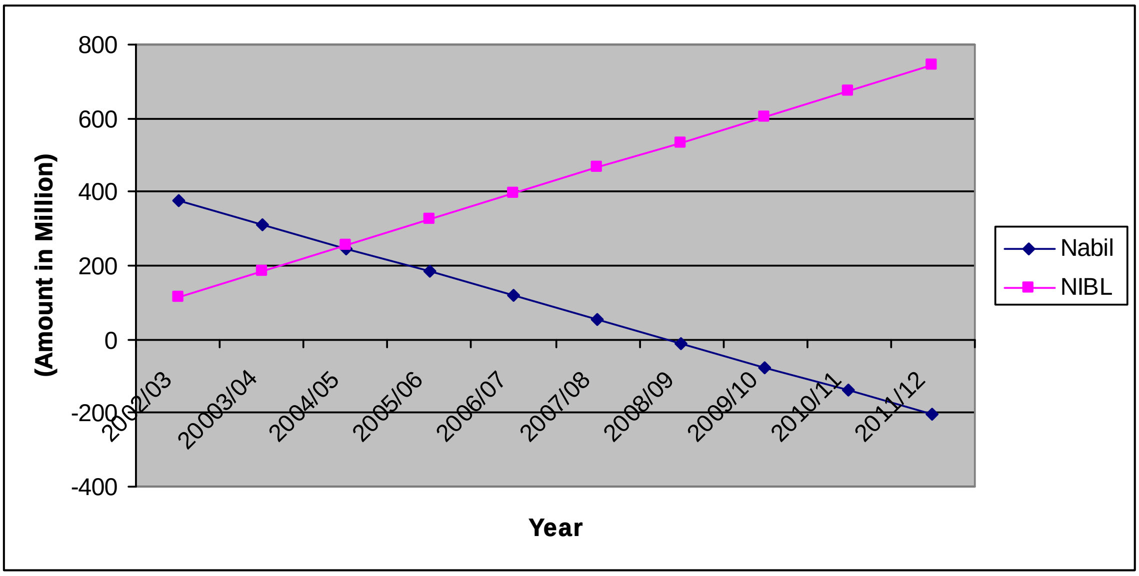
Year (Mid July)	Nabil Bank a =247.80 b =(64.6)	NIBL a =254.60 b =70.10
2002/03	377	114.4
2003/04	312.40	184.50
2004/05	247.80	254.60
2005/06	183.2	324.70
2006/07	118.60	394.80
2007/08	54	464.90
2008/09	(10.6)	535
2009/10	(75.20)	605.10
2010/11	(139.80)	675.20
2011/12	(204.40)	745.30

The table 4.11 shows that Nabil Bank has decreasing trend but NIBL have increasing trend of Non Performing Loan. The average NPL of Nabil bank

is 247.80 million, which is decreasing at the rate of Rs.64.6 million each year. Hence the expected NPL of Nabil is supposed to decrease from Rs 54 million in 2008 to negative Rs 204.40 million in 2012.The negative value of Nabil shows that the Nabil bank has no non performing loan by the end of 2008.Due to Nabil's recovery efforts through establishment of Recover cell, its NPL has come down in recent years. Hence Nabil shows decreasing trend of NPL. This may be due to good credit control system of Nabil. Likewise, the average NPL of NIBL is Rs.254.60 million, which is increasing every year at the rate of Rs.70.10 million. The expected NPL of NIBL is Rs 464.90 million in 2008, which is increase to Rs.745.30 million in 2012. Following figure 4.8 represents the trend line of non-performing loan of two banks for 10 consecutive years.

Figure 4.7

Trend of Non-Performing Loans of Nabil and NIBL



4.3.3. Trend Analysis of Loan Loss Provision

The calculated values of average loan loss provision (a) rate of change of LLP (b) and trend values of LLP for 10 years from Mid July 2002/03 to mid July 2011/12 of the two banks are as follows.

Table 4.11

Trends values of Loan Loss Provision

(In Million)

Year (Mid July)	Nabil Bank a =357.80 b =(0.4)	NIBL a =313.60 b =187.20
2002/03	358.60	(60.80)
2003/04	358.20	126.40
2004/05	357.80	313.60
2005/06	357.40	500.80
2006/07	357	688.00
2007/08	356.60	875.20
2008/09	356.20	1062.40
2009/10	355.80	1249.60
2010/11	355.40	1436.80
2011/12	355.00	1624.00

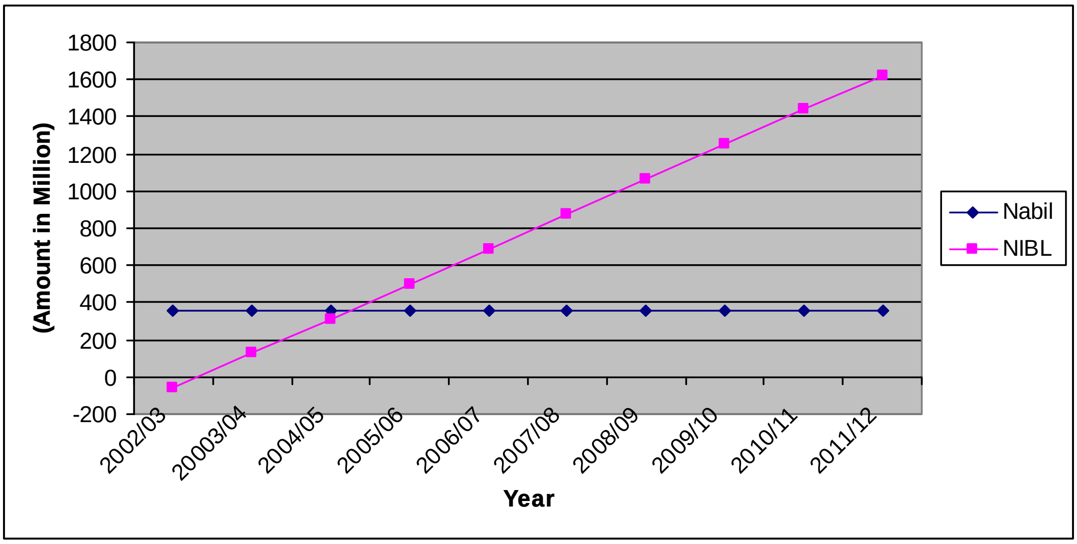
The table 4.12 shows that Nabil Bank has decreasing trend of LLP while NIBL have increasing trend of LLP. The average LLP of Nabil is Rs.357.80 million which is decreasing every year at the rate of Rs 0.4 million. Hence the expected LLP of Nabil is supposed to decrease from Rs.356.60 million in 2008 to Rs 355.00Million in 2012.The average LLP of NIBL is Rs.313.60 million which is increasing every year at the rate of Rs.187.20 million. Hence the expected LLP of NIBL is supposed to Rs 875.20 million in 2008 which is increased to Rs.1624.00 million in 2012.The increasing trend of LLP of NIBL is due to the increasing trend of loans and advance in total asset.

As we know that higher the NPL the higher will be the LLP. Nabil decreasing trend of LLP shows that it is successful in reducing the non

performing loan of the banks, so LLP shows decreasing trend.LLP increase accordingly with increase in NPL.Following figure 4.9 shows that the trend of increase and decrease in flow of LLP of the two banks for 10 consecutive years respectively.

Figure 4.8

Trend of Loan Loss Provision of Nabil & NIBL



4.3.4. Trend Analysis of Net Profit

The calculated values of average Net Profit (a), rate of change of Net profit (b) and trend values of Net Profit for 10 years from mid July 2003 to 2012 of two banks are as follows

Table 4.12

Trends values of Net Profit

(In Million)

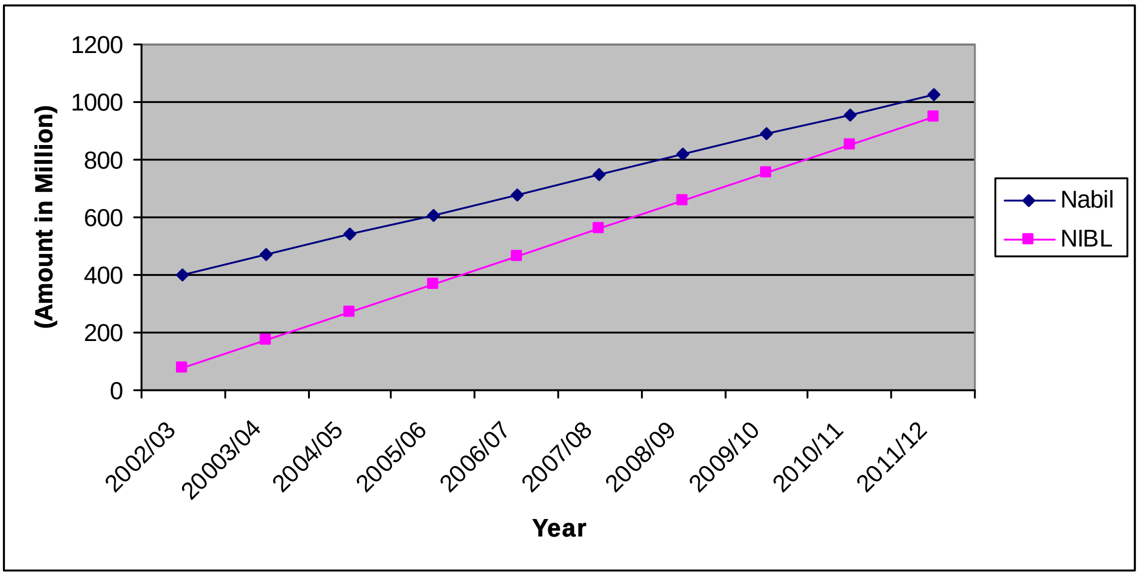
Year (Mid July)	Nabil Bank a =540 b =69.60	NIBL a =270.60 b =96.50
2002/03	400.80	77.60
2003/04	470.40	174.10
2004/05	540	270.60
2005/06	609.60	367.10
2006/07	679.20	463.60
2007/08	748.80	560.10
2008/09	818.40	656.60
2009/10	888.00	753.10

2010/11	**957.60**	**849.60**
2011/12	**1027.20**	**946.10**

The table 4.13 shows that Nabil Bank and NIBL have the increasing trend of net profit. The average net profit of Nabil is Rs.540 million and increasing every year at the rate of Rs.69.60 million. Hence expected net profit of Nabil is supposed to increase from Rs.748.80 million in 2008 to Rs.1027.20 million in 2012.The average net profit of NIBL is Rs.270.60 million which increase by Rs.96.50 million every year. Hence it is expected that net profit of NIBL is supposed to increase from Rs.560.10 million in 2008 to Rs 946.10 million in 2012. Following figure 4.10 represent the trend line of net profit of two banks for 10 consecutive years.

Figure 4.9

Trend of Net Profit/Loss of Nabil & NIBL



The above figure depicts that Nabil Bank is ahead of in generating net profit and its rate of increment of net profit is higher than that of NIBL.

4.4. Analysis of Loan Loss Provisioning as per Nepal Rastra Bank's Directives

According to Nepal Rastra Bank E.Pra. Directive No 2/061/062, NRB has issued new directive, regarding loan classification and Provisioning of loans and advances of financial institutions. As per this directive, loans and advances are to be classified into four categories namely Pass, Substandard, Doubtful and Loss with respective Provisioning 1%, 25%, 50%, 100% on the basis of ageing past dues.

The study will focus on to find whether the sampled banks are maintaining required Percentage of loan loss provision as imposed by NRB for their pass, substandard, doubtful and bad loan respectively or not.

4.4.1. Loan Loss Provisioning of Nabil Bank Limited

The loan loss provision maintained by Nabil Bank Limited is presented in the following table.

Table 4.13

Loan Loss Provisioning of Nabil Bank Limited

Types of Loan	LLP Requirement	Loan Loss Provisioning By the Bank (%)				
		2003	2004	2005	2006	2007
Pass Loan	1% of Pass Loan	1.6	1.55	1.016	1.001	1.12
Substandard loan	25% of substandard loan	24	23.22	27.27	67.93	47.31
Doubtful Loan	50% of Doubtful Loan	48.95	49.40	73.20	47	49.19
Bad Loan	100% of bad loan	85.14	97.19	97.045	94.55	86.46

Above table 4.14 shows the loan loss provision maintained by Nabil bank for different types of loan in different fiscal year. Nabil bank has met the provision requirement for pass loan throughout the study period which was enough than the requirement (i.e. more than 1%).But while talking to the provision required for substandard loan it should be 25% but it has failed to meet in 2003 and 2004 and maintained only 24 % and 23.22%

which is slightly lower than that the requirement. And from year 2005, loan loss provisions are more than requirement.

Similarly bank is required to maintain 50 % loan loss provision for its doubtful loan. But except in 2005 it has failed to meet that much provision for doubtful loan, which is required. It has provisioned 73.20% which is 23.2% more that the requirement. But it has provisioned 48.95%,49.40% 47% and 49.19 % in year 2003,2004 ,2006 and 2007 respectively In other words they were slightly lower than as per directives, which should be 50 percent.

Similarly 100 % loan loss provision is must for bad loan. But it is found that the bank has not enabled to maintain loan loss provision as per requirement. In other word, Loan loss provision made by the bank for bad loan does not exactly meet the NRB's Directives which should be 100 percent.

It is found that the bank could not maintain loan loss provision, perfectly in accordance to NRB's directives. The bank maintained higher than requirements for one when lower for another class of loan. Therefore the bank should give priority to maintain loan loss provision appropriately as per NRB's directives. Obeying NRB's rules and regulation is a major responsibility of the bank.

4.4.2 Loss Provision of Nepal Investment Bank Limited

The loan loss provision maintained by NIBL is presented in the following table.

Table 4.14

Loan Loss Provision of Nepal Investment Bank Limited

Types of	**LLP**	**Loan Loss Provisioning By the Bank (%)**

Loan	Requirement	2003	2004	2005	2006	2007
Pass Loan	**1% of Pass Loan**	**0.98**	**0.98**	**0.99**	**1.00**	**1.00**
Substandard loan	**25% of substandard loan**	**11.31**	**25.16**	**25.79**	**25.00**	**25.36**
Doubtful Loan	**50% of Doubtful Loan**	**12.72**	**46.80**	**50.11**	**50.00**	**50.07**
Bad Loan	**100% of bad loan**	**97.84**	**98.37**	**91.79**	**99.00**	**99.07**

NRB has set up directives regarding to be maintain loan loss provision for different type loan of a bank. In this context, the table 4.16 shows the loan loss provision maintained by NIBL for its different types of loan.

One percent loan loss provision is required for its pass loan. The NIBL maintained 0.98 %, 0.98%, 0.99 % in year 2003, 2004 & 2005 respectively, which is slightly lower than NRB's directive but met 1 % in year 2006 and 2007.Similarly, 25 % loan loss provision is required for the substandard loan of the bank. Except in year 2003, it has met the requirement, but in year 2003 it is 13.69 % lower than to meet the requirement.

Likewise, bank must maintain 50% loan loss provision for its doubtful loan. But the NIBL maintained only 12.72 % which is much lesser than the requirement. Likewise it has maintained slightly lower than the requirement in year 2004.But from year 2005 it has maintained exactly same as requirement. Similarly 100 % requirement is needed for bad loan, but it failed to maintain in whole study period.

Despite of better management of its non-performing assets, the bank does not maintain its loan loss provision as per NRB's directive. Such case indirectly depicts that NRB has been failed to regulate commercial banks properly. Obeying NRB's rules and regulation is one of the major responsibilities of any commercial bank. Therefore the all banks should maintain loan loss provision as stated as in NRB's directives.

4.5 Major Findings of the Study

As per the analysis of data, following major findings have been obtained.

The average loans and advances to total asset of Nabil and NIBL during the study are 60.72 % and 64.918% respectively. The relatively low ratio of Nabil Bank is the indication of risk adverse attitude of the management or they have the policy of investing low in the risky assets i.e. loans and advances. Nabil has higher proportion of its investment in risk free or nominally risky asset like treasury bills; National saving bonds. In the same way NIBL has the most consistent ratio through out the study. Nabil is moderate in terms of the ratio, its deviation and variability.

The core banking function is to mobilize the funds obtained from the depositors and how successfully this function has been discharged by the banks. It is measured by the ratio of loans and advances to total deposit ratio or simply CD ratio. The average CD ratio around 70-80 % is considered as appropriate. The average CD ratio of Nabil and NIBL during the study period is to be 66.48% and 70.78% respectively. This ratio of the NIBL has the most consistent and least deviation ratio during the study period. The ratio of Nabil Bank indicates that it has less than the appropriate standard.

Loan loss provision to loan and advances ratio of NIBL is 2.73% and Nabil is 2.68%.Since higher ratio is an indication of higher non-performing loan in the total loans and advances. Nabil has least ratio with decreasing trend which is the indication of sound assets as compared to

that of NIBL. In other word Nabil's asset quality is improving. NIBL has the least ratio, least deviation and least variation during the study period.

The analysis of non-performing loans to total loans reveals that average NPL of Nabil and NIBL is 1.45% and 2.152% of total loan respectively. It means 97.47% and 97.69% of total loan of Nabil Bank and NIBL is performing loan. As per international standard only 5% NPL is allowed but in the context of Nepal 10% NPL is acceptable. In recent year Nabil Bank has significant decrement in NPL, which is the result of bank effective credit management and its efforts of recovering bad debts through establishment of Recovery Cell. During the study period this ratio is the least in NIBL but NPL shows increasing trend. NIBL has the least variation and Nabil has the highest variation in this ratio through out the study period

The average ratio of Provision held to Non-performing loan of Nabil and NIBL is 203.36% and 133.074 % respectively. Hence Nabil has significantly higher ratio in comparison to NIBL, which portrays that the bank has adequate provision against non performing loan .Nabil shows the highest deviation and variability in this ratio than that of NIBL.

The main objective of commercial banks is to earn profit through mobilization of fund. The ratio of return on loans and advances ratio indicates how efficiently the bank has employed its resources in the form of loans and advances. This ratio of Nabil and NIBL are 4.29% and 3.5%. Nabil has the highest ratio as it is ahead in generating net profit.

While analyzing correlation between loans and advances and deposit, it has been found that Nabil and NIBL have high degree of positive correlation between these two variables they are also more than 6 times of

theirs P.E. The respective correlation coefficient of Nabil and NIBL are 0.9671 and 0.9941 respectively, which is significant and reliable.

The correlation coefficient between LLP and loans and advances of Nabil and NIBL are -0.4726 and 0.9828 respectively. Here correlation coefficient of Nabil is negatively correlated and it is less than the value of 6 times P.E, so it is insignificant and there is no evidence of correlation. Since higher provision has to be provided for non performing loans in the total loan portfolio. NIBL has positive correlation between LLP and loans and advances, it is more than the value of 6 times P.E, and it is significant.

The correlation between LLP and NPL revealed that there is positive correlation between LLP and NPL in NIBL but shows very low correlation between LLP and NPL in Nabil. The correlation coefficient between these two variable in Nabil and NIBL is 0.00105 and 0.3734.The correlation coefficient of Nabil is 0.00105 i.e., slightly Positive correlated, and is less than 6 times of P.E .Hence NPL and LLP of Nabil is insignificant. The main reason behind this is Nabil's NPL is decreasing but the LLP is increasing (same as before).The positive correlation coefficient of NIBL is significant .As earlier mentioned higher provision needs to be provided for NPL, higher the NPL, higher would be the LLP. The reason behind this is relatively higher proportion of LLP to NPL level.

Trend analysis has done based on the data of past five years and forecast has made for next five years. The trend analysis of loans and advances shows increasing trend in both sampled bank. The loans and advances of Nabil and NIBL is expected to increase at the rate of Rs.2031 million and Rs.463.40 million respectively every year.

The trend analysis of Non-performing loan in Nabil shows decreasing trend in coming years and trend of LLP is also decreasing in Nabil. The NPL and LLP of Nabil are expected to decrease at the rate of Rs 64.60

million and Rs.0.4 respectively every year. This is due to Nabil's recovery efforts towards reducing NPL through establishment of Recovery Cell.

From the trend analysis of Net profit, it is found that Net profit is expected to increase in coming year in Nabil and NIBL. The net profit of Nabil and NIBL is increasing Rs.69.60 million and Rs.96.50 million respectively every year. The high rate of net profit earning is due to more investment in less risky asset resulting low NPL and hence less loan loss provision.

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 the requirement of NRB's directives up to fiscal year 2006/2007.If the bank continue this trend the bank may have to face different legal hassle regarding its lending in future. The main reason may the over provision create inadequacy of capital and less provision create 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. It is found that Nabil slightly could not maintain loan loss provision for doubtful and bad as per requirement during the study period .NIBL has provisioned very lower than requirement in year 2003/2004 for all categories of loan. From then it has tried to meet the provision amount as much as requirement. Despite of outstanding success in managing NPA, the loan loss provision made by Nabil and NIBL is not considerable.

CHAPTER - V
SUMMARY, CONCLUSION AND RECOMMENDATIONS

Finally an attempt is made in this chapter to summarize the whole study and findings, make general conclusions based on the finding presented in previous chapter and also to suggest some recommendations based on the result of the analysis of data.

5.1 Summary

This research is aimed at studying about the non performing loan and loan loss provisioning of commercial banks. In first chapter the study dealt about basic assumption of the study .Basically it highlights the concept and importance or significance of the study. It also presents research issues, research problems, basic objectives of the study, rationality of the study, limitation of the study, and organizational structure of the study.

Second chapter helped to provide knowledge about the development and progress made by the earlier researcher on the concerned field or topic of the study. It also tried to know the some concept used in this study. Moreover, it reviewed and summarized the finding of the previous findings of the study to provide knowledge about the background of the work done by them and to stop the duplicate of previous work.

Third chapter of the study discussed about various research methodologies used for the study. Basically, research methodology here signifies the research design, sources of data, population and sample of data, data collection procedure, data collection technique, data collection methods and tools and techniques employed etc. For this purpose descriptive cum analytical research design was adopted. Out of the total population of 26 commercial banks, two banks were taken as sample using judgmental

sampling method. Two major commercial banks Nabil Bank and Nepal Investment Bank were selected from private sector banks. Secondary data have been used in the study. Annual reports and other publication form the basis of secondary data. Beside this, newspaper, relevant thesis, journals, articles, related websites etc are also taken for this research. The data collected from various sources are recorded systematically and presented in appropriate forms of tables and charts and 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 objective of the study. Fourth chapter of the study dealt about data presentation and analysis .It first presented the generated data in tabular form and analyzed them in systematically as per the objectives. The researcher tried to analyze the comparative position of bank in terms of Non performing asset and its impact on relative variables. Detail of the findings can be presented as below.

NIBL and Nabil Bank has least proportion of loan and advances during the study period. The credit deposit ratio also shows the same thing. It indicates the risk adverse attitude of the management of Nabil. Because of this less orientation towards lending has made this bank successful in to have low ratio of provisioning and lower ratio of non-performing loans. However in recent year Nabil has shown significant decrement in NPL and thus in LLP. Regarding NPL, NIBL has the least NPL than the Nabil. The non-performing loan in total loans and advances of Nabil and NIBL are 2.53% and 2.31%respectively which is quite less than the acceptable standard of 10%.This is result of managing NPL by the both banks. The ratio of provision held to NPL of Nabil is the highest than NIBL.

Although, NIBL have the higher portion of their investment in the most income generating assets i.e. loans and advances those banks could not get

more profit than Nabil. In other word the return on loans and advances is comparatively lower than Nabil.In the same way Nabil and NIBL have moderate portion of investment in loans and advances with higher rate of return on investment due to proper lending and monitoring function with low cost of fund ,high fee based income etc.

The correlation between loan and deposit shows the positive relationship in all sampled banks. It means that when the deposit amount increases the loan and advances also increases. There is negative correlation between LLP and loans and advances in Nabil but shows the positive correlation in case of NIBL. The correlation coefficient are negative as the loans and advances are increasing but LLP is decreasing (same).It is not increased with the increment in Loan and advances. Another reason may be the better management of Nabil that it is successful not to turn its loan and advance as Non-performing loan. Lower NPL means lower LLP. But in case of positive correlation between LLP to Loan and advance of NIBL this is due to increment of non performing loan in increased loan and advance portion. Amount to be provisioned depends upon the non performing loan and its quality. Higher provision has to be provided for higher NPL.

The trend analysis of loans and advances shows increasing trend in both the sampled banks. The trend analysis of Non-performing loan and loan loss provision in Nabil shows decreasing trend in coming years. This is due to Nabil's recovery efforts towards reducing NPL through establishment of Recovery cell .But the NIBL has increasing trend of Non-performing loan and loan loss provision in coming years. The trend analysis of net profit exhibits that Nabil and NIBL have increasing in coming year.

Nepal Rastra Bank has set up a directive regarding loan loss provisioning of Nepalese commercial bank. According to this provision a bank has to

maintain 1%, 25%, 50%, and 100% loan loss provision for its pass loan, substandard loan, doubtful loan and bad loan respectively. It is found that sampled banks maintained higher than requirement for one type of loan where as lower for another class of loan category. They should make provision perfectly as per requirement, neither more nor less. The reason may be over provision create inadequacy of capital, reduce profit and less provision create legal hassle to the bank. The loan loss provision made by Nabil and NIBL seem satisfactory, not a serious matter, only little attention is needed to manage LLP of each loan category. Like wise role of NRB is essential. Regular supervision and control over the Nepalese commercial bank by NRB, whether they are implementing NRB's directive perfectly or not, is very important.

Finally, conclusion and summary and various suggestions were described in fifth chapter. It drew the conclusion from the findings of the study and explained the summary of the research paper. Besides, it also provides various suggestions to give further improvement.

5.2 Conclusion

Banking sector in Nepal has expanded substantially in the last one and a half decade, following the financial liberalization policy. People now have several choices in pursuing their banking activities. This sector has gradually embraced modern technologies to deliver value added product and services to its clientele. However, the expansion and adoption of new technologies has brought new types of risk to the fore, the management of which is crucial for the bank and the banking industry in the long run. At the beginning of the 1980s when financial sector was not liberalized, there were only two commercial bank, and development banks performing banking activities in Nepal. After the induction of economic liberalization policy, particularly the financial sector liberalization that impetus in the establishment of new bank and non bank financial institutions.

Consequently, by the end of mid-July 2007 altogether 208 bank and non bank financial institutions licensed by NRB are in operation. Out of them, 20 are "A" class commercial banks, 38 "B" class development banks, 74 "C" class finance companies, 12 "D" class micro-credit development banks, 17 saving and credit co-operatives, and 47 NGOs.

Nepalese banking industry is faced with variety of serious challenges, the prominent being the management of large volume of non performing loans and the development of corporate values and ethics among the stakeholders in the banking industry. There is already a stiff competition between the market players and the possibility of entry of new players is going to further add to the pressure. So in such a scenario, stakeholders including NRB have to be vigilant that banks do not compromise on the prudent risk management practices in order to survive the competition, which might ultimately lead to the bank failure .At the same time, NRB has to keep tight vigil in the banking industry so as to be take corrective measures in creating and maintaining a stable and a sound banking industry.

It has been found that effective credit management and its efforts of recovering bad debts through establishment of Recovery cell; Nabil has resulted to decrease in the level of NPL during the study period resulting in less provisioning. It is successful to increase loan and advances and total deposit. The net profit of Nabil is increasing each year. The result is due to the recovery of the bad debt, reduction in operating cost and better management.

Similarly, the total loan and advances, assets, deposits and net profit of NIBL is increasing year by year where as the level of NPL is not increasing as much to the ratio of increment in the other balance sheet and off balance sheet items. The increase in the LLP shows the sound position of NIBL to recover form the loss created by the defaulters

The quality of loan has a direct bearing on the bank's financial health. The banks are required to develop reserves and provision in accordance to the quality of loans. A rapidly deteriorating loan portfolio is a huge drain on the bank's profitability and subsequently on the capital adequacy. This has the potential to erode the bank's capital in no time. Thus the quality of loan is arguably the key determinant of bank's financial health. Poor corporate governance and risk management practices are the key reasons for high level of NPL in our banking system. Other causes are economic slowdown, legal hurdles in recovery and poor quality of credit information. Management practices in many banks are still very weak, particularly in the areas of credit analysis, credit administration and risk management and internal control system. Hence, the management of NPL is great challenge for the Nepalese banking sector. It is high time to start strengthening and reshaping the reform process. It is a must not only to capitalize on the achieved robustness of the banking industry, but also to integrate it with the global economy deep into the twenty first century.

We can say that continual review and classification of loans 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 Asset management Company are also measures to resolve the problem of NPL .The Present loan classification and provisioning directives seem more stringent than the previous one.

5.3 Recommendations

High level of non-performing loan not only decreases the profitability of banks but also affect the entire financial as well as operational health of the organization. If the NPA level is not controlled immediately, it will be main cause for failure of bank in future. Proper loan classification and loan loss provisioning also helps to confront the problems of NPA.

Therefore following are some of the recommendations which will help to reduce the level of NPA of Nepalese Commercial Banks:

The average CD ratio of Nabil and NIBL during the study period is found as 66.48% and 77.21%respectively.The CD ratio of Nabil is relatively low. The average CD ratio around 70-80 % is considered as appropriate. Disbursement of loan has direct effect on bank's financial health .But now a days mushrooming growth of bank and financial has created intense competition in this field They have over liquidity caused by lack of good lending opportunities just sharing a small size of the cake among the banks. Hence it is recommended for both the banks to continuously explore new areas of investments as customer's need and trend. Also try to sustain their valued customer by maintaining an appropriate spread between the cost of interest on deposit and interest from loans and advances.

As per international standard only 5% NPA is allowed but in the context of Nepal 10% NPA is acceptable. This means NPL to total loan ratio of Nabil and NIBL are 2.53% and 2.31% respectively. The average percentage of NPL to total loan of Nabil and NIBL are below the prescribed standard. Since NPL is one of the causes of banking crisis, all the sampled banks should give serious attention to this matter. Hence proper homework should be done before lending to the new customer as well as while increasing the limit of the old customer too. Proper credit appraisal, site visit, financial analysis, etc should be done to decrease the credit risk which will certainly play a vital role in decreasing the level of NPL as well as to maintain a balance in the level of NPL to total loan.

Due to huge amount of NPA in bank financial structure it is having losses on loan and advance during the study period. So the serious step must be taken on this head for getting off from losses.

Inadequate study of loan proposals, bad intention, week monitoring, mismanagement, lack of portfolio analysis, ineffective credit policy, shortfall on security, poor loan recovery system, focus on only trade sector, unfair trade practices are some internal factors responsible for NPA growth. Like wise political instability, inconsistency in government policy, week legal provisions for loan recovery are some external factor responsible for the NPA growth. Beside that negligence in taking information from credit Information Bureau may also lead to bad debts. Hence both the banks are recommended to be more
cautious and realistic while granting loans and advances. After advancing loans there should be regular supervision and follow up for proper utilization of loan. Banks are the business partner of its credit customer. Bank should be advisor of their credit customer.

While disbursing loans to the client there should be the strong practice in commercial bank to float loans on the basis of the business position, scope of viability and business need .At the same time the commercial banks are required to give proper attention on the personal integrity of the borrower too. Further the offered security should also be assessed properly as on the distress situation if the retained security is good then the loan can be recovered

In commercial banks there should be approach of portfolio management. Lending towards the single sector of economy may create higher level of risk, thus it is recommended that the credit should be floated to the different sectors of economy. If there is recession to the any specify sectors other remaining sectors of economy may function well and there may not be severe impacts on the whole lending part of the commercial banks.

Government has to formulate strong legal system to support the loan recovery process of commercial banks. It is felt that in absence of strong

legal system and framework huge loans could not be recovered. Willful defaulters should be punished under legal framework and government should help the commercial banks for the recovery of due loans. The bank should be empowered to proceed to arrest the debtors who do not have any property to pay the dues to the bank. The act should empower the bank to freeze and sell the property that belongs to the joint family members of the debtor. An explicit provision in the act is a must as to charging of various expenses incurred in course of auction of the property to the borrowers' account. The Tribunal constituted under the Bank and Financial Institution's Loan Recovery Act, 2058 should pay special attention while translating the provision of the act into practice.

No work can be success without proper management. Inefficient management may be the cause to increase the non-performing assets in Nepalese Commercial Banks. Training and development makes a man more competitive and updated regarding the current issues and practices. Therefore, both the banks are recommended to initiate indoor and outdoor training programs to make employees efficient and professional in credit appraisal, monitoring and proper risk management.

Strictly implementing the NRB directives also assists to reduce credit risk and non performing loans. Hence both banks are advised to follow the NRB directives appropriately. Similarly it is also recommended that both the banks should incorporate a sound internal audit and a compliance department to ensure that the directives are properly implemented.

Lack of proper financial analysis of the borrower by the banks is one of the major causes behind increasing NPA of Nepalese Commercial Banks. Thus proper financial analysis should be done before lending to the borrowers.

NRB, as a central bank, issues various directives and polices from time to time to streamline the financial sector. In this regards, E.Pra.directive no 2/061/062 has given more emphasized on loan classifications and provisioning which is tighter than that of previous. In order to smooth operation of banking industry, only imposing policy would not be sufficient, implementing them is necessary. NRB should play supportive role as well as by credit information Bureau so that commercial banks can get required credit information about borrowers. In addition, NRB should establish a NPA management cell which may deal with NPA of all commercial banks. These steps would also help to reduce the non performing loans.

It is often said that Prevention is better than cure", hence it is recommended for both the banks to take preventive measures before the loan goes to default and it become unmanageable. All the banks are recommended to have a make sound information system to gather all the possible information about its borrowers so that necessary precautions can be taken in time. Because this is an age of information so banks should update with various business related information. For this, following Directive of NRB of KYC (Know your Customer), seems important and necessary.

It is also recommended that banks and financial institution should demand supportive role from Government of Nepal to recover from the bad loans specially created because of willful default. And also recommended that never protect and support those defaulters by politician.

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