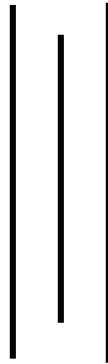


**NON PERFORMING ASSETS ANALYSIS OF NEPAL
BANK LIMITED AND NEPAL RASTRIYA
BANIJYA BANK LIMITED**

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**A Thesis Submitted to:
Office of the Dean
Faculty of Management
Tribhuvan University**



*In partial fulfillment of the requirement for the Degree of
Master of Business Studies (MBS)*

**Kathmandu, Nepal
May, 2010**

RECOMMENDATION

This is to certify that the Thesis

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BANK LIMITED AND NEPAL RASTRIYA
BANIJYA BANK LIMITED**

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according to the prescribed format. We recommend the thesis to
be accepted as partial fulfillment of the requirement for*

Master Degree of Business Studies (MBS)

Viva-Voce Committee

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DECLARATION

I hereby declare that the work reported in this thesis entitled “**Non Performing Assets Analysis of Nepal Bank Limited and Nepal Rastriya Banijya Bank Limited**” submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Master Degree in Business Studies (MBS) under the supervision of **Joginder Goet** of Shanker Dev Campus.

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Banking sector plays vital role for the country's economic development and considered as a pre-requisite for the economy. It is source for economic developments it maintains economic confidence of various segments and extends credit to people.

Increasing level of non performing assets in Nepalese commercial banks from some years has been the top concern in economic field. As the effect of this the lending of commercial banks made towards industrial, trade and commerce sector have been badly affected and banking sector is having huge overdue outstanding loans.

The main objective of this study is to find out overall impact of NPA on the profitability of the banks, non banking asset and its relationships with NPA. Similarly, external factor that have significant contributing on NPA increment and internal factors that influence the NPA growth. It is expected that after analysis of the above issues it will be helpful to the concerned to address the problem of non performing asset of commercial banks.

This study has been divided into five main parts; namely introduction, review of literature, data presentation and analysis and lastly summary, conclusion and recommendation. Secondary data as well as primary data included for the analysis purpose. Summary of the findings, conclusion of the analysis and required recommendation has been forwarded at the end of this study.

It has been pleasure for me to complete this thesis under the guidance of Joginder Goet of Shanker Dev Campus. He has been helpful in providing all sorts of guidance, critical and analytical support in order to complete this thesis.

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Bijay Gautam

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ABBREVIATIONS

AD	:	Anno Domini
ADB	:	Agriculture Development Bank
AMC	:	Assets Management Company
BS	:	Bikram Sambat
CEO	:	Chief Executive Officer
CIAA	:	Commission on Investigation for Abuse of Authority
CPG	:	Credit policy Guidelines
DRT	:	Debt Recovery Tribunal
FNCCI	:	Federation of Nepalese Chamber of Commerce & Industry
Freq	:	Frequency
FSR	:	Financial Sector Reform
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
IBRA	:	Indonesia Bank Restriction Agency
IMF	:	International Monetary Fund
N	:	Number
NBA	:	Non Banking Assets
NBL,	:	Nepal Bank Limited
NPA	:	Non Performing Assets
NPC	:	National Planning Commission
NPL	:	Non Performing Loan
NRB	:	Nepal Rastra Bank
RBB	:	Rastriya Banijya Bank
RBI	:	Reserve Bank of India
RNPL	:	Remaining Non Performing Loan
ROA	:	Return On Assets
ROE	:	Return On Equity
SBI	:	State Bank of India
SCBNL	:	Standard Chartered Bank Nepal Limited
SI	:	Suspend Interest

SN : Serial Number
TU : Tribhuvan University
UA : Unutilized Asset
WB : World Bank
WTO : World Trade Organization

CHAPTER - I

INTRODUCTION

1.1 Background of the Study

As in most of the countries, the banking institutions predominate the financial system of Nepal. Among these institutions, the banking sector's share in the total deposit and lending is not only significantly high but that the problems and the stakes in this sector are also accordingly challenging. A big chunk of resources are being utilized on loan and advances. As the return from loan floatation is higher than the return from any other activities, commercial banks are concentrating their financial activities for the management of loans and advances. By virtue of principle for higher return higher risk should be taken and vice versa. The mushrooming growth of the banks has led them towards cutthroat competition. On the one hand the economic condition of the country is not grooming rather remained stagnant, not any avenue is being explored. The competition among the banks is just to share from the small size of the cake.

The less opportunity for getting avenues for loan floatation has compelled the banks to finance without being choosy. Quality of loans and advances could not be maintained to the desirable level if there is no choice whether to finance or not. Once the loan is given it is supposed that the repayment of interest or principle shall have to be served without any hindrance. The resources could not be regular and if there is cumulative overdue outstanding. There may be various reasons behind the loan that turn regular one. The main reason may be economic situation of the country which has global and far reaching impact. The smooth operation of the commercial bank is possible only when the economy of the country functions well. Satisfactory level of return on investment is the pre-requisite for the financial sector to be groomed. The other contributing factor that turn the good loan into the bad are the attitude of the borrower, types and quality of the security taken and legal hurdles created by 'the borrower when the recovery action is started. Once the distributed loan is not return timely by clients and becomes overdue than it is known as Non-Performing Assets (NPA) for the banks. Reduction of NPA has always been significant problem for every commercial banks and proper attention for the management

of NPA now under top priority. Due to various hurdles in the management of NPA, commercial banks are now losing their profitability struggling for their existence.

The negative level of capital fund, high level of NPA, poor risk management skills, government weaknesses and there several deficiencies have been found in the banking system. So with the view to addressing the huge problems and challenges of this sector, the strategies paper of the government in financial sector reform has focused more on the banking sector as the overriding component of the overall financial sector reforms strategy in Nepal. But it does not mean that other areas have been neglected. The other areas such as insurance sector, securities market and corporate sectors are also being strengthened side by side by the government.

1.2 Statement of the Problems

After the economic liberalization initiated in mid-1980s, there were significant developments in the growth of financial institutions. For instance, the financial system which consisted of only two commercial banks and few other financial institutions before liberalization become more than hundred within two decades. As of December 2008, there are 26 commercial banks, 77 finance companies, 11 micro finance development banks, 19 financial cooperatives (under NRB licensing) and around 3000 cooperative finance companies in the financial system of Nepal.

NRB had taken the management of Nepal Lumbini Bank some years ago because of huge NPA on their account and now after improving the condition of this bank it is operating with its own management. And also NRB has taken the management of Nepal Bangladesh Bank regarding the deterioration of its NPA. RBB and NBL are still suffering from the high level of NPL problems. In order to strengthen the credit operations and enhance risk skills, the bank is under the contract of foreign management teams, credit functions have been strengthen now a days. The management has been given targets to lower down the level of NPA and recover/restructure the problem loans. Due to these efforts made by these management teams, the level of NPL in RBB and NBL is

decreasing but still at astounding level. The following table reflects the NPA positions of these banks:

Table 1.1
Level of NPL in RBB and NBL

July 2005	NBL	RBB	Banking System	July 2007	NBL	RBB	Banking System
NPL Amt(Rs)	10964.91	16005.3 2	32226.66	NPL Amt(Rs)	9640.08	14470.5 2	28933.41
Total							
Total Loans (Rs)	18123.3 3	26608.8 3	111900.5 9	Total Loans (Rs)	17937.6 6	25105.6 8	127065.40
NPL %	60.47	60.15	28.8	NPL %	53.74	57.64	22.77
July 2006	NBL	RBB	Banking System	July 2008	NBL	RBB	Banking System
NPL Amt(Rs)	8372.11	13689.34	27s877.84	NPL Amt (Rs)	3233.90	12313.8 4	25904.91
Total Loans (Rs)	16866.55	25835.2 0	147200.7 8	Total Loans (Rs)	12879.2 2	27158.8 9	1875950.8 6
NPL %	49.64	52.99	18.94	NPL %	25.11	45.34	13.81

Source: Bank and Financial Regulation Dept., NRB

The above table reflects that the level of NPL is decreasing gradually but it has not come down at the desired level, i.e. at below 5% to date. However, there are various constraints in the recovery any other problems associated with the economic and non economic factors, but the management team has been able to recover around Rs. 17 billion during the project period of 4 years. It has been observed that the recovery made by the management team has come from medium and small size loans. It has not been able to catch big fishes of the financial system such as from the problem loans of above Rs. 50 million. If we analyze the share of NPA of the banking system, RBB and NBL hold around 60% of the system. Unless and until the NPL of this bank will not decrease drastically, the NPL of the system will not come at the prudent level.

The small borrowers have paid their debt by selling their collateral, their homes and their belongings but the big borrowers have gone to court to obtain stay orders, delayed the recovery process and creating various problems to complete the auctions of their properties. Lender banks are raising the voice that instead of being them declared as bankrupt or having social exclusion: their life style, social status, political affiliation and expending pattern on luxurious items is increasing (Dhungana, 2063: 29).

Commercial banks have been the source of inspiration to entrepreneurs who have no resource base in terms of liquid financial assets of their own. Thus resources collected by banks from savers are channeled to entrepreneurs running different economic activities, which contribute to increase national income, provide employment and infrastructure development. All know that the collections of deposits and making loan and advances are core functions of banks and financial institutions. While collecting the deposits the banks has to provide interest to the depositors, it is cost to the banks. The money collected in the form of deposits is again translated into loans and advances and banks get interest income. On this transformation process banks have a small interest spread from which they have to meet the operating expenses, cost of bad debts and a small profit margins. In order to pay the interest to the depositors, there should be regular repayments of principal and interest of loan from the borrowers as per agreed schedule. In order to make this system smooth, banks should have all the loans as performing assets i.e. good loans. Good loans and advances are called performing assets. Banks and financial institutions always try to have almost all the financial assets as performing assets to make them sound, sustainable, profitable and healthy within the system. Sometimes, unfavorable internal economic shocks and other discrepancies affect the quality of such assets. Deterioration in the quality of loans and other assets give birth to non-performing loans and ultimately invites the financial crisis (Dhungana, 2063: 30).

Most of the loan had been defaulted from the long back when the economic situation was achieving a higher level of economic growth. Their track record is not good and even in that time they have not paid the bank as per agreement. It is business principle that entrepreneur has full right over profits and losses of the business if any. If there will be a continuous loss in the business, or any symptoms of losses are envisaged, then the borrower should either change the business or stop the operations to control further losses. This is because; borrower has to meet the obligation of loss from its own resources. In such cases, borrower needs to liquidate their assets for debt servicing. Growing NPA is really a big problem for the whole nation's economy. And the major share of NPA is from these two largest commercial banks. So the root cause of NPA should be analyzed. The effect of NPA on bank's profitability is to be examined. This

research is focused on these areas particularly. This study has identified the following research questions regarding to NPA with special reference to Nepal Bank Limited and Rastriya Banijya Bank:

-) What is the overall impact of NPA on the profitability of the banks under study?
-) What is the relationship of NBA and NPA?
-) What are major external factors that have significant contribution on NPA increment?
-) What are major internal factors that influence the NPA growth?

1.3 Objectives of the Study

The gradually increasing NPA has now become a major issue for every commercial bank. Every bank has now put the NPA management under top priority. Thus in present context analyzing the cause and implication of NPA obviously shall be useful for banking sector. The basic objective of this study is to analyze and identify the impact, cause and consequences of NPA. The following objectives have been considered as specific objectives of this study.

-) To study and examine the non performing assets of NepalBank Limited and Rastriya Banijya Bank.
-) To analyze the impact of NPA on overall financial performances of the banks under study.
-) To evaluate whether the banks are efficient to face the challenges and cope with the points outlined in the statement of the problem of this study or not.
-) To conduct opinion survey regarding the causes of NPA and their impact on the financial position of the banks.
-) To provide suggestion on the banks of study result.

1.4 Significance of the Study

NPA is a growing concern among banks and financial institutions in Nepal. RBB and NBL are suffering from the highest level of NPA. So the new management team has been appointed to solve the mounting NPA with due consideration. To overcome from this

situation, great effort is needed in the recovery of loan and advances by the banks and financial institutions themselves. Recovery of distress loan is a challenging task for banks and financial institutions. This study will have both academic as well as practical significance. The finding and conclusion of the study will add to the literature of Non Performing Assets in general and review the previous findings. The study will be helpful for the banking industry to identify and to trace its level. This study will also be helpful for the regulating authority to know existing recovery problem so as to have some modification on directives, laws and other proceedings. This study will find out the trend of NPA on individual basis of NBL and RBB. The result of the study is thought to be importance for the following groups:

-) Management of the bank:- After analyzing the cause and effect of NPA, it would be helpful to the management. They can observe internal as well as external reasons for growing NPA in their organizations.
-) Potential investors:- They can analyze themselves the condition of banks whether it is advisable or not by reviewing this research.
-) Government:- Government can think to make necessary policy or adjustment in current policy and guidelines by reviewing current study. They can make a base whether the commercial banks following their policy and guidelines or not.
-) Policy formulators:- They can review many aspects of NPA related matters by going through this research.
-) Academicians:- This study will be helpful to them for further research and for their syllables.

1.5 Limitation of the Study

Present study is a milestone in explanatory study in searching the NPA problems and its solutions in Nepalese financial sector. Findings of the study might be very much useful for academicians as well as for practitioners. However this study suffers from many limitations such as:

-) Cross sectional data are the major limitations to find the causal linkage between NPA and profitability of the banks as well as NPA and its relationship with NBA.

- J Among various banks the study will focus only two banks i.e. Nepal Bank Limited and Nepal Banijya Bank because of limit time and resources factors.
- J Analysis will mostly base on secondary data and questionnaire also included for primary information.
- J Due to availability of limited information this study will not cover every part of the NPA.
- J Only five years period will be taken for the study.
- J This study will be prepared in a limited period of time and will be submitted for the partial fulfillment of the MBS degree which cannot be considered as master piece.

1.6 Organization of the Study

The entire study is compiled in five chapters.

First chapter includes the introductory framework of the study with the brief conceptual clarification about the existing financial condition of the commercial banks in Nepal, increasing NPA and its impact on commercial banks. It also includes the focus of the study, objectives of the research work, methodology applied for the used throughout the research work for the assessing cause and impact of NPA, the limitation of the study with reference to the constraint the research paper has to bear.

Second chapter includes the review of literature available and review of related theoretical background of the relevant field of the study which aims at forming a conceptual framework of the study. Concept of commercial bank, evolution of the banking sector in Nepal. This also covers the review of the theoretical background being implemented as for the management of NPA. Present regulatory provisions and their assessment are also reviewed in this chapter.

Third chapter deals about the research design and tool techniques used in the research work.

Fourth chapter includes the secondary data classification, tabulation, analysis using the tools and techniques as mentioned in methodology part and also includes the analysis, interpretation of the primary data and information collected through survey.

And last chapter presents summary in aggregate, conclusions and the probable recommendations enlightened through the study.

CHAPTER - II

REVIEW OF LITERATURE

2.1 Conceptual Review

This chapter includes the brief presentation of the concept of commercial bank and evolution of the banking sector in Nepal. This also covers the review of the theoretical background being implemented as for the management of NPA. Nepalese commercial banks have started to give proper attention on NPA regarding the huge impact of it on their organization. Some banks have introduced the NPA management policy for the recovery and regularization of the dues. But relating to the cause of NPA growth and its total impact on financial position of the banks had not been studied so far in detail. There are some articles in this perspective that comes occasionally however those are also not specific for tracing out the cause and effect of NPA.

No previous research papers have been found in this sector. However, it is tried the best to give the introduction of NPA and categorization norms in India and Nepal through Reserve Bank Of India (RBI)'s guideline and NRB directives on country specific. For some theoretical aspect some banking related books have also been studied for the assessment of banking approach towards NPA.

Non-Performing assets are defined as debt instrument whose obligors are unable to discharge their liabilities as they become due. The term debt instrument refers to both loans and bonds. Therefore, non-performing assets comprise the wider area of assets portfolio where as the non-performing loan is referred to distressed loans classified as per regulations of the central bank. Loans means loans and bills purchased and discounted by the banks and financial institutions. Since loan being the significant component on financial asset's portfolio, non-performing loans and non-performing assets are used interchanging. (Bhisma Raj Dhungana, Problems of NPL and need of financial discipline in the Nepalese banking system (Rastra Rin Khabarpatra, 2063: 63).

2.2 Concept of Commercial Bank and Historical Review in Nepalese Perspective

"Tejarath Adda" was established during the tenure of Prime Minister Ranodip Sing Rana as a first institutionalized credit house. In the overall development of the banking system in Nepal, the Tejarath Adda may be regarded as the father of modern banking institution and for a quite long time it tendered a good service to government employee as well as to the general public. No financial institutions were established over a long period due to political reasons. To fulfill the growing need of economy in Nepal, banking activities were performed only after the establishment of Nepal Bank Ltd. In 1994 B.S., as the first commercial bank of Nepal. This bank was established under Nepal Bank Act 1994 B.S. (1938 A.D.).

At the beginning, 49% of the ownership belongs to the promoters as well as general public and remaining belongs to government. The incorporation of Nepal Bank Ltd. is the real starting of the banking institution in Nepal. Nepal Bank Ltd started the act of consolidating the scattered capital since its establishment in order to mobilize it in productive sector. It developed systematic tradition in culture of modern banking system in Nepal. Such system could be able to establish a strong base for the upliftment of national economy. Besides, it also acted as Central Bank for more than three decades. Nepal Rastra Bank established in Baisakh 14, 2013 (1956 A.D.) under Nepal Rastra Bank Act 2012 (1955 A.D.) as the central bank of Nepal. It is totally owned by government NRB is heavily assisting for the development of whole economy. It is giving timely directives to all financial institutions operated and conducted in all over the country.

After a long period, the second commercial bank namely Rastriya Banijya Bank has been established in 2022 B.S. with cent percent government ownership. This bank has been established under the Rastriya Banijya Bank Act 2121 B.S. both Nepal Bank Ltd. And Rastriya Banijya Bank has made a remarkable contribution by providing reliable banking services to the Nepalese people. Its contribution is well noted in terms of capital formation to the small dispersed saving into meaningful capital investment in order to flourish industry, agriculture, trade and commercial sector in the country. The

government introduced Commercial Bank Act in Nepal in 2003 B.S. to cover the vast field of financial sector. This act has helped to emerge a number of commercial banks with a view to maintain the economic interest in comfort of the public in general facilitated to provide loan for agriculture, industry and trade and make available banking services to the country and people.

Along vacuum in the banking sector got some rays of hope only when the government* forwarded the economic liberalization policy in 2039 B.S. and decided to allow foreign banks to operate their activities in Nepal in "Joint-Venture Model". Joint venture banks can be defined as an association of two or more parties having common objectives and goals so as to get maximum satisfaction. Basically at that time, it was envisioned that joint venture banks would support the country in various ways. In Nepalese context the main purpose of joint venture is to develop economic forces in order to achieve distinguished results, which the partners separately could not achieve. Nowadays, joint venture banks are playing dynamic and vital role in economic development of the country.

2.3 Highlights of Performance of Nepalese Commercial Banks

In mid-July 2008, the number of total branches of commercial banks stood at 650 which reached to 750 in mid-April 2009. If 100 banking branches of ADB are to be included, the number of bank branches has reached 750, including ADB, number of commercial banks totaled 26. The number of commercial banks and their branches are given below:

Table 2.1
Number of Commercial Banks

S.N	Names	Operation date(A.D.)	Head Office
1	Nepal Bank Limited	1937/11/15	Kathmandu
2	Rastriya Banijya Bank	1966/01/23	Kathmandu
3	ADB Ltd.	1968/01/02	Kathmandu
4	NABIL Bank Limited	1984/07/16	Kathmandu
5	NIB Limited	1986/02/27	Kathmandu
6	SCB Nepal Limited.	1987/01/30	Kathmandu
7	Himalayan Bank Limited	1993/01/18	Kathmandu
8	Nepal SBI Bank Limited	1993/07/07	Kathmandu
9	NB Bank Limited	05/06/1994	Kathmandu
10	Everest Bank Limited	1994/10/18	Kathmandu
11	Bank of Kathmandu Limited	1995/03/12	Kathmandu
12	NCC Bank Limited	1996/10/14	Rupendehi
13	Lumbini Bank Limited	1998/07/17	Chitwan
14	NIC Bank Limited	1998/07/21	Biaratnagar
15	Machhapuchhre Bank Limited	2000/10/03	Pokhara
16	Kumari Bank Limited	2001/04/03	Kathmandu
17	Laxmi Bank Limited	2002/04/03	Birgunj
18	Siddhartha Bank Limited	2002/12/24	Kathmandu
19	Global Bank Ltd.	2007/01/02	Birgunj
20	Citizens Bank International Ltd.	2007/6/21	Kathmandu
21	Prime Commercial Bank Ltd	2007/9/24	Kathmandu
22	Sunrise Bank Ltd.	2007/10/12	Kathmandu
23	Bank of Asia Nepal Ltd.	2007/10/12	Kathmandu
24	Development Credit Bank Ltd.	2001/01/23	Kathmandu
25	NMB Bank Ltd.	1996/11/26	Kathmandu
26	Kist Bank Ltd.	2003/02/21	Kathmandu
27	Janata Bank Ltd.	2010/04/05	Kathmandu

Source: www.nrb.org.com / directives, notification

Total deposits of commercial banks increased by 7.6% in the first eight months of FY 2006/07. It increased by 2.4% only in the same period in the last fiscal year. The high level of remittance has caused this high growth in the bank deposits. Current deposit declined by 5% in the first eight months of FY2005/06 and this deceleration decreased to 3.1% during the same period of this FY 2006/07. Saving deposits during the same period in eight months of both the fiscal years increased by about the same rate, i.e. 8% in

FY2005/06 and 7.9% in the FY 2006/07. Fixed deposits on the other hand had a negative growth rate of 2.2% in FY 2005/06 which increased by 11.4% in the FY 2006/07. High level of remittance and absence of suitable investment opportunities resulted into an increase in the deposits with the banks. Likewise, there is an increase in the deposit margin. It increased by 0.9% in the FY 2005/06 and this growth rate increased to 1.3% in FY 2006/07.

In the first eight months of FY 2006/07, there was some slackness in the commercial banks' lending and investment. In the last fiscal year, loans and investment increased by 9.7% which could increase by 8.1% only in FY 2006/07. Such a decline in the growth of commercial banks' loan and investment is due to conflict situation, Political disturbances and consequent slackness in industrial environment of the commercial banks' loan and investment, claims on government have shown an increase. Claims on government have increased by 1.5% in last FY 2005/06 and this growth rate increased to 2.8% in FY 2006/07. Similarly, in context to 43.5% growth in the first eight months of last fiscal year, the net claims of commercial bank on non-financial public enterprises has declined by 5.1%. Mainly because of priority accorded by Nepal Bank Limited and Rastriya Banijya Bank on loan recovery and net repayments by Nepal Oil Corporation, Nepal Electricity Authority, National Trading Limited and Hetauda Textiles Industries, the net claims became negative. Similarly there was declined in loans advanced by commercial banks to private sector. In the previous fiscal year, such credit had increased by 12.1% which remained at only 10.1% in the first eight months of the fiscal year and thus the net credit flow was only Rs. 16.58 billion. In the total credit flow, the share of principle is 84.5% and interest 15.5%. The percentage in previous fiscal year was 83.7% and 16.3%. The slackness in credit flow to private sector is due to political instability and overall economic instability (Economic Survey, 2005/06: 53).

2.4 Definition of Loan and Advances

Loan is defined as a thing that is lent, especially a sum of money. Likewise, debt means a sum of money owed to somebody. However in financial terms loan or debt means principle or interest availed to the borrower against the security. Debt means money that

bank owes or will lend to individual or person. Further debt means 'principle and interest provided to debtors by banks or financial institutions, with the pledge of immovable or movable property or other securities or guarantee of without guarantee, and the word also means overdue of the transaction beyond balance or fees, commission and interest incurred in that relation.

Loan and advances are the most profitable of all the assets of a bank. Banks universally seek after the assets. These constitute primary source of income to banks. As the business institution, a bank aims at making a huge profit and providing loans and advances are more profitable than any other assets, banks are willing to lend as much as of their fund as possible but it has to be careful about the safety of such loan and advances. "Banking when properly organized aids and facilitates growth of trade and industries and hence of national economy. The bankers have to timer liberality with caution. If he is too liberal, he may easily impair his profits by bad debts, if he is too timid he may fail to obtain adequate return on the fund (Radhaswamy and Vasudevan, 1991: 29).

Loan and advances dominate the assets side of balance sheet of any bank. Similarly earning from such loan and advances occupy major space in income statement of the bank. Lending can be said to be the major source of generating income of a bank. However, it is very important to be reminded that most of the banks are failures in the world due to shrinkage in the value of the loan and advances. Hence loan is known as risky assets. Risk of non-repayment of loan is known as credit risk or default risk. Performing loan has multiple benefits to the society while non-performing loan erodes even existing capital (Dahal and Dahal, 2002: 27-29).

2.5 Definition of NPA

We all know that collection of deposits and making of loan and advances are core functions of bank and financial institutions. The 13 money collected in the form of deposits by providing certain interest to depositors is translated into loans and advances and banks get interest income. On this transformation process bank have a small interest spread from which they have to meet the operating expenses, cost of bad debt and small

profit margins. In order to pay the interest to the depositors and meet the withdrawals of depositors, there should be regular repayments of principle and interest of loan from the borrowers as per agreed schedule. In order to make this system interrupted banks should have all the loans as performing assets i.e. good loans. Good loans and advances are called performing assets. Banks and financial institutions always try to have almost all the financial assets as performing assets as performing assets to make them sound, sustainable, profitable and healthy within the system. Sometimes unfavorable internal economic shocks and other discrepancies affects the quality of loans and other assets give birth to non performing loans and ultimately invites the financial crisis.

The assets which cannot be used productively regarding the objective is called Non-performing asset. Sub-standard, doubtful and loss loans are called non-performing loan. In other words, all loans which are dues but not paid for 2 quarters are called NPL. In general, NPA is the sum of following terms.

$$NPA = NPL + NBA + RNPL + SI + UA$$

On the process of collection of debts, remaining amounts of loan after realizing the collateral are called non banking asset (NBA). Outstanding interest and other amounts from the loans which are due called remaining non-performing loan (RNPL). The amount which bank and financial institution cannot get from their capital investment are called suspend interest (SI). The movable and immovable assets which cannot be used in bank's own transaction and the asset which have no contribution for the value addition in the bank and financial institutions are called unutilized assed (UA).

An asset is classified as NPA if the borrower does not pay dues in the form of principal and interest for a period of 90 days. NPA could wreck bank's profitability both through a loss of interest income and write off the principal loan amount. It tackles the subject starting from the stage of their identification till the recovery of dues in such account. The details and classification of non-performing loans vary from country to country as the country put in place norm as per the requirements of their own banking system. Generally

speaking, a loan is classified, as non performing loans only after an-ears at least 3 months. In Nepalese case too, the same rule has been adopted. So we can say that NPA is that portion of lending or loans which is irrecoverable by banks in the specific period as marked up by central bank (Regmi and Byabasthapan, 2062: 75).

2.5.1 Classification of NPA

The assets are classified in the following broad groups:

a. Standard Assets

It is one, which does not disclose any problems and which does not carry more than normal risk attached to the business. Such as assets is not a NPA for e.g.. if an account is regular and there is no problem of repayment, then the collateral placed for that loan is standard asset.

b. Sub-Standard Assets

It is one, which has been classified as NPA. In such cases, the current net worth of the borrower/guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the bank in full. In other words, such as assets has well defined credit weaknesses that jeopardize the liquidation of a debt and is characterized by the distinct possibility that the bank will sustain some loss if deficiencies are not corrected. However, in respect of accounts where there are potential threats of recovery an account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers, it will not be prudent for banks to classify them as sub-standard and then as doubtful after expiry of specified years from the date the account has become NPA. Such accounts should be straightway classified as doubtful or loss assets as appropriate, irrespective of the period for which it has remained as NPA.

c. Doubtful Assets

A doubtful asset is one, which has remained NPA for a period exceeding 2 years. In the case of term loans, where installments of principle have remained overdue for a period exceeding 2 years should be treated as doubtful. A loan classified as doubtful has all the

weaknesses inherent that has been classified as sub-standard with the added characteristics that the weakness*makes collection or liquidation if full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

d. Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the central bank's inspectors but the amount has not been written off, wholly or partly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable assets is not warranted although there may be some salvage or recovery value and where no security is available ([http/www. rbi.org. in](http://www.rbi.org.in)).

2.5.2 NPA/NPL in East Asia

Financial crisis did hit Asian economies in July. As a result, East Asian countries in 1998 recorded negative growth ranging from 5 to 12%. In 1999, however, economies improved in several countries; South Korea in particular recorded a "v" type of recovery. Although, the growth process has slowed somewhat in 2000, progress continues and on the basis of the recent rapid recovery. There is optimism that the East Asian financial crisis has ended. On the other hand, there is also the opinion that the situation does not warrant optimism, as structural reforms, including NPL problem in the financial and corporate sectors, have not progressed sufficiently. This paper looks into the issues of the current status of NPL, restructuring in Malaysia, South Korea, Thailand and Indonesia.

Immediately preceding the Asian financial crisis, Japan was tackling a NPL problem that resulted from the bursting of the so-called bubble economy in 1990. Economic depression has continued for nearly ten years since then, and the Japanese economy has yet to get back to the track of sustainable growth. The chief cause of this crisis, in a nutshell, was that the government did not take measures to deal with NPL in a timely manner. Cooperative credit purchasing company was launched in 1998 to buy NPL, and the Housing loans management company was set up in 1996 to deal with the problem of housing related NPL. These efforts were inadequate and the real solution had to wait for large scale public funds that were made available to financial institutions in March 1998,

eight years after the bursting of the bubble economy. The process of resolving NPL in Japan was indeed too little, too late. Japan adopted the policy of waiting for the economic environment to take a favorable turn, instead of taking swift, decisive action.

On the other hand, many East Asian countries addressed the problem of NPL rather swiftly; South Korea for example, immediately injected large amounts of public funds into financial institutions. After the financial crisis, the solution of NPL is progressing relatively well in South Korea and Malaysia. While Thailand and Indonesia are lagging behind. To solve the issue of NPL, it is necessary to make structural improvements, especially in the financial system and corporate governance that actually caused the NPL problems. The economic growth rate in each of these countries is projected to register a downward trend in 2000, compared to the previous year, and the current account surplus is diminishing. Since East Asian economies depend heavily upon the US economy, its current slowdown will be a damper to these countries' recovery. It is therefore necessary to analyze the current status of NPL problems, financial restructuring and corporate governance to make sure they can cope with an adversely changing economic environment.

Private debt as the main cause of the main characteristic of the external debt of East Asian economies was the large amount of private sector debt. As opposed to this, the main characteristic of the external debt issue in Latin America, beginning with Mexico in 1982, was the huge amount of public debt owed by governments that could not raise funds from the market, as the economic fundamentals of public finance, current account balance and inflation deteriorated, leading to their failure to repay their debt. In comparison, the fundamentals of East Asian economies were rather strong compared to Latin American nations in the 80s. Many of the East Asian governments closed down unhealthy financial institutions soon after the crisis occurred, while public funds were made available to those that were allowed to continue. The South Korean and Indonesian governments provided guarantees on deferred external bank debts in agreements with foreign banks. The Thai government maintains credit lines from foreign banks. All the governments with the support of the IMF maintained a policy of not bailing out corporate

debt. The Miyazawa plan of US\$ 30 billion also did not cover facilities to private companies.

Status of bad loans measures the policies adopted by South Korea, Malaysia, Indonesia and Thailand to deal with the problem of NPL were as follows:

-) Establishment of asset management companies to gather NPL
-) Allocation of public funds to banks and other financial institutions
-) Creation of framework for the promotion of autonomous, non-courtroom regulations between creditors and debtors.

These governments either revamped existing organization or created new ones to implement the above policies in 1998. Further, in Thailand and Indonesia, it was necessary to revise bankruptcy law, since they were not functioning properly. For this reason, negotiations between creditors and debtors on NPL. After the crisis, differences in their growth chart are beginning to emerge the quarters in which the NPL problem was adequately treated and restructuring of NPL started to make significant progress and the trend in their bad loan ratio (bank credit in arrears for over 3 months) are indicated below:

	Malaysia	South Korea	Thailand	Indonesia
Asset Management Co.	1998/3q	1998/1q	None	1998/2q
Funds Infusion	1998/3q	1998/1q	1999/1q	1999/3q
Promotion on NPL negotiation	1998/4q	1998/2q	1999/2q	2000/1 q
Bad loan ratio %	18.1(6)	8.4(6)	47.7(5)	8.7(32000 mo)
	11.2(2)	8.4(1999/12)	31.3(7)	NA

(Source: <http://www.iima.or.jp>)

As seen from the above Malaysia and South Korea have taken the lead, whereas Thailand and Indonesia, which began to address this problem only in 1999. Thailand is yet to set up an asset management company. Further, the NPL ratio of banks is comparatively low South Korea and Malaysia but in Thailand it is currently around 30% and in Indonesia it is said to be as high as before.

Thailand

The process of settlement of NPL is delayed in Thailand, primarily because the government's response has been rather weak. It did not adopt a centralized solution to NPL, but rather encouraged each bank to set up and transfer NPL to its assets management company. By this method, where valuation is depreciated at the time of transfer, there is the risk of not doing enough or delaying the transfer, since it is left to the discretion of individual banks. In addition, the actual amount of public funds made available was less than banks needed. As a result, the solution to the problem of NPL has been delayed and bank lending has not yet picked up. A framework for corporate debt negotiations outside court was set up in September 1998, but revision of the Bankruptcy Act was left pending before the upper house for as long as one year. Bankruptcy courts began to function in the third quarter of 1999 and by June 2000, 553 large cases worth US\$23 billion, were reorganized. Nevertheless, the whole process has been lagging behind.

In Thailand, it is not usual to settle matters before a court of law. There is strong public resistance to pumping public funds into a particular financial institution, and dislike of official interference in management when a public fund infusion is made. Unless the government overcomes their obstacles, a quick solution to Thailand's NPL problems will be elusive. According to an announcement by the Bank of Thailand, between Oct 1999 and Feb 2000 NPL worth 334.3 billion Bhat were reduced based on the agreement for restructuring of NPL, but fresh NPL worth 2091.3 billion Bhat were also generated. Further, as a result of reorganization, loans that were regarded as healthy became bad; such loans totaled 55.8 billion Bhat bad loans that were settled one, but turned again imply that the restructuring process has not been carried out properly.

Indonesia

Among the 4 nations cited here, it was most seriously affected by the Asian economic crisis, and many of its banks became insolvent. Despite the pumping in of large amount of public funds including emergency loans by the central bank the road to recovery is still long and a solution to the NPL problem has been the most delayed among the 4 East

Asian countries. The Indonesia Bank Restriction Agency (IBRA) was established in Jan 1998 to pool NPL and infuse public funds. It presently holds NPL worth 125 million rupees. A breakdown includes: shares of corporate real estate worth 125 million rupees collected from the owner of 28 banks (later nationalized) that received emergency funding from the central bank. NPL of national/nationalized of liquidated banks worth 250 million rupees taken over as a result of capital allocation. In short, a considerable amount of inferior quality loans is included. One year after its inception, IBRA continues to be bogged down by politics and there was scarcely any progress in the resolution to NPL in 1999. IBRA started its activities after President Wahid's government assumed office in Nov 1999 and when Mr. Chachuk became its President in Jan 2000. A basic agreement to restructure 35% of IBRA's top debtors was reached in IMF in June 2000 and it is believed that the 21 top debtors account for one third of total NPL to 250 trillion rupees. All are either to Suharto family or their followers. The problem of NPL in this country is complicated, since it involves political as well as economic issues.

The Jakarta initiative, in charge of out-of court settlement, was set up in Jan 1998. It began to function only in the first quarter of 1999, after it was recognized as Jakarta Initiative Task Force and given legal sanction following the promulgation of the revised Bankruptcy Act. It is said to have settled 57 NPL cases worth US\$3.3 billion in 1999. Foreign banks, which provided loans to relatively better quality companies, have settled in many cases through negotiations with individual debtors, without going through the Jakarta Task Force. Tending the loan period and there may be a number of doubtful cases where restructuring has been earned out without strict cash flow management. Even in Malaysia, it has been said that simple extension of the loan period is the main even method used, while debt equity conversion and changes in management is hardly seen. Compared to other regions such as Latin America, there are few instances of conversion of debt into equities. According to the accounting practices of some East Asian Countries it is believed that once NPL are restricted, they may be recognized as healthy loans that do not require reserve. Therefore, there may be cases where banks and creditors have entered into relatively easy restructuring plans, and it is feared that in such cases resolution problems may simply be deferred. Though it is not easy to grasp the details of

corporate restructuring, it is necessary to pay attention to the fact that the decline in NPL ratios does not necessarily mean that real amount of NPL has been reduced (<http://www.iima.org.jp>).

2.5.3 NPA in Nepalese Financial System

In April 2010 there are 27 commercial banks, 53 Development banks including 11 Micro Credit lending development banks, 77 Finance Companies, 47 Non-Governmental organizations and 19 Cooperatives Societies authorized to do limited banking operations in the country. Besides, these organization regulated by NRB, there are other players with this growth in the number of banks and financial institutions, one could argue that the impact of domestic conflict and political instability in the country caused less impact in the financial sector compared to other sectors of the economy like tourism, industrial production and development.

First of all let us review the domestic problems and challenges of the financial system in Nepal. First, the capital fund of the banking sector shows negative balance of 7447.57 million in mid-July 2007. This is particularly the result of the poor performance of the Rastriya Banijya Bank and Nepal Bank Ltd. Even some joint venture banks are not performing at a satisfactory level. Although some progress had been made in the areas of downsizing the staff, establishing system and procedures and reducing the operational costs in these banks, the main problems of overdue loans remain still crucial issues in both banks. Despite the efforts from the NRB to reform the two largest banks in Nepal, the results so far is not encouraging. RBB non performing loans records as high as 45% as of July 2007 and NBL non performing loans 25.11%.

In Nepalese case, the quality of loans has been deteriorated mostly not because of the unfavorable economic condition of the nation not because of the bad intention of the borrower. This is because, if we study the defaulted loan files of the banks we can find that most of the loan had been defaulted from the long back when the economic situation was favorable to the borrowers and also economy was achieving a higher level of economic growth. Their track record is not good and even in that time they have not paid

to the bank as per agreement. It is business principle that entrepreneur has full right over profits and responsibility to bear losses of the business if any. If there will be a continuous loss in the business, or any symptoms of losses are envisaged, then borrower should either change the business or stop the operations to control further losses. This is because; borrower has to meet the obligation to loss from its own resources. In such cases, borrower needs to liquidate their assets for debt servicing. If we see the scenario to repay the loans, they would have been using available options such as liquidation of their personal assets and cut down the cost for luxurious life in order to repay the bank's debt.

The government of Nepal has been endeavoring a lot of efforts to make the Nepalese financial sector healthy and prudent through various reforms initiatives. Despite various efforts within reform program, the level of NPL in the Nepalese Banking system has not come down to an acceptable level. The efforts to date succeeded only to reduce the NPL to some extent but sufficient to maintain the sound health of the system to the desired level. The level of the NPL was around 30% in 2004 and is continuously decreasing thereafter with the implementation of FSRP. It was decreased to 18.94% in July 2006 and 14.22% in July 2007.

Level of NPL in the Banking System

	July 2007	July 2008
Commercial Banks	18.94%	14.22%
Development Banks	3.50%	4.91%
Finance Companies	7.63%	8.46%

On the other hand, the level of NPL is still increasing in the Development Banks and Finance Companies. Therefore, we can see that the financial discipline and level of NPL is improving in banks, where as the problems in Development banks and finance companies are deteriorating. The table provides above highlights the facts. In the healthy financial system the level of the NPL should be contained within 5%. The financial sector reforms program has focused its efforts at reducing the level of NPL to this minimum

level. Therefore, it has still been a challenging task for Nepalese authorities to date (Dhungana, 2063:30).

2.5.3 Effects of ISTA on Profitability of the Bank

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

a. Profitability Impact

- J The resources locked up in NPA are borrowed at a cost and have to earn a minimum return to service this cost.
- J 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.
- J Since they do not earn interest they bring down the yield on advances and the net interest margin or the spread.
- J NPA have a direct impact on return on assets and return on equity, the two main parameters for measuring profitability of the bank.
- J 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.
- J Return on equity is also affected as provisioning eats more and more into profits earned.
- J The cost of maintaining these assets includes administrative costs, legal costs and cost of procuring the resources locked in.
- J NPA bring down the profits, affects the shareholder value and thus adversely affect the investor confidence.

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

- J Lower ROE and ROA
- J Lower image and rating of bank
- J Disclosure reduces investors' confidence
- J Increases costs/difficulties in raising capital
- J NPA do not generate income
- J They require provisioning

- J Borrowing cost of resources locked in
- J Opportunity loss due to non recycling of funds
- J 100% risk weight on net NPA for CAR
- J Capital gets blocked in NPA
- J Utilize capital but does not generate income to sustain the capital that is locked.
- J Recapitalization by government comes with string,
- J Administration and recovery cost of NPA
- J Effect on employee morale and decision making (Saraswati and Venkatakrishnan, 2001:5).

2.5.5 Directives Regarding Loan Classification and Provisioning

Nepal Rastra Bank has issued Unified Directives to banks and financial institution for implementation effective from 2062/4/1 B.S (16 July 2005 A.D.). This also contains new directive concerning classification of loan portfolios and provisioning. Except a few important changes, this directive has retained most of the previous provisions. The classification criteria are as follows:

a. Pass Category

All loans and advances the principal of which are not past due or past due for a period of up to 3 months. Only loans falling under Pass Category are termed as "performing loan".

b. Sub-standard Category

All loans and advances the principal of which are past due for a period of more than 3months and up to 6 months.

c. Doubtful Category

All loans and advances the principal of which are past due for a period of more than 6 months and up to year.

d. Loss Category

All loans and advances the principal of which are past due for period of more than 1 year.

The loss provisioning on the outstanding loans and advances and bills purchases shall be done on the basis of classification, as follows:

Classification of Loan	Loan Loss Provision
Pass	1%
Sub-standard	25%
Doubtful	50%
Loss	100%

For all non-banking assets acquired by the licensed institutions up to FY2060/061, where the assets were not disposed off in 3 years after the FY2062/063 i.e., up to FY2064/065, provisioning for loss on such non-banking assets shall be provided at one hundred percent within 3 fiscal years, as follows:

Fiscal Year	Provisioning for Loss
FY2062/063	33.33%
FY2063/064	66.67%
FY2064/065	100%

For all non-banking assets acquired by the licensed institutions during 2062/063 and thereafter, provisioning at 25% shall be provided in the year of acquisition, and provided as follows within subsequent 3 fiscal years:

Fiscal Year	Provisioning for Loss
First year	50%
Second year	75%
Third year	100%

In case of disposal of the non-banking assets, the existing provision against such assets may be adjusted in the Profit and Loss Account in the year of sale of such assets (NRB Directives, 2063)

2.5.6 Policies Initiated By NRB to Control the Level of NPA

Various initiatives have been taken by the NRB to address the high risk assets such as: NPL, non-banking assets, monitoring of high risk exposures. These steps include

strengthening of capital, monitoring risk, enhancing the capacity absorbing identified risk, strengthening credit management and implementing best credit policies.

Directive on Good Governance

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

Adequate Capital in Relation to Risk Weighted Assets

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

Prudent Loan Classification and Provisioning

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

Requirement to Monitor the Concentration of Assets

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

Maintaining of a Good Loan Portfolio and Establishing Proper System for the Collection of Interest and Principal

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

Compulsion for Formulating and Implementing Credit Policy Guidelines (CPG)

NRB regulations require the bank and financial institutions to prepare and implement prudent credit management procedures. For this purpose CPG needs to be formulated and implemented by each bank and financial institutions. Credit management aspects needs to be specified by the CPG. A standard CPG should address all the area that cover all aspects on credit risk management policies and procedures.

Strengthening the Credit Information System and Blacklisting Procedures

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

Provisioning of Loan Write-Offs

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

Strengthening of Consortium Loan Management

The consortium loans disbursed in the past were turning into problematic loan due to lack of adequate procedures for risk management in the bank. To fill this gap NRB issued

policy directives to guide such exposures. It is observed that there is still a huge exposure in the consortium NPL in the Nepalese banking system.

Refinance Facility to Sick Industries

NRB has provided refinance facility for the rehabilitation of sick industries since 2001/02. During the last five years a sum of Rs. 3 billion has been disbursed to 151 hotels and 41 industries. NRB still has allocated Rs. 2 billion in current fiscal year to facilitate them. If the loan is performing and fulfill the criteria, then these industries can benefit from this facility. The provision has also helped to make the loan as performing for difficult time.

Working with government to deal with big defaulters of this System

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

Other Measures

Other measures focused for maintaining a good asset portfolio comprised various prudential norms. These measures are enhancing the eve if corporate governance, limitation to investment (such as unlisted shares and debentures) and deduction in capital for such activities, monitoring of liquidity gap through asset and liability mismatch, monitoring of foreign exchange exposure etc (NRB Directives, 2063).

2.6 Review of Related Studies

On way to conduct this research some books, articles, journals and publications have been studied to formulate ideas about the subject matter. Although, the specific books

regarding the NPA could not be found. However, some banking related book and some thesis have been consulted such as Tannan's Banking law and practice in India (1997).

2.6.1 Review of Books and Articles

Assessing the gravity of the problem Tannan found saying that banks and financial institutions at present face considerable difficulties in recovery of dues from the clients and a significant portion of the funds of banks and financial institutions is thus blocked in unproductive assets. Likewise for taking reference book on Management of banks credit written by **Suneja (1992)** has also been consulted. Suneja pointing out the cause of NPA says that the risk connected with lending to business depend on an enormous number of factors. For any particular type of business, the risk failure is affected by the state of economy, trend in demand for the product or service provided, competition from any other suppliers, financial resources are too limited and management skills are lacking. Reiterating the difficult decision facing a banker is to determine when it becomes necessary to recall a loan and to begin the process of liquidating the security. Further, she suggests that if a customer fails to make repayment on the due date the bank has to consider what steps need to be taken to recover the debt.

Pradhan (2001) in his article "*NPA: Some Suggestions to Tackle Them*" found that unless the growth of NPA is kept in control, it has the potential to cause systematic crisis. He has mentioned that a dream of globalization led to huge investment which unfortunately could not be utilized properly due to hesitant liberalization policies. Large corporate misused the credits and delayed payments and contributed indirectly for enhancing NPA ratio. He further argues that lack of vision in appraisal of proposal while loan sanctioning, reviewing or enhancing credit limits, absence of risk management policy of financing, concentration of credit in few group of parties and sector, lack of initiatives to take timely action against willful defaulters, indecision on existing out of bad loans for fear of investigation agencies like special police CIAA, public accounts committee of the parliament have also contributed in whatsoever measures to the worsening situation on NPA front. He further pointed out that most crucial reason for the increase in the NPA is the shabby and defaulter friendly legal system. Suggesting the

remedy of NPA, he adds that administrative system should be strengthened. Legal reforms should be made and assets Reconstruction Company should be formed.

Poudel (2004) in his article "*Financial System, Impaired Assets and their Resolution in Nepal*" states that NPL/total loan ratio of Nepal is the highest among China, Japan, Korea, Malaysia, Philippines and Thailand. NPL in Nepalese banking sector has been mounting since early 1990's financial system of Nepal could be categorized as the weak financial position of most of the government-owned financial institutions as reflected in their negative net worth and huge accumulated losses, higher portions of NPA, predominance of the informal financial system, high interest rate differential between the formal and informal sectors, large interests spread between lending and borrowing rates in the formal financial sector etc. it is estimated that the size of the NPA in the commercial banking system is as high as 18 % and 50% of this ratio we can found in the two largest banks (RBB and NBL). For resolving this situation the government has initiated FSR program. He argues that the government has a paramount role in building an atmosphere for paving the way for the emergence of professional management and efficient financial operations not only in the institutions owned by it but also in the private owned institutions. To tackle this problem, the financial system should be strengthened by improving its regulatory and supervisory systems. He explain the FSR strategy should ensure that financial institutions are run in accordance with sound business principles and practices. The central bank's capability for effective supervision of the financial institutions should be enhanced. Similarly, financial discipline based on adequate provisions of disclosure and implementation of internationally recognized accounting and auditing practices and systems should be ensured. Competition oriented policies should be pursued along with strong regulatory supervisory framework to enhance financial sector efficiency and effectiveness.

He gives an example of the Asian crisis of 1997-98 and suggests to take lesson from it. The crisis seriously affected the financial system and economic stability of the region. Large currency depreciation, capital market collapses, large scale bankruptcies, swollen NPA level of the financial system, negative economic growth rates, massive

unemployment, disrupted social services, dwindled investor confidence and sharp reduction in the general standards of living were the immediate effects of the crisis. It is commonly believed that one of the critical factors behind the crisis was the absence of adequate central banking autonomy which substantially reduced the efficiency and effectiveness of the central banking functions and responsibilities. He suggests the concerned parties should review the measures they taken for solution of the crisis.

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

World Bank, principal donor of the country, has clarified tat it will not start any new Budget support to loan negotiation as long as the government does not take concrete actions against blacklisted willful defaulters, posted on The Kathmandu Post on dated Nov. 24, 2006. Made it clear by WB vice-president for South Asia Praful Patel in Ktm that the WB first wants action against defaulters before initiating any future loan negotiations. Addressing an interaction organized by FNCCI in Ktm, Assistant Secretary General of United Nations Kulchandra Gautam expressed his views about NPA that FNCCI should take a strong stand against bank defaulters and encourage its member to be law-abiding citizens" posted on Kathmandu on Oct. 20, 2006. "It is unconscionable that well-to-do businessmen, industrialists and investors abuse the banking system and get away with impunity, while small borrowers are deprived of loans and penalized for delayed payment" he said, he urged the business community to act responsibility and ensure that the defaulters pay off the debts promptly.

Dhungana (2006) in his article "*Problem of NPL and the Need of Financial Discipline in the Nepalese Banking System*" states that Nepalese financial system still has a high level of NPL. System's soundness cannot be restored without resolving the problem of NPL. He further says, the level of total loan is highest level in the Nepal in 2003 than that of other South Asian Countries. According to him, the main causes for NPL problem in the Nepalese banking system are internal and external factors consist poor system, procedures and credit culture in credit management, management oversight deficiencies in policy level and lack of competencies in the Board of Directors to monitor risk, limited supervision by the bank itself and fraud in lending and recovery, poor recovery efforts even the loan is categorized under bad, lack of loan write-off policies, poorly managed few banks. External factors consists lack of financial discipline within borrowers and in financial system, poor legislative regime, fragmented legal environment, lack of supportive institutions helping to reduce the NPA, deterioration in economic growth rates and activities since last few years, poor legislative and supervising capacity of the central bank in the past, security problems and conflicts in the economy. He further suggests that for the management of NPL and a good banking there should be a proper risk management. Preventive and curative measures are acquired to be initiated in the system. He insists that the financial discipline is most crucial to enhance the good credit culture for the benefit of the society and achieve the high level of economic growth. Preparation of best CPG, establishing best credit approval procedures installing proper credit management system and credit culture are some of the preventive measures to control NPL growth. Curative measures such as assisting the banks and financial institutions to dispose the distress loan and facilitating to recover NPL are also equally important. He says both strengthening of the internal capacity of the financial institutions and improving capacity of the system, building financial discipline in the system as a whole is the need of the day.

Basyal (2006) discussing about the financial sector reform in his article "*Financial Sector Reform Program in Nepal: Prospects and Challenges*" states that the host of challenges and complexities that confront the financial system of Nepal could be categorized as the weak financial position of most of the government-owned financial

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

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Sharma (2006), former vice chairman of NPL said, "Courts are easily issuing stay orders to defaulters hurting the bank's loan recovery initiatives. The government must act urgently to address it", printed on Kathmandu Posts on September 2, 2006. he added it must exert social pressure against willful defaulters from the state's facilities, should be implemented. Addressing the banker's conference 2006, Ken Ohasi, Country Director of WB, viewed the defaulters' issue was no longer an issue of survival of banks, but the issue of survival of the market system in Nepal. He said the political leaders and the government should deal with the matter seriously and urgently.

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

An another article "Defaulters Are The Villains Of Market Place" published on Kathmandu Post of same day, Rajib Upadhyya, Sr. External Affairs Specialist of the \YB, says defaulting or the impunity with which borrowers refuse to pay back their bank loans

on various pretext is symptomatic of the larger governance problems that bedevil Nepal. He writes further commercial banks have been a source of easy money for a predatory and politically well connected clique. He says when banks have provision for these losses, the cost of borrowing rises for honest business and the return on deposits diminishes for the depositors, everyone suffers. He warns ahead, if defaulting continues the government will have to spend money from its budget to fix the problem at the expense of programs that would help the poor.

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

2.6.2 Review of Previous Research Works

Khadka (2004) studies on "*Non-Performing Assets of Nepalese Commercial Banks*". He has taken the main objective to examine and study of level of non-performing assets in total assets, total deposits and total lending of Nepalese commercial banks. He says escalating level of NPA has been becoming great problem in banking business in the world. It is well known fact that the bank and financial institution in Nepal have been facing the problem of swelling NPA and the issue is becoming more and more unmanageable day by day, he adds. His study is especially focused in five Nepalese commercial banks i.e. Nepal SBI bank, Nepal Investment Bank, Nepal Bangladesh Bank, Bank of Kathmandu and NABIL bank Ltd. only. Among these five sampled commercial banks, he found the NPA of NBBL seems very worse than all other banks. He concludes that the level of NPA in sampled banks is not so alarming and the situation is quite satisfactory. He warns ahead if the increasing trend remains continue in coming days, the situation will be unmanageable. He states the commercial banks could not give full attention towards supervising their lending and towards recovering their bad loans perfectly. He recommends to overcome the problem of NPA than being loan a risky asset, effort should be made to have proper control in the every step of loan management. Corporate structure of the banks play key role in the effective loan management. He further insists the banks should take collateral from the borrower so that in the event of default this collateral is disposed for recovery of loan. Proper financial analysis of the borrower should be done by the bank. He thinks fundamental changes are necessary to correct business practices based on connections, bribery and lenient credit screening by banks. He has followed descriptive research design with analytical approach. His research is based on secondary data. He considered twelve commercial banks as target population which are inside the Kathmandu valley as on mid July, 2003 among them five banks are taken as sample bank by the researcher. He has used simple percentage tool like arithmetic tool, Karlpearson coefficient of correlation and regression analysis for data processing procedures. His research based on research variables like NPL and the level of NPL in different parameter.

Kafle (2005) aims to study the level of NPL in total assets, total deposits and total lending by Nepalese commercial banks and to find out whether the Nepalese commercial

banks are following the NRB directives regarding loan loss provision for NPL or not in his thesis titled *"Non-Performing Loans Of Nepalese Commercial Banks"*. He found the level of NPA in Nepalese banking sector is alarming and increasing. His study is focused only on five banks i.e. Nepal SBI Bank, Nepal Investment Bank, Nepal Bangladesh Bank, Bank of Kathmandu and NABIL Bank Ltd only. Levels of NPA in the sample banks are not so alarming and the situation is quite satisfactory.

He further states not any bank could meet the requirement of NRB directives. He thinks that corporate structure of the banks play key role in the effective loan management. Lack of proper financial analysis, management inefficiency, and lack of proper collateral are the causes of high-level NPA. Nepalese commercial banks should strongly think on these areas, he recommends. Fie has followed descriptive research design with analytical approach. His research is based on secondary data. He considered twelve commercial banks as target population which is inside the Kathmandu valley as on mid July, 2003. Among them five banks are taken as sample bank by the researcher. He has used simple percentage tool like arithmetic tool, Karlpearson co-efficient of correlation and regression analysis for data processing procedures. His research based on research variables like NPL and the level of NPL in different parameter.

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

provisioning directives seems more stringent than previous one. She further says adequate provisioning strengthens the financial health of the banks and makes them able to face any kind of future contingencies. She recommends that there should be regular supervision and follow up for proper utilization of loan. Strict monitoring and control system should be there for timely recovery of the loan, she adds. She recommends to create separate department in every commercial bank to control their NPA like credit appraisal dept., credit control dept., credit administrative dept., legal dept., etc. On the way of conducting her research, she follows analytical and descriptive research design in research methodology. Population for her study comprised all the licensed commercial banks of the country and sample for her study comprised two commercial banks namely NABIL and SCBNL by using judgmental sampling method. She thinks these two banks could represent true picture of so called successful commercial banks that is why she selects these banks as sample. Different kinds of appropriate mathematical, statistical and financial tools have been applied for analysis purpose. Correlation analysis, ratio analysis and different diagrams and graphs are used in her research as tools and techniques.

Though these studies are found to be quite useful in their own side but the question of NPA and its cause as well as effect on various aspects empirically and qualitatively in Nepal Bank & Banijya Bank, commercial bank is yet to be researched. These thesis are mainly focused on the condition of NPA in Nepalese banking sector and other policies and directives regarding this topic. The contribution of NPA of these two banks is more than 60% on overall NPA. Previous researchers have analyzed only other commercial banks' NPA problem. None of them could addressed the cause and effect of NPA in profitability of these two major commercial bank. NPA problem in these two commercial banks are mounting regularly. The problems are needed to be solved promptly. In view of these, this study has been based on the various contributing factors that increase NPA level in these bank specifically in Nepalese perspective and its effect on profitability position of the banks. The methodology adopted in this research are research design, population and sample, type and nature of data, data gathering procedure, data processing procedure, techniques of analysis and so on. Secondary as well as primary data are used for the purpose of the study. Primary data is based on opinion survey which focused on the causes of NPA from the perspective of employees of the sampled banks.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Introduction

The main objective of the study is to examine the major components of (lie portfolios of the balance sheet and income statements of the NBL and RI3B as well as to evaluate the NPA growth of the banks during the period of the study. Research methodology describes the method and process applied in the entire aspect of the study.

3.2 Research Design

This study seeks to analyze the impact of NPA on profitability, NPA and its relationship with NPA and influencing external and internal factors. To achieve the objective, analytical research design has been adopted in this study. In other words, the research design of the study is therefore combination of two major research designs i.e., descriptive design for secondary data and survey research design for primary data.

3.3 Population and Samples

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

- a. Nepal Bank Ltd.
- b. Rastriya Banijya Bank Ltd.

3.4 Nature and Types of Data

Since this study aims to assess the impact of NPA on the profitability of the bank as well as the influencing variables of NPA, the nature of data is both primary and secondary in nature.

3.4.1 Sources of Data

For the analysis of impact of NPA secondary data have been collected from the annual reports of the sample banks, economic survey published by NRB, quarterly economic bulletin published by NRB, banking and financial statistics published by NRB, different publication by NRB concerned about commercial banks, previous dissertations, other publications and related websites. Likewise for the study of cause of NPA primary data in form of questionnaire have been collected from the respondent of sample banks.

3.5 Data Gathering Procedure

After (lie identification of sources of data, the required data for the study have been gathered through the following procedures:

- a. First of all nature of data have been identified
- b. For the collection of secondary data yearly annual report of the sampled banks have been taken for the period of five years i.e. during fiscal year 2059/60 to 2063/64.
- c. For the collection of primary data the official from sample banks have been identified as the respondent and questionnaire have been distributed and required information are collected.

3.6 Data Processing Procedure

The computer print outs of financial key figures and the information collected through questionnaire have been processed according to the requirements of the study. Financial data of the sampled bank have been put aside and the primary data collected through questionnaire have been tabulated as per the need of calculating financial and statistical tools.

3.7 Nature of Respondents of Survey

The respondents of the questionnaire designed for the assessment of internal and external factors having significant contribution for turning good loan into bad loans are the bankers from the sample banks in different level and have experience on credit operation and debt recovery operation of the commercial banks. Their details are as follows

3.7.1 Lender of the Respondents

Following table shows the actual status of male female ratio of the respondents.

Table 3.1
Gender of the Respondents

Category	Frequency	Percent	Cumulative Percent
Male	31	91.18	91.18
Female	3	8.82	100.0
Total	34	100.0	

From table 3.1, there are around 91% male and 9% female out of total respondents. All know the representatives of female in high position of any organization are low comparing other countries.

3.7.2 Age of the Respondents

Present survey design attempted to gather the information from diverse groups of respondents. Age is also one factor in this campaign. All know that fact and genuine things could be found by the young aged people. By keeping this in mind, researcher has tried to collect information from young age group of employees.

Table 3.2
Age of the Respondents

Category	Frequency	Percent	Cumulative Percent
Age below 30	12	35.3	35.3
31 to 35	7	20.6	55.9
36 to 40	4	11.8	67.7
41 and above	11	32.3	100.0
Total	34	100.0	

Above statistics shows that majority of the respondents were from the age of below 30 and 41 and above groups. This indicates that mostly new employees are below-30 and they are well educated and familiar about the situation of commercial banks in Nepal. All know that you have to use your' more time to get upper position in Nepalese

organizations. And age -group 41 and above shows that these respondents are from high designation who know the problems of banks and solution as well from their long experiences make them initiative.

3.7.3 Respondents from Commercial Banks

Data has been collected from sample banks namely, Nepal Bank Ltd and Rastriya Banijya Bank Ltd.

Table 3.3
Related Banks of the Respondents

Hanks	Frequency	Percent	Cumulative Percent
NBL	20	58.8	58.8
RBB	14	41.2	100
Total	34	100.0	

It is evident from table 3.3 that most of the respondents are from NBL, since most of the respondents from RBB could not forward the questionnaire within the specified time.

3.7.4 Levels of the Respondents

Present survey attempts to collect information from the various level of banker. This survey has gathered information from credit department and debt recovery department of the sampled banks. This survey was conducted through the following level of bankers:

Table 3.4
Level of the Respondent Bankers

Level	Frequency	Percent	Cumulative Percent
Senior Assistant	2	5.9	5.9
Assistant Manger	14	41.2	47.1
Deputy Manager	15	44.1	91.2
Senior Officer	3	8.8	100.0
Total	34	100.0	

Table 3.4 shows that most of the respondents were managers. Out of total respondent around 85% are manager level and 9% are high class officers. From this table it seems

that most of the respondents were from upper class employees. AH know that high class employees have been taken good education and well experience of their related field. Present survey has been able to collect information about the concerned area from those banker.

3.8 Tools and Techniques

Few statistical packages such as Excel and SPSS were used to process and analysis information. Secondary information collected from annual reports of the sample banks were first tabulated in Excel spreadsheet and then analyzed using formulae and charts of the same software. For this, statistical tools such as correlation analysis are done and in some case financial tools such as ratio analysis has also been conducted. Likewise primary data were collected from carefully designed questionnaire. These data were first tabulated in SPSS program and variables are defined properly. Some data were parametric and some were non-parametric data. Suitable tools such as descriptive statistics, mean, standard deviation were done wherever necessary.

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

4.1 INTA, NBA and Profitability Assessment

In this chapter, efforts have been made to present and analyze the collected data. Data collected from various sources were classified and tabulated as requirement of the study and in accordance to the nature of the collected data. Different arithmetical and statistical tools are used to analyze the data. To make easier and clearer to understand, data are presented in the required figure also. Simple percentages are used to analyze the data as arithmetical tools. Karl Pearson's correlation coefficient is also used to analyze data as statistical tools. This chapter presents the secondary data analyses that are collected from the annual reports of the sample banks. For the purpose of study five years data from fiscal year 2060/61 to 2064/65 of all sample banks have been taken into consideration. In this chapter, two type of analysis have been carried out, i.e., description analysis and inferential section of analysis.

4.2 Descriptive Analysis

Descriptive analysis is carried out to assess the NPA level and its relationship with other key factor in the firms under study. Five years data relating to NPA, operating profit, net profit and loan loss provisioning position and NBA ratio to all the sample banks have been obtained. For the analysis of trend of NPA with other related variable this has been subdivided into three parts:

Firstly, for the analysis of the trend of NPA, operating profits, net profit and loan loss provisioning increment level compared to previous year has been computed. Then trend of NPA with operating profit, net profit and loan provisioning is compared to assess whether the increment ratio of NPA is similar to increment ratio of operating profit, net profit and loan loss provisioning.

In second part, trend of loan portfolio and NPA increment level on the basis of previous year positions have been computed. The purpose of assessing the trend is-for finding the relationship of loan expansion and growth of NPA.

Third part of the analysis is for assessing trend of NPA and NBA, since NBA is created when the security either current of fixed kept in the banks custody auctioned after the borrower defaults. Situation arises when banks has to accept the ownership of the security in its own name then NBA has significant relationship with NPA.

4.2.1 Trend Analysis of NPA & Profitability of the Banks

There is intimate relationship between NPA and Net Profit of all commercial banks. Here the NPA and Net Profit trend of all commercial banks and the sampled banks namely NBL and RBB are presented simultaneously. Tables and graphs if necessary are taken for this purpose.

Table 4.1
Analysis of NPA and Profitability of Commercial Banks
(use upto 2064/065 or 2065/066)

(Rs. in Million)

Years	Net Profit	Increment %	NPA	Increment %	NPA %
2060/061	-9428	-	32226.66	-	28.8%
2061/062	-3317	-64.82	28933.41	-10.22	22.77
2062/063	3707	-211.76	27877.84	-3.65	18.94
2063/064	5205	40.41	28763.58	3.18	18.04
2064/065	7983.51	53.38	26770.42	-6.93	14.22

Source: Annual Reports of Bank

Table 4.1 represents the situation of the whole Nepalese commercial banks during the study period concerning about Net Profit and NPA trend. The growth of the Net Profit in the F/Y 2060/061 was negative then the generation of profit begins to grow steadily. The NPA is continuously in decreasing trend except the F/Y 2062/063, where NPA is increased by 3.18%. From the F/Y 2061/062 commercial banks of Nepal are started to make profit that is the indication of the improvement of two biggest commercial banks

namely, NBL and RBB which are discussing further. The overall NPA is also decreasing trend that is why the profit has been generated gradually. If we conclude the relationship between NPA and Net Profit regarding the above table, we could say that Net Profit would be increased when NPA is in decreasing trend and vice versa.

Table 4.2
Analysis of NPA and Profitability of NBL

(Rs. in Million)

Year	NPA	Increment %	Operating Profit	Increment %	Net Profit	Increment	Loan Loss Provision	Increment %
2060/06	1083	-	-3196		-3071		10614	
2061/06	1096	1.21	-384	-87.98	-252	-91.79	10161	-4.27
2062/06	9640	-12.08	511	-233.07	710	-381.75	9056	-10.87
2063/06	8372	-13.15	279	-45.4	1730	143.66	8648	-4.51
2064/06	2262	-72.98	-389	-239.43	1207	-30.23	-2685	-131.05

Source: Annual Reports of Bank

NPA, Operating Profit, Net profit and Loan Loss Provision trend of NBL are presented at the above table. From the above analysis it reveals that the NPA growth in case of NBL is continuously decreasing. And if we see the scenario of operating profit and net profit we found same mixing result. Operating profit is negative in the FY 2060/061 and FY 2061/062 and thereafter it is positive till FY 2063/064 and again it becomes negative. However growth of loan loss provisioning is gradually in declining phase. That is why the increase of net profit is possible. In FY 2064/065 operating profit is negative, loan loss provisioning is also negative. NPA is at low point comparing other years and in the same fiscal year net profit is positive. This is because of the non operating income resulting from the decreases of NPA level. It can be concluded that NPA has significant impact on profitability. In the context of NBL, decreasing level of NPA made bank to keep less loan loss provisioning which made bank to enjoy profit. The following figure also depicts the movement of NPA, Net profit, Loan loss provision and Gross profit.

Figure 4.1
Analysis of NPA and Profitability of NBL

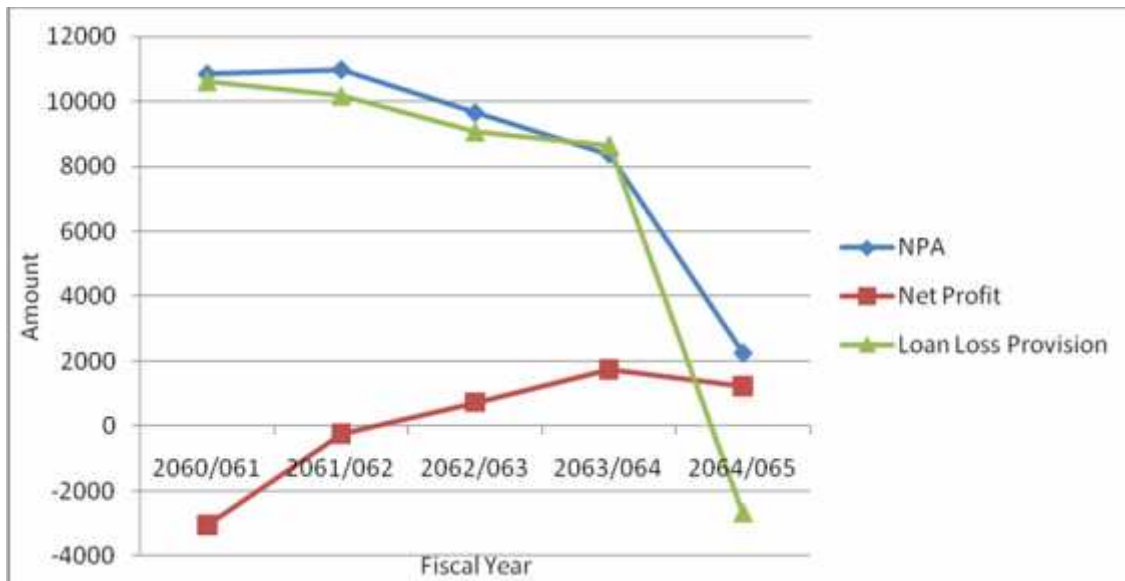


Table 4.3
Analysis of NPA and Profitability of RBB

Year	NPA	Increment t	Operating Profit	Increment t	Net Profit	Increment t	Loan Loss Provision	Increment %
2060/061	14883		-1226		-7068		13347	
2061/062	16005	7.53	-3252	165.25	-4839	-31.54	14929	11.85
2061/063	14471	-9.58	280	-108.6	1040	-121.49	14275	-4.38
2063/064	13689	-5.4	768	174.29	1323	27.21	13570	-4.94
2064/065	12315	-10.04	333	-56.6	1688	29.59	12633	-6.91

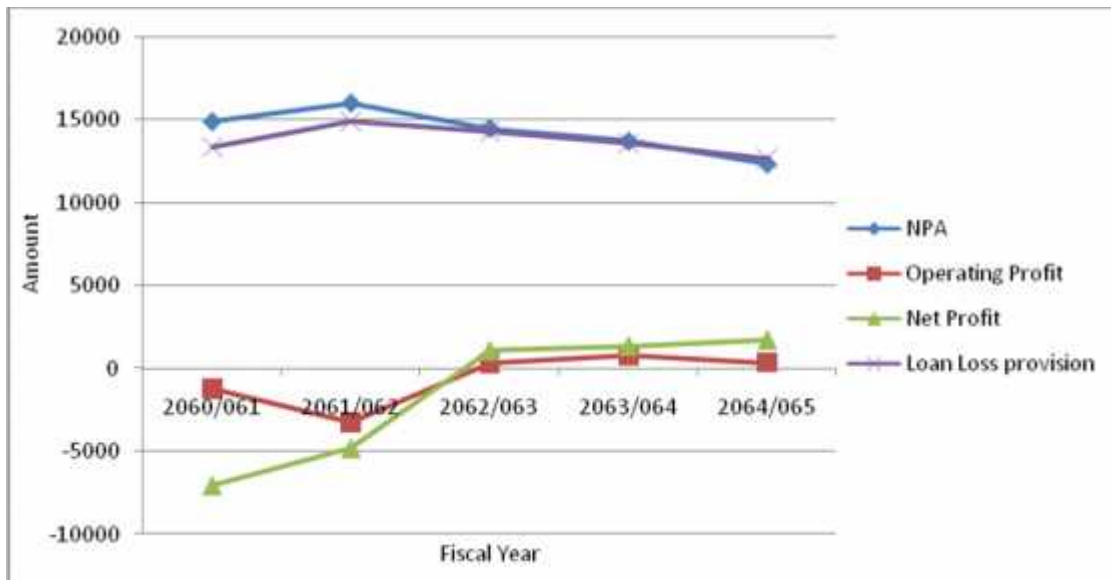
Source: Annual Reports of Bank

In case of RBB, the scenario is approximately similar as the scenario of NBL. Here also NPA is in decreasing level. As the consequences amount of loan loss provisioning is also declining comparing previous years. And from the FY 2062/063 bank have started to make profit through the trend of operating profit is not steady. Net profit on the other hand is growing significantly and steadily. In the FY 2064/065 operating profit is declined by 56.6% and in the same year net profit is increased by 27.59%, indicates that the income from other sources and non operating income was low comparing other years.

After analyzing the above statistics we can say that when there is negative growth of NPA there is significant positive increment of net profit but when there is positive growth of NPA resulted reduction on net profit.

After reviewing the overall positive position of these two commercial banks, it reveals that NPA and loan loss provisioning is decreasing more or less. And on the other hand net profit is increasing regarding the decline of NPA and loan loss provisioning. But operating profit sometime increase and sometime decrease though the level of NPA and loan loss provisioning, declining. The basic reason of this is the requirement of allocate some portion of it's amount for loan loss provisioning and the decrease of other incomes and non operating income if we follow the balance sheet of these banks. Hence in summary we may conclude that whenever there is growth of NPA, it affects the net profit of the bank. The following figure makes clearer the situation of RBB's NPA profitability.

Figure 4.2
Analysis of NPA and Profitability of RBB



4.2.2 Trend Analysis of NPA & Loan Outstanding of the Banks

Table 4.4

Analysis of NPA and Loan of Commercial Banks

Years	Total Loan	Increment %	NPA	Increment %	% of NPA
2060/061	113174.6	—	32226.66	—	28.8
2061/062	124522.4	10.03	28933.41	-10.22	22.77
2062/063	140031.4	12.45	27877.84	-3.65	18.94
2063/064	159641.4	14.00	28763.58	3.18	18.04
2064/065	173383.4	8.61	26770.42	-6.93	14.22

Source: Annual Reports of Bank

From table 4.4, the overall level of NPL is in declining phase. This shows the seriousness of banks over NPA for past couple of years. Because of their huge concern about NPA brings it down from 28.8% in FY 2060/061 to 14.22 in FY 2064/065, which is still not able to get standard ratio i.e. 5% , but they are optimistic to control it. From the FY 2060/061 to FY 2063/064 the portion of total loan is significant and steady. On the other hand NPA is decreasing continuously except in the FY 2063/064, when NPA is increased by 3.18%. In the FY 2064/065 the growth of total is by 8.61% and growth of NPA is negative. We can draw the conclusion based upon above analysis that these days banks are increasing there loan with giving too much attention in NPA. So most of the banks have adapted less aggressiveness on loan policy.

Table 4.5

Analysis of NPA and Loan of NBL

Years	Total Loan	Increment %	NPA	Increment %	%of NPA
2060/061	19253	—	10834	—	56.27
2061/062	18132	-5.82	10965	1.21	60.47
2062/063	17938	-1.07	9640	-12.08	53.74
2063/064	16867	-5.97	8372	-13.15	49.64
2064/065	12442	-26.23	2262	-72.98	18.18

Source: Annual Reports of Bank

Figure 4.3
Analysis of Loan and NPA of NBL

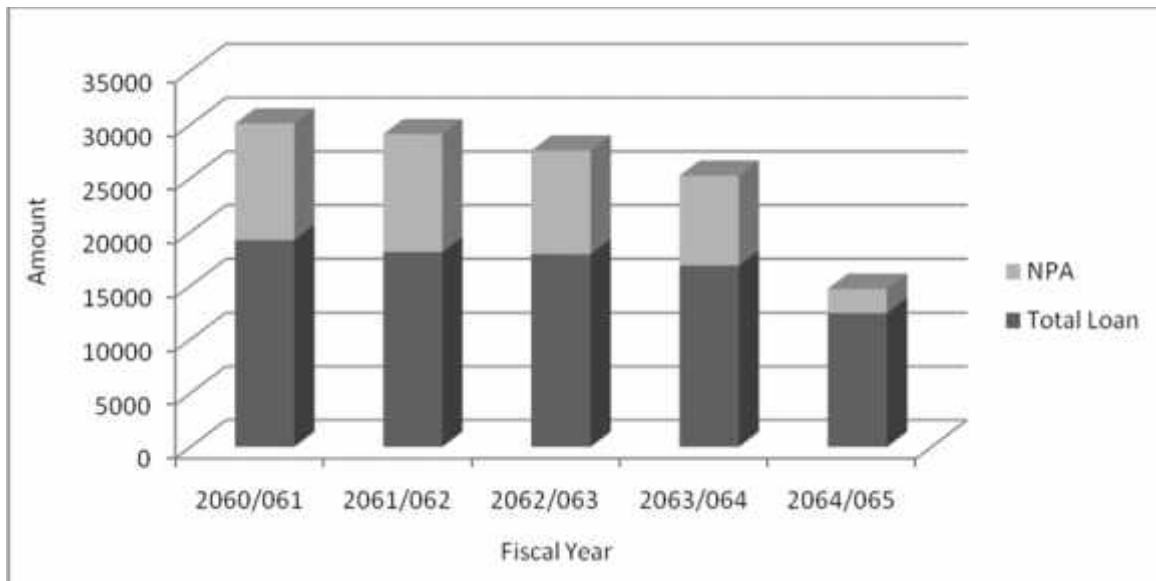


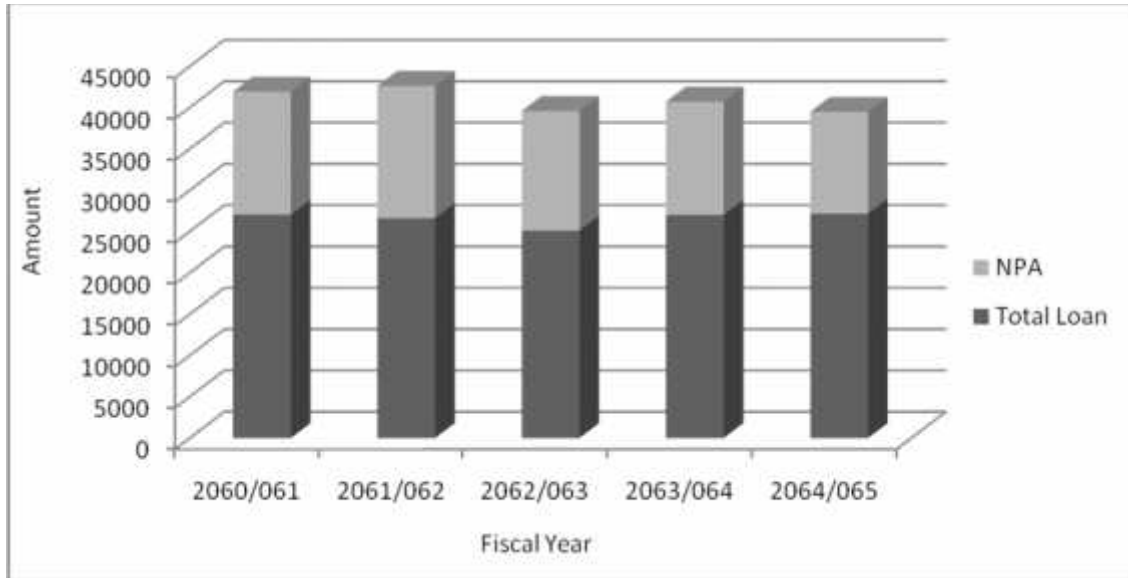
Table 4.5 and figure 4.3 says that it is continuously declining more or less. And in the FY 2064/065, NPA is decrease to 18.18% from 49.64 in FY 2064/065. The growth of total loan is continuously reducing and in the FY 2064/065 total loan is reduced by the highest percentage comparing other years' level, i.e. by 26.23%. On the other hand, the growth of NPA is also reduced greatly in the same year by 72.98%. This indicates that the bank is showing much attention on their loan portfolio by strong supervision, credibility and capability of applicants, other related topics etc. and to reduce NPA level, they are asking their debtors with legal support and with rearranging the structure of loan which they had taken from bank and couldn't pay back on time.

Table 4.6
Analysis of NPA and Loan of RBB

Years	Total Loan	Increment %	NPA	Increment %	%of NPA
2060/061	27037	—	14883	—	55.05
2061/062	26609	-1.58	16005	7.53	60.15
2062/063	25105	-5.65	14471	-9.58	57.64
2063/064	27001	7.55	13689	-5.4	50.70
2064/065	27159	0.58	12315	-10.04	45.00

Source: Annual Reports of Bank

Figure 4.4
Analysis of Loan and NPA of RBB



From Table 4.6 and figure 4.4, it can be said that the NPA level is declining over the past few years which shows the great concern taken by RBB in NPA topic. However still they couldn't get the standard NPA level but we can be optimistic. From the FY 2060/061 to FY 2062/063, total loan is declining and then the growth of total loan is positive till FY 2064/065. On the other hand, growth of NPA is negative till FY 2064/065 except 2061/062, where NPA is positive. In the last two fiscal years bank is able to flow more loan comparing other years while controlling NPA level which indicates the bank's capability and ability to analyzing and reviewing the credit matters.

After reviewing the situation of these two banks regarding total loan and NPA, it can be said that the condition is improving gradually and simultaneously. They are adapting less aggressive policy on loan portfolio while controlling level of NPA which indicates they are giving NPA problem a huge time and effort. It can inferred from the analysis of above table that expansion of loan level can be regarded as one of the cause of NPA increment. If we see at above table, with the decline of loan amount there is also decline of NPA amount.

4.2.3 Trend Analysis with Respect to NPA Ratio and NBA Ratio

NPA and NBA are both concerning each other but it cannot be said that they have positive or negative relationship. Here the growth of NPA and NBA of sample banks are tabulated.

Table 4.7
Analysis of NPA and NBA Ratio of NBL

Year	NPA Ratio	Increment %	NBA Ratio	Increment %
2060/061	56.27	—	—	—
2061/062	60.47	7.46	—	—
2062/063	53.74	-10.44	—	—
2063/064	49.64	-7.63	1.00	—
2064/065	18.18	-63.38	6.42	542

Source: Annual Reports of Bank

We are unable to collect the amount of NBA before FY 2062/063, because the bank has kept in other assets section on their report and they are unable to provide us the separate NBA amount. So here only two years NBA amount are tabulated which are provided by the bank. In case of NBL, the growth of NPA ratio is gradually decreasing trend or negative where the growth of NBA is also the cause of the increment of NPA but it can be difficult to conclude based on the above on the above data which are of only two years.

Table 4.8
Analysis of NPA and NBA of RBB

Year	NPA Ratio	Increment %	NBA Ratio	Increment %
2060/061	55.05	—	0.6	—
2061/062	60.15	9.26	0.4	-33.33
2062/063	57.64	-4.17	0.2	-50
2063/064	50.70	-12.04	1.01	405
2064/065	45.00	-11.24	1.48	46.53

Source: Annual Reports of Bank

Table 4.8 shows some things about the relationship of NPA and NBA. In FY 2061/062, growth of NPA ratio is positive whereas the growth of NBA is negative. Likewise, in FY 2062/063 the growth of both ratios are negative and in FY 2063/064 and FY 2064/065 growth of NPA ratio is negative whereas growth of NBA ratio is positive for same years. This indicates it cannot be said that whenever there is NPA growth, level of NBA should increase or vice versa. It is difficult to draw rigid conclusion that NBA is increased only because of the increment of NPA. Hence it can be said that direct relationship between both of them is difficult to establish.

In consolidation after assessing the NPA and NBA level of all sample banks it can be concluded that drawing firm and rigid relationship between NPA and NBA is difficult. The reason behind this is though there is NPA, bank may delay initiating legal action or the property auctioned had been sold or bank has not accepted the ownership in its own name or sold some of NBA. Simply, we can say that NBA is created due to having NPA that is why NBA growth is result of NBA growth. But we cannot say that whenever there is NPA it creates NBA.

4.2.4 Loan Loss Provisioning of NBL & RBB

Rises of non-performing loans increase their provisions to shore up their reserves for loan losses. As a result the net profit is going to be negative by contributing great portion of gross profit in loan loss provision. According to NRB's directives for the commercial banks, banks should maintain certain percent of the different class loan as a loan loss provision. Here are the loan loss provisioning maintain by NRB and RBB respectively. The data regarding loan loss provision by all types of loan for FY 2060/061 is not provided by NBL, so data are presented from FY 2060/061. First of all, the loan loss provisioning of NBL is as follows:

Table 4.9
Loan Loss Provisioning of Nepal Bank Ltd.

Types of Loan	Requirement	Loan Loss Provisioning by Bank				
		2060/061	2061/062	2062/63	2063/064	2064/065
Pass Loan	1% of pass loan	-	1.17	1.83	1.12	4.75
Substandard Loan	25% of substandard loan	-	23.11	21.4	24.31	28.12
Doubtful Loan	50% of doubtful loan	-	41.65	48.2	48.05	69.45

Bad Loan	100% of bad loan	-	94.47	94.48	94.86	115.96
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Source: Annual Reports of Bank

In case of NBL, the provision requirement for pass loan is fulfilled throughout the period of study. And in the case of substandard loan, doubtful loan and bad loan, the required provision has not maintained. However in FY 2064/065 the required provision are fulfilled for all types of loan. It is found that, the bank could not maintained loan loss provision perfectly in accordance to the NRB's directives. The bank maintained higher than requirement for pass loan whereas the bank maintained lower than requirement for other types of loan. Therefore, the banks also have to give priority to fulfill the requirement of NRB's directives.

Table 4.10

Loan Loss Provisioning of Nepal Rastriya Banijya Bank

Types of Loan	Requirement	Loan Loss Provisioning by Bank				
		2060/061	2061/06	2062/0	2063/064	2064/065
Pass Loan	1% of pass loan	0.90	0.92	4.02	3.19	3.08
Substandard	25% of ubstandard Loan	22.07	20.79	22.21	23.89	21.96
Doubtful Loan	50% of doubtful loan	47.07	44.67	43.31	45.36	48.46
Bad Loan	100% of bad loan	93.17	96.22	95.43	94.69	92.57

Source: Annual Reports of Bank

It can be said after reviewing table 4.10, that the bank has not followed NRB's directives. The requirements of pass loan only meet the directives from FY 2062/063. And if we analyze the provision kept by bank in other class of loan than none of the fiscal year has maintained as per NRB's directives. So the bank should follow directives for their betterment. Obeying NRB's rules and regulation is a major responsibility of the bank.

From above analysis, we can clearly know that lack of regular supervision and survey by NRB made NBL and RBB to keep lower provision than the requirement. It can be conclude that all Nepalese commercial bank did not following NRB's directives regarding loan loss provision till now. Such results raise questions, whether the NRB fails to implement its directives or not? Therefore regular supervision and control over the

Nepalese commercial bank by NRB becoming very essential for growth and survive of banks.

4.3 Inferential Analysis

Inferential analysis is based on the sampling and statistics. It helps to estimate a good estimator of population parameter. Attempts are therefore made to estimate the population parameters to predict the future outcomes i.e. to establish relationship between NPA and other factor in case of different banks under study. For this purpose, ratio analysis concerning other class of loan and other balance sheet terms and correlation coefficient have been computed between loan and NPA as well as NPA and NBA.

4.3.1 Data Analysis and Presentation of NBL & NRB

First of all the analysis of RBB is presented here. All know that RBB is only one commercial banks owned by government fully. It has completed 42 years of the operation. Data collected from various sources are calculated and presented accordingly here.

Table 4.11
Different Ratio Analysis and Presentation of RBB

S.N.	Particulars	2060/061	2061/062	2062/063	2063/064	2064/065
1.	Percentage performing loan to total assets	27.01	24.56	23.6	23.43	27.9
2.	Percentage performing loan to total loan	44.93	39.85	42.36	49.3	55.43
3	Percentage performing loan total deposit	31.23	27.61	26.02	30.95	32.86
4	Percentage non-performing loan to total assets	33.11	37.07	32.12	24.09	22.82
5	Percentage non-performing loan to total loan	55.07	60.15	57.64	50.7	45.34
6	Percentage non-performing loan to total deposit	38.28	41.68	35.41	31.82	26.88
7	Percentage sub-standard loan to total NPL	17.87	8.83	4.89	3.79	2.07
8	Percentage doubtful loan to total NPL	37.8	26.84	12.4	4.25	3.17

9	Percentage bad loan to total NPL	44.33	64.32	82.71	91.96	60.1
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From table 4.11, up to FY 2063/064 total performing loans to total assets are decreased and only in FY 2064/065 the ratio increased from 23.43% to 27.9%. If we move on total performing loan to total loan than we found in FY 2061/062 ratio is decreased from 44.93 to 39.85 but from FY 2062/063 the ratio is increased significantly and reached 55.43% in FY 2064/065. On the other hand the situation of total performing loan to total deposit, the scenario is quite similar to the ratio of total performing loans to total loan. This trend indicates the condition of RBB is improving slowly. Higher level of performing loans in total assets, total deposits and total loan represents the sound financial health of the organization. Similarly higher level of performing loans to total deposits attracts deposits while lower level of performing loans creates threatens to the depositors of losing their deposits.

In case of non-performing loan to total assets, total loan and total deposit are in same trend. This means in FY 2061/062, the ratio are increased compared to FY 2060/061 than begins to increase till the FY 2064/065. This trend indicates that bank is continuously giving concentration towards credit related matters. But if we see the ratio of NPL, to substandard loan, doubtful loan and bad loan, in FY 2061/062 the level is increased but thereafter the level is decreased. On the other hand if we see the portion of substandard loan, doubtful loan and bad loan than it can be found that bad loan ratio is highest among them. It shows that bank still couldn't exercise much to recover NPL and couldn't take a strong step against defaulters.

Data regarding performing loan, substandard loan, doubtful loan and bad loan has not provided by NBL for the FY2060/061, so we analyze from FY 2061/062.

Table 4.12**Different Ratio Analysis and Presentation of NBL**

S.N	Particulars	2060/061	2061/062	2062/063	2063/064	2064/065
1.	Percentage performing loan to total assets	-	14.65	19.51	17.38	28.34
2.	Percentage performing loan to total loan	-	39.53	48.02	48.48	81.81
3	Percentage performing loan total deposit	-	28.65	24.11	22.76	28.41
4	Percentage non- performing loan to total Assets	21.67	22.41	21.83	17.8	6.3
5	Percentage non- performing loan to total Loan	56.27	60.47	53.74	49.64	18.18
6	Percentage non- performing loan to total deposit	31.62	31.32	26.96	23.3	6.31
7	Percentage sub-standard loan to total NPL	-	11.77	3.71	1.53	2.08
8	Percentage doubtful loan to total NPL	-	27.38	16.38	2.99	3.89
9	Percentage bad loan to total NPL	-	60.82	76.63	99.27	81.12

From Table 4.12, the ratio of performing loan to total assets, total loan and total deposit in FY 2064/065, the ratios are higher than previous years which is satisfactory level. But the ratios of previous fiscal years are sometime increasing and sometimes decreasing trend which shows the volatile condition of bank in past years. The percentage of NPL to total assets, total loan and total deposits are increased in FY 2061/062 than decreasing significantly till current fiscal year. The ratio of NPL to total asset, total loan and total deposits of FY 2064/065 are 6.3%, 18.18 % and 6.31% respectively, which shows good condition of bank regarding these titles.

The percentage of NPL to substandard loan, doubtful loan and bad loan are satisfactory till now. However, the level of bad loan to NPL is highest among others which shows the bank could not give full attention to recover bad loan which will be the cause of

destruction in future so the bank should take immediate and firm action to recover it's bad loan.

4.3.2 Analysis of Correlation Coefficient between Loan and NPA

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

- i) A positive or negative relationship exists
- ii) The relation is significant or insignificant
- iii) Establish cause and effect relation if any

Here the correlation analysis is used to identify the relationship between loan and NPA.

Table 4.13
Correlation Coefficient between Loan &NPA of NBL

(Rs. in Million)

Years	Loan	NPA
2060/061	19253	10834
2061/062	18132	10965
2062/063	17938	9640
2063/064	16867	8372
2064/065	12442	2262

Coefficient of Correlation (r) = 0.9864

Since r is positive and almost +1, it can be said that there is perfectly positive correlation between credit expansion and NPA level in case of NBL. It means that relationship between loan and NPA is significant. In other words, because of close relationship whenever there is credit expansion, NPA is increased and vice versa. It can be seen in the amounts of both Loan and NPA, where both are in decreasing trend.

Table 4.14
Correlation Coefficient between Loan and NPA of RBB

(Rs. in Million)

Years	Loan	NPA
2060/061	27037	14883
2061/062	26609	16005
2062/063	25105	14471
2063/064	27001	13689

2064/065	27159	12315
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Coefficient of Correlation (r) = - 0.2864

Since r negative, it can be said that there is negative correlation between loan and NPA in case of RBB. It means that when loan is increased NPA level is decreased or vice versa. It seems that though level of loan is increased the level of NPA remains constant or decreased because the relationship between loan and NPA is insignificant. It can be seen in the amount of both loan and NPA where one is increased and other is decreased.

4.3.3 Analysis of Correlation Coefficient between NPA and NBA

Table 4.15

Con-elation Coefficient between NPA & NBA

(Rs. in Million)

Years	NPA	NBA
2060/061	10834	-
2061/062	10965	-
2062/063	9640	-
2063/064	8372	169.3
2064/065	2262	798.2

Coefficient of Correlation (r) = - 1

Since r is negative and almost -1, we can say that there is perfectly negative correlation between NPA and NBA of NBL. It tells that because of no relation whenever there is growth of NPA level, there is reduction of NBA and vice versa. In general the relationship between NPA and NBA of NBL is significant.

Table 4.16

Correlation Coefficient between NPA and NBA of RBB

Years	NPA	NBA
2060/061	14883	163
2061/062	16005	106
2062/063	14471	50
2063/064	13689	273

2064/065	12315	403
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Coefficient of Correlation (r) = - 0.8451

Since r is negative and near to -1, we can say that there is negative correlation between NPA and NBA of RBB. It means that when NPA level is increased then NBA level is decreased and vice versa. It seems that though level of NPA is increased but NBA remains constant or decreased due to non acceptance of the property and assets in the name of the bank and/or bank dispose it by sale or other way the level of NBA decreased. In this case, it is found that there is not direct relationship between NPA and NBA. In general, there is no significant relationship between NPA and NBA.

From above analysis we can say that when there is NPA increment, bank take action and auction the property held in its custody. Some times situation occurs where bank has to accept the property in its own name due to this there is increment of NBA. The case of both bank reveals that either banks has not auctioned the property or situation prevails so where bank has not accepted the property in its own name. Same time bank might have been sold portion of NBA.

4.4 Cause and Impact of NPA in Nepalese Banks

Here causes and impacts of NPA in selected Nepalese banks are analyzed. Primary data collected through questionnaire from the respondent banker of the sample bank for analysis. Nepalese banking sector are taken as the population of the study. Researchers have conveniently selected two biggest commercial banks of the country. Nepal Bank Ltd. and Rastriya Banijya Bank has selected as the sample for the study. External and internal contributing factors on NPA were raised as issues to ask the respondents. Questionnaire was designed including the major issues of NPA in structured questions. Various measurement scales were used to collect information. Questionnaires were administered to forty respondents and only thirty-four respondents returned the valid questionnaire for the study. For the processing of data the software SPSS has been used and accordingly data have been tabulated and processed. To find out the significance of the variables with respect to NPA, some statistical tools such as Standard deviation, Mean analysis have been computed.

4.4.1 Basis of floating loans by Nepalese Commercial Banks

One of the potential factors may be lending policy of the commercial banks in increasing non performing assets. To find out the existing lending practice in Nepalese commercial banks. Researcher has designed a questionnaire to test the attitude of employees. People build attitude based on their experience, therefore the view of the respondent may be useful method to identify how effective the lending policy in Nepalese commercial banks. A set of questions were designed to identify the basis of floating loan to the borrowers were provided to the respondents to rate their agreement on them.

Table 4.17

Basis of floating loan in Nepalese Banks

Variables	N	Mean	Std. Dev.
a. Financial strength of the borrower is a basis for floating loan	34	1.91	1.06
b. While floating loan your bank takes basis of security offered	34	1.82	0.46
c. Personal integrity of the borrower is always taken into consideration in your bank	34	1.59	0.96
d. Relationship of the borrower with top authority in your bank sometime may influence to float the loan	34	3.74	1.08
e. While floating loan portfolio management is given priority in your bank	34	1.74	0.58
f. Monitoring and control system is effectively adopted in your Bank	34	1.79	0.64

Above descriptive statistics shows that most of the respondents identified personal integrity of the borrower as a major factor in floating loan in Nepalese commercial banks. Secondly, respondent identified portfolio management as a major reason for floating loan in the certain sectors. Mean value of monitoring and control, security offered and financial strength were found with in average. Most of the respondent denied accepting the relationship between borrowers with top authority as a reason in floating loan to borrowers.

Table 4.18**Analysis of basis of Floating Loan in Nepalese Banks**

Range	Financial strength		Security offered		Personal integrity		Relationship of the client with top authority		Priority on Portfolio management		Monitoring and control system	
	Fre	%	Fre	%	Fre	%	Freq.	%	Fre	%	Freq.	%
Strongly Agreed	15	44.1	7	20.6	21	61.8	—	—	11	32.4	11	32.4
Agreed	12	35.3	26	76.5	9	26.5	5	14.7	21	61.8	19	55.9
Neutral	2	5.9	1	2.9	2	5.9	10	29.4	2	5.9	4	11.8
Disagree	5	14.7	—	...	1	2.9	8		—	—	—	...
Strongly Disagree	—	—	—	—	1	2.9	11		—	—	—	—
Total	34	100	34	100	34	100	34		34	100	34	100

From table 4.18, it is found that out of 21 out of 34 respondents are strongly agreed that personal integrity of the borrower is taken into consideration as a basis for loan floatation in Nepalese banks. 76.5% respondents were only agreed that security offered as a basis for loan floatation. Respondents have given mixed opinion that financial strength is a basis for loan floatation in banks. And 11 out of 34 i.e. 32.4% respondents are strongly disagreed that relationship of the borrower with top authority as a basis for loan floatation in Nepalese commercial banks.

Follow up practice to recover the loan in commercial banks Another reason to increase the non performing loan is due to weak follow up system in commercial banks. After taking loan, most of the borrowers thinks, if bank did not call me loan would not be repaid. As a result, there is an increase of bank's non performing loans. Four alternatives were assigned to the respondents about the period of follow up after the maturity of loan. These were seven days, fifteen days, one month and one month onward.

Table 4.19

Follow up practice to recover the loan in commercial banks

Follow up period	Frequency	Percent	Cumulative percent
a. within 7 days of overdue period	10	29.4	29.4
b. within 15 days of overdue period	10	29.4	58.8
c. within 1 month of overdue period	4	11.8	70.6
d. within 1 month onward	10	29.4	100
Total	34	100	

Above analysis depicts that 10 out of 34 respondents specified the follow up system starts in their organization within 7 days of overdue period and same number of respondents specified the follow up system starts within 15 days of overdue period. So it can be concluded that highest number of respondent agreed within 15 days of overdue period as a whole the follow up starts. In other words, 15 days later the maturity of the loan the follow up starts in Nepalese commercial banks.

4.4.2 Internal Reasons of Turning Good Loan into Bad Loan

For the increment of NPA, bank's internal things are also responsible greatly. For this purpose researcher has tried to draw employees' opinions of the sample banks regarding various subject related to banks' internal environment. Respondents were requested rank eight factors and these factors are mismanagement, Bad intention of borrower, weak monitoring, lacking on portfolio analysis, shortfall on security, weak legal provision, credit concentration and not having effective credit policy.

Table 4.20

Rank of the External Reasons Turning Good Loan into Bad Loan

S.N.	Variable	Mean Rank
1.	Mismanagement	3.68
2.	Bad Intension	2.59
3.	Weak Monitoring	3.26
4.	Portfolio Management	5.24
5.	Shortfall on security	4.32
6.	Weak legal provision	5.53
7.	Credit concentration	5.88
8.	Credit policy	5.5

Table 4.20 shows that respondents have ranked more important to bad intention of borrower as a internal reason for turning good loan to bad loan in Nepalese commercial banks. They have ranked after this are weak monitoring and mismanagement at average level. Some factor such as portfolio management, shortfall on security, credit concentration and credit policy were identified as less importance on the matter for turning good loan to bad loan in bank.

4.4.3 External Reasons for Turning Good Loan into Bad Loan

External environment is a major factor that affects organization's efficiency. External can also play role for turning good loan to bad loan. Five relevant factors were supplied to the respondents to rank them. These factors are economic and industrial recession, high and conservative provisioning requirement, not having strong legal provision for the recovery of dues, inconsistency on government policy and lack of monitoring and supervision from NRB.

Table 4.21

Rank of the External Reasons Turning Good Loan to Bad Loan

S.N.	Variable	Mean Rank
1.	Economic and industrial recession	2.29
2	High and conservative provisioning requirement	4.21
3	Not having strong legal provision for the recovery of dues	3.03
4.	Inconsistency on Govt. policy	3.03
5.	Lacking on monitoring and supervision from NRB	2.44

From table 4.21, it can be said that economic and industrial recession has played a significant role for turning good loan to bad loan. Respondents have ranked lacking on monitoring and supervision from NRB in second place in cause for NPA. They have ranked at the least preferred to high and conservative provisioning requirement for increasing non-performing in Nepalese commercial banks. Not having strong legal provisions for the recovery of the dues and inconsistency on government policy are ranked in an average level by the respondents.

Descriptive statistics of respondents are collected in items designed to assess the external reasons for NPA growth. A set of questions designed to collect the opinion of the employees. Six statements relating to reasons behind NPA growth provided to the respondents to rate their agreement on them. These statements were related to economic and industrial recession, inconsistency government policy, high and conservative provisioning requirement, lacking on monitoring and supervision from NRB, in absence of strong legal provision for loan recovery and due to political, bureaucratic and external pressure loan is being floated without being choosy. The opinion of the respondents has been tabulated then processed so that the external factors so that the external factors that cause NPA growth mostly in commercial banks could be analyzed. Following table represents the descriptive statistics of the responses collected from the respondents.

Table 4.22
External Causes for NPA Growth

External reasons	Mean	Std. Dev.
a. economic and industrial recession	1.76	0.61
b. inconsistency on Govt. policy	2.26	0.86
c. high and conservative provisioning shows NPA level high	2.88	1.04
d. lacking on strong and timely monitoring	1.88	0.98
e. not having strong legal provision for loan recovery	2.00	0.78
f. political, bureaucratic and external pressure of float loan	2.44	1.02

Similar to the earlier findings, mean value shows economic and industrial recession is the main causes of increasing NPA. In other words, respondents gave most attention for the increment of NPA at this category. They identified lacking on strong and timely monitoring and supervision from NRB and not having strong legal provision for loan recovery as a second and third most important category respectively for the cause of increasing in Nepalese commercial banks. Respondents did not give much emphasis on other category, viz, inconsistency on government policy, high and conservative provisioning and political, bureaucratic and external pressure of float loan.

Table 4.23
Analysis of External Causes of NPA growth

Range	Economic and Industrial		Inconsistency on Government		Conservative Provisionin		Monitoring and Control		Weak legal System		Political and Buearacracic Pressure	
	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%
Strongly	11	32.4	4	11.8	4	11.8	14	41.2	8	23.5	4	11.8
Agreed	20	58.8	21	61.8	6	17.6	13	38.2	20	58.8	18	52.9
Neutral	3	8.8	6	17.6	16	47.1	5	14.7	4	11.8	7	20.6
Disagree	—	—	1	5.9	6	17.6	1	2.9	2	5.9	3	8.8
Strongly	—	—	1	2.9	2	5.9	1	2.9	—	—	2	5.9
Total	34	100	34	100	34	100	34	100	34	100	34	100

From Table 4.23, it can be said that 31 out of 34 respondents are strongly agreed and agreed that economic and industrial recession is the cause of NPA growth. However 41.2 respondents are strongly agreed that lacking monitoring and control system of NRB is the cause of NPA growth. But there are 14.7%, 2.9 and 2.9% respondents who have ranked neutral, disagreed and strongly disagreed for the cause of NPA growth is monitoring and control system.

It is therefore, can be generalized that economic and industrial recession and not having strong legal provision for loan recovery are the major external factors that have major contribution for the increasing level of NPA.

4.4.4 Lending Priority by Nepalese Commercial Banks

Different sectors have been involving for the increment of NPA in Nepalese commercial banks. All know that sometimes lending priority of banks cause NPA. Keeping that on mind, some questionnaires have been designed for drawing loan priority field for Nepalese commercial banks. Respondents were asked to weight the industrial, trade, service and other sector for floating loan. The alternatives were the major field of economy where commercial banks can float loan and advances. They were asked to weight from 0% to 100%.

Table 4.24
Analysis of Lending Priority Given by Banks

Economic Field	Mean	Std. Dev.
a. Industrial Sector	.54	.20
b. Trade Sector	.65	.23
c. Service Sector	.45	.20
d. Other sector of economy	.35	.16

Table 4.24 shows that Nepalese commercial banks prefer to give loan to trade sector. It means that banks emphasis trade sector for taking loan. And industrial and service are in second and third place respectively for lending priority, Furthermore, Nepalese commercial banks give less priority for other sectors. The following table makes more clear about the lending priority of banks.

Table 4.25
Analysis of Lending Priority Given by Banks

Weight	Industry		Trade		Services		Others	
	Freq.	%	Freq.	%	Freq.	%	Freq.	%
0.25	7	20.6	4	11.8	15	44.1	24	70.6
0.50	16	47.1	11	32.4	11	32.4	7	20.6
0.75	10	29.4	13	38.2	8	23.5	3	8.8
1.00	1	2.9	6	17.6	-	-	-	-
Total	34	100	34	100	34	100	34	100

Table 4.25 shows 6 out of 34 respondents have given 100% weight to trade sector which indicates the major lending priority given by banks is trading sector. And on the other hand more than 70% respondents have put others sector in less priority sector in less priority sector for lending by banks.

4.5 Major Findings

After the analysis is has been found that though there is negative growth of NPA in case of all sample banks but the growth of operating profit is negative of both banks except FY 2062/063 for RBB. The reason behind this is the need to maintain loan less provisioning as per NRB's guidelines. Thus it can be said that the profitability is affected by NPA because significant portion of operating profit is used for maintaining loan loss provisioning which results negative growth of profits. On the other hand net profit is growing slowly because of non operating incomes and other gains.

Relationship with growth and expansion of credit, there is some relationship between credit expansion and increment on NPA. In general, expansion of loan level so some extent can be regarded as one of the reason of NPA increment. The correlation coefficient between loan and NPA of NBL, which is perfectly positively correlated, one of the cause of increment of NPA is loan portfolio. But the relationship of loan and NPA of RBB, we found different conclusion. Correlation coefficient between NPA and loan of RBB is negative which indicates inverse relationship of their relationship is insignificant.

Findings showed that NBA is created due to having NPA. It is cannot said that whenever there is NPA it always creates NBA as on some occasion bank may not auction the property after acceptance of the same I the name of the bank is disposed off. The correlation coefficient between NPA and NBA of both sample banks has come negative which indicates that we cannot say increment of NPA resulting increase in NBA.

From the analysis, it can easily found that none of the bank has been following NRB's directives regarding loan loss provision diligently. However, NBL maintains the requirement of loan loss provision in FY 2063/064 only, whereas RBB could not maintain the requirement throughout the study period in all class of loan except pass loan.

Percentage of performing loan to total assets, total loan and total deposit of both banks is increasing slowly, which indicates that both banks are trying to make them financial strong and both bank are giving much time on credit related matters. And also NPL to total assets, total loan and total deposits of both bank are declining significantly but still could not reached in standard level. It shows they are exercising to get over from the situation of huge NPL. But the portion of the bad loan in NPL of both banks is highest among other loan class which shows banks are still needs to be focused on defaulters continuously.

Present study is concerned about the cause and effect of NPA in Nepalese banking sector. In this regard questionnaire is prepared and drew opinion from bankers of the sample banks. Six different factors have chosen for this purpose, to find out the reasons of NPA increment with commercial banks. Basis of loan floatation procedures, follow up practice carried out by the banks for the recovery of overdue loan outstanding. Internal responsible factor causing NPA growth as well as external factor that has significant impact for NPA growth have been tried to sort out.

Survey design was based on 34 respondents. Out of them 91% are male and rest are female. Likewise around 5.9% of the respondents were senior assistant level staff, 41.2% were assistant manager, 44.1% were deputy manager and 8.8% were senior officers. Most

of the respondents were of below 30 and above 41 from the sample banks out of 34 respondents 14 bankers were from RBB and 20 bankers were from NBL.

Analysis shows that personal integrity of the borrower is given most attention while giving loan by banks. Similarly it is found that portfolio management consideration as the second most adopted basis of floating loan. While monitoring and control, security offered and financial strength were given average emphasis. It is found that commercial banks are giving least weight on relationship of borrowers with top priority as a basis for floating loan.

Nepalese commercial banks start to follow up after the maturity of loan after 15 days if we look at the opinion of the respondents. Where 29% respondents agreed their bank starts to follow up within 7 days of overdue and another 29% agreed their banks starts follow up within 15 days of overdue. So it can be said that almost 60% of the respondents agreed their bank starts to follow up after 15 days of loan maturity. It shows NPA growth is not because of flaw of banks' policy but because of other external or internal factors.

In regard to the internal responsible factor that contributes turning good loan into bad loan, some alternatives were on the questionnaire which has been filled by respondents. It is found that bad intensions of borrower, weak monitoring and mismanagement are the most responsible factor for NPA growth. Similarly weak legal provision and credit concentration are found as the least preferred factor in turning good loan into bad. Some factors such as lack of portfolio analysis, not having effective credit policy and shortfall on security were identified as having average effect on NPA growth.

In connection to the external factors it has been found that economic and industrial recession in the cause of NPA growth. Lacking on monitoring and supervision from NRB and absence of strong legal provision for loan recovery have been identified by respondents, second and third major factors for increasing NPA. Likewise, respondents give least emphasis that high and conservative provisioning requirement as a reason for the increment of NPA.

It is tried to find out the economy sector where the commercial bank are giving emphasis for lending. After collecting and analysis regarding this area, it is found that more emphasis is given for trading sector and thereafter industry sector. So it can be inferred that most of the NPA is belong to these two sectors. However, less weight is given by respondent to other sectors.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

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

In Nepalese case, RBB and NBL are suffering from the high level of NPL problems. Researchers have tried to find out the causes and effects of NPL, as well as the situation of these two biggest commercial banks of Nepal. From the fiscal year 2062/063 net profit of overall commercial banks has started to be positive and on the other hand overall NPA is decreasing slowly. There has been positive gross and net profit of NBL since FY 2062/063, whereas the increment is negative because the major chunk of profit has been allocated for maintaining loan loss provisioning required by NRB. It is found same situation in case of RBB. However, indication of positive increase in net profit is a good sign for the management of bank.

Total loan of commercial banks of Nepal is increasing till the FY 2063/064, but in FY 2064/065 growth of the loan is declined. And in the FY 2063/064 growth of NPA is positive and in the FY 2064/065 it is negative by 6.93%. So it can be said that banks have been adopting less loan aggressive policy. But in the case of NBL, growth of both total loan and NPA are negative which shows their deep concern over controlling non-performing assets. However, growth of total loan is positive in the FY 2063/064 and FY 2064/065, but in the same time growth of NPA is negative of RBB.

For the analysis of relationship with NPA growth and expansion of credit it has been found that there is some relationship between credit expansion and increment on NPA. NBA is created due to having NPA. But it is not certain that NPA always created NBA. About the data regarding NBA, NBL has provided only two years data. And after analysis, NPA level of NBL is decreasing whereas the level of NBA has been increased highly. And in case of RBB, same scenario can be found. Where growth of NPA is negative but growth of NBA in some year is negative but mostly positive.

Both banks have not followed the provision requirement of NRB. NBL only could maintain the provision regarding all class of loan in the FY 2063/64 whereas RBB could maintain the required provision by NRB throughout the study period except for pass loan in the FY 2064/065.

Analyzing different ratios of RBB, it can be said that the condition of bank is improving slowly. Higher level of performing loans in total assets, total deposits and total loan represents the sound financial health of the organization. Similarly higher level of performing loan to total deposits attracts deposits while lower level **of performing** loans creates threatens to the depositors of loosing their deposits. And the portion of the bad loan in total NPA is increased till the FY 2063/064, but in the FY 2064/065 the ratio is decreased which says the condition of the banks is improving. And we can found that the same scenario in the case of NBL.

Analysis shows that personal integrity of the borrower is given most attention while giving loan by banks. Similarly it is found that portfolio management consideration as the second most adopted basis for floating loan. While monitoring and control, security offered and financial strength were given average emphasis. It is found that commercial banks are giving least weight on relationship of borrowers with top priority as a basis for floating loan.

Nepalese commercial bank starts to follow up after the maturity of loan after 15 days by the opinion of the respondents. Where 29% of the respondents agreed their banks starts within 7 days of overdue and another 29% agreed their banks starts to follow up after 15 days of loan maturity. It shows NPA growth is not because of flaw of banks' follow up policy but because of other external or internal factors.

In regard to the internal responsible factor that contributes turning good loan into bad loan, it is found that bad intension of the borrower; weak monitoring and mismanagement are the most responsible factor for NPA growth. Similarly weak legal provision and credit concentration are found as the least preferred factor in turning good loan into bad. Some factors such as lack of portfolio analysis, not having effective credit policy and shortfall on security were identified as having average effect on NPA growth.

In connection to the external factors it has been found that economic and industrial recession is the cause of NPA growth. Lacking on monitoring and supervision from NRB and absence of strong legal provision for loan recovery have been identified by respondents, second and third major factors for increasing NPA. Likewise, respondents give least emphasis that high and conservative provisioning requirement as a reason for the increment of NPA.

It was tried to find out the economy sector where the commercial bank are giving emphasis for lending. After collecting and analysis of data regarding this area it is found that more emphasis is given for trading sector and thereafter industry sector. So it can be

inferred that most of the NPA is belong to these two sectors. However, less weight is given by respondents to other sectors.

It can be sum up that the condition of these two banks is improving sluggishly. So more works should be done to minimize the level of NPA, to control the bad debt, to make loan recovery efficiently and effectively. The situations of these two banks are still below than others' commercial banks, which has less than 5% NPA and managing them efficiently and effectively.

5.2 Conclusion

) Present research is very much important to analyze cause and effect of NPA. From secondary information, there is positive gross profit and net profit for the banks from the FY 2061/62, but growth of profits is negative. Because of the loan loss provision required by NRB's rules, major portion of profit goes to provision as a result in level of net profit decline. Mounting problem of NPA make these banks to adopt less aggressive policy towards loan. That is why the growth of loan is increasing very slowly. They are much more concerned about the problem of NPA and giving required concentration need to make good loan, there is close relationship of loan and NPA of NBL, so whenever there is credit expansion, NPA will increased. But in the case of RBB, the relationship between loan and NPA is insignificant. That means there is a inverse relationship between loan and NPA.

) It is found that there is not direct relationship between NPA and NBA. In general, there is not significant relationship between NPA and NBA. In general, there is no significant relationship between NPA and NBA. NBA is created due to having NPA. But it is not certain that NPA always creates NBA. From the analysis we can say that when there is NPA increment bank take action and auction the property held in its custody. Some times situation occurs where bank has to accept the property in its own name due to this there is increment of NBA. The case of both bank reveals that either bank has not auctioned the property or situation prevails so where bank has not accepted the property in its own name. Same time bank might

have been sold some portion of NPA. After analyzing primary information, personal integrity of the borrower is given most attention while giving loan by banks. Similarly portfolio management consideration as the second most adopted basis for floating loan. While monitoring and control, security offered and financial strength were given average emphasis. Commercial banks are giving least weight on relationship of borrowers with top authority as a basis for floating loan.

- J Nepalese commercial banks start to follow up after the maturity of loan after 15 days. Where 29% respondents agreed their bank starts to follow up within 7 days of overdue and another 29% agreed their bank starts to follow up within 15 days of overdue. So it can be said that almost 60% of respondents agreed their bank starts to follow up after 15 days of loan maturity. It shows NPA growth is not because of flaw of banks' follow up policy but because of other external or internal factors.
- J In regard to the internal responsible factor that contributes turning good loan into bad loan, bad intention of borrower, weak monitoring and mismanagement are, the most responsible factor for NPA growth. Similarly weak legal provision and credit concentration are found as the least preferred factor in turning good loan into bad. Some factors such as lack of portfolio analysis, not having effective credit policy and shortfall on security were identified as having average effect on NPA growth.
- J In connection to the external factors, economic and industrial recession is the cause of NPA growth. Lacking on monitoring and supervision from NRB and absence of strong legal provision for loan recovery has been identified second and third major factor for increasing NPA. Likewise, least emphasis is given high and conservative provisioning requirement as a reason for the increment of NPA.
- J It is tried to find out the economy sector where the commercial bank are giving emphasis for lending. After collecting and analysis of data regarding this area it is found that more emphasis is given for trading sector and thereafter industry sector. So it can be inferred that most of the NPA belongs to these two sectors. However,

less weight is given by respondents to other sectors. Present research might be useful to address the problem of increasing level of NPA.

5.3 Recommendations

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

) Internal Capabilities

Internal capabilities of most of the banks and institutions are poor to evaluate, manage, monitor and control the risk of the assets. Following internal measures can help to avoid in its books:

-) Detail analysis to protect from potential fraud, completely know your customer (KYC), assuring that the documents are genuine.
-) Inspect and apprise the physical collateral's by bank staff.
-) Always take the precautionary actions in favor of the bank by analyzing own position and strength, talk with the borrower frequently and understanding the borrower's situation very carefully and initiating precautionary action in time to protect the bank.
-) Book NBA if auctions fail, it makes easier to sell the assets and establish a regular system for loan write-off.
-) Dispose NBA in time of sale before the time if the market price has improved.

The following efforts are required to deal are needed to strengthen the system trough supportive institutions in order to manage high risk assets and reduce the level of NPLs.

) Strengthening of the Capability of NRB

NRB is the supervisory body responsible to maintain sound, stable and competitive financial system. Therefore, the capacity, professionalism and skill of the staffs of these institutions should be enhanced to cope up with the development in the financial system.

) Establishment of Asset Management Company

Focused institutions such as AMC could be helpful to manage the high risk assets and reduce the level of NPL. Special purpose vehicle such as AMC are required to manage distress assets of the banks and financial institutions. Nepal does not have such type of institution, therefore, such type of institution should be established as soon as possible. The draft act was prepared and presented to the government two years ago but it has not yet been enacted. Some problems which can not be resolved through DRT, can be solved through AMC.

) Additional Legislative Support is Required to Deal with Banking Problems

Debt Recovery Tribunal (DRT) and Affiliate Court has been established as per Debt Recovery Act 2002. But the acute problem of high risk associated with banking business is demanding some other kind of institutions to support them. Effective and Efficient notary public office could solve the problems associated with negotiable instruments and bills.

Similarly financial legislation should be strengthened by promulgating bankruptcy law, banking fraud control law, AMC law, Asset Securitization law and Trustee law etc.

) Enhancing of Bank and Borrower Relationship

This is a crucial issue that is not being developed, as it should be in the economy. Sometimes, banks are fully against the defaulters of all types and do not hear their problems. Some borrowers only blame the bank instead of showing their genuine constraints and convincing the banks. The bank and borrowers have the equal role in the financial system. Without borrowers the bank can not survive and without bank the borrower can not expand its activities. Therefore, the borrower should maintain a good relationship with the bank and make fully aware about their business condition all the times. Defaulting borrower should prove to the bank that he has made every possible effort to pay the debt. A good co ordination and healthy environment should be created by both the parties.

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