

# **CHAPTER - I**

## **INTRODUCTION**

### **1.1 Background of the Study**

The most important financial institutions in the economy are called banks. Without the presence of bank, we cannot imagine about the economic development of country. Generally, the institution that does the transaction of money and cheque is called bank. In modern age an institution which issues currency is not called bank, there are several bank e.g. agricultural development banks, industrial bank, commercial bank, joint-stock bank, co-operative bank, rural development bank, development bank, etc. Now, a days we can find several changes in banks because of increase in population, changes in industrial and business field, starting of competitive age, relation with foreign countries, changing view of people, etc. Bank is distinctly identified because of its function performed in the economy. There are several financial institution, security dealers, brokerage firm and insurance company trying to offer services as bank, in this condition meaning of bank should be clear. Hence, there are some definitions:

According to CROWTHER, “The banker’s business is to take the debts of other people to offer his own in exchange and thereby create money.”

According to Chamber’s twentieth century dictionary, “Bank is defined as an institution for keeping, lending and exchange, etc of money.”

According to KENT, “A bank is an organization whose principle operations are concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to others for expenditure.”

In addition, according to SAYERS, ordinary banking business consists of changing cash for bank deposits in exchange for bills of exchange, government bonds, the secured or unsecured promises of businessperson to repay, etc.

It is clear from above definitions that a bank is an institution, which accepts deposits from the public and in turn advances loans by creating credit. However, other institutions only accept deposits and cannot create credit. According to U.S law, any institution offering deposits subject to withdrawal on demand and making loans of a commercial or business nature is a bank. In conclusion, banks are those institutions that offer the widest range of financial services, like credit savings and payments services and perform the widest range of financial function of any business firm in the economy.

The first bank was established in Venice, Italy in 1157, called “Bank of Venice.” banking system was started from the merchant banker by trading in commodities than money. The next stage is goldsmith. Gold smith started to take charge for caring bullion, money and jewelry. As evidences, he used to issue a receipt to the depositors that became the modern cheques as a medium of exchange and a means of payment. Lastly, goldsmith started charging interest on advancing coins on loan. In this way, gold smith became moneylender by performing two functions, accepting deposits and advancing loan.

Hence, among most of the infrastructures, financial infrastructure has a vital role as banks/finance/insurance companies are needed for all the infrastructure development. Banks constitute an important segment of financial infrastructure of any country. Bank came into existence mainly with the objective of collecting the idle funds and mobilizing them to productive sectors in the form of loans and advances causing overall economic development, which finally leads to national development of the country.

As banking sector is a key of economic growth to developing country, modern banking systems have been characterized by frequent and widespread bank failure. Even advanced countries with sophisticated banking practices and supervision have periodically experienced large scale banking distress. In the United States, for example, in a period of high interest rates in the early 1980s the collapse of oil and real estate prices brought another wave of bank failure. Virtually no country is immune to banking crisis. According to recent crisis, more than 130 countries have suffered major bank failures in the past two decades. In many cases, the impact on the economy has been devastating. In Argentina, Estonia and Poland more than half the banks failed in recent banking turmoil. The amount of public money needed to resuscitate the failed banks often staggering.

Banks have access to unusually high leverage. In banking, unlike non-banking firms, debt-equity ratio of high i.e. 10 to 1 is considered prudent. Such leverage intensifies business risk. With fractional reserve requirements, bank may end up with no cash on hand to pay depositors. They can borrow from other banks or from the authorities, but

only within limits. Bankers also face the risk of insolvency. If bank loses a fifth of its assets value, it is technically insolvent and may be taken over by regulators. Hence, to protect the banks from such situation and protect depositors and shareholder's money central bank issues various directives and guideline from time to time with modifications and amendments for sound regulation of the banking system.

### **1.1.1 Origin and Development of Commercial Banks**

The history of commercial bank in Nepal begins from the establishment of the Nepal bank on 1994 B.S. It was the first commercial bank in Nepal then another commercial bank called Rastriya Banijya Bank. However, in 2031B.S both Rastriya Banijya Bank and Nepal Bank Ltd. were unified under commercial bank act. This was the milestone in the foundation of modern banking system in Nepal.

Modern banking practices emerged with the establishment of Nepal bank limited. However, the establishment of Nepal Bank Limited alone in total monetary and financial sector was not sufficient and satisfactory. Thus, Nepal Rastra bank was set up on 14<sup>th</sup> Baishak, 2013 as a central bank under Nepal Rastra Bank Act 2012 B.S. Similarly, on 2022 Rastriya Banijya Bank was established as a fully government owned commercial bank. With the emergence of RBB, banking service spread to both the urban and rural areas but customers failed to have taste of quality, competitive service because of excessive political and bureaucratic interference. With the concept of industrial development of the nation, Industrial Development Corporation (NIDC) was set up in 2013 B.S.

Similarly, to develop and support agricultural products so that agricultural productivity could be enhanced through introduction of modern agricultural techniques, Agricultural Development Bank was established on 2024 B.S. Agricultural Bank has the responsibility at performing commercial functions, since 2041 B.S in Nepal.

The first commercial bank was started with the paid up capital Rs. 8, 45,000. It started its business by accepting deposits from the public by collecting Rs. 17, 02,000 or 51% of the government equity and rest 49% of the general public i.e.100% government ownership.

Nepalese economy has adopted the policy of privatization, liberalization and globalization since 1980. As a result, private sector banks with joint venture begin to emerge. NABIL Bank Limited is the first joint venture bank, which was established when the banking industry was totally dominated by government and semi-government banks. Because of liberal economic policy adopted by the successive governments, many commercial banks have been established all over the kingdom.

Following is the list of commercial banks that have been came into existence in Nepalese banking industry after liberalization policy adopted by the nation as on 15<sup>th</sup> July 2006.

**Table 1.1**  
**List of Licensed Commercial Banks**  
**Mid-July 2008**

| S.No. | Names                                  | Operation Date<br>(A.D.) | Head Office               | Paid up<br>Capital<br>(Rs. In<br>Million) |
|-------|--|--------------------------|---------------------------|---|
| 1     | Nepal Bank Limited                     | 1937/11/15               | Kathmandu                 | 380.4                                     |
| 2     | Rastriya Banijya Bank                  | 1966/01/23               | Kathmandu                 | 1172.30                                   |
| 3     | Agriculture Development Bank Ltd.      | 1968/01/02               | Kathmandu                 | 9278.00                                   |
| 4     | NABIL Bank Limited                     | 1984/07/16               | Kathmandu                 | 689.20                                    |
| 5     | Nepal Investment Bank Limited          | 1986/02/27               | Kathmandu                 | 1203.00                                   |
| 6     | Standard Chartered Bank Nepal Ltd.     | 1987/01/30               | Kathmandu                 | 620.80                                    |
| 7     | Himalayan Bank Limited                 | 1993/01/18               | Kathmandu                 | 1013.50                                   |
| 8     | Nepal SBI Bank Limited                 | 1993/07/07               | Kathmandu                 | 874.50                                    |
| 9     | Nepal Bangladesh Bank Limited          | 1993/06/05               | Kathmandu                 | 744.10                                    |
| 10    | Everest Bank Limited                   | 1994/10/18               | Kathmandu                 | 831.40                                    |
| 11    | Bank of Kathmandu Limited              | 1995/03/12               | Kathmandu                 | 603.10                                    |
| 12    | Nepal Credit and Commerce Bank Ltd.    | 1996/10/14               | Siddharthanagar,Rupendehi | 1275.80                                   |
| 13    | Lumbini Bank Limited                   | 1998/07/17               | Narayangadh,Chitawan      | 750.00                                    |
| 14    | Nepal Industrial & Commercial Bank Ltd | 1998/07/21               | Biaratnagar,Morang        | 792.00                                    |
| 15    | Machhapuchhre Bank Limited             | 2000/10/03               | Pokhara, Kaski            | 821.70                                    |
| 16    | Kumari Bank Limited                    | 2001/04/03               | Kathmandu                 | 900.00                                    |
| 17    | Laxmi Bank Limited                     | 2002/04/03               | Birgunj, Parsa            | 732.00                                    |
| 18    | Siddhartha Bank Limited                | 2002/12/24               | Kathmandu                 | 790.00                                    |
| 19    | Global Bank Ltd.                       | 2007/01/02               | Birgunj, Parsa            | 700.00                                    |
| 20    | Citizens Bank International Ltd.       | 2007/6/21                | Kathmandu                 | 560.00                                    |
| 21    | Prime Bank Ltd                         | 2007/9/24                | Kathmandu                 | 700.00                                    |
| 22    | Sunrise Bank Ltd.                      | 2007/10/12               | Kathmandu                 | 700.00                                    |
| 23    | Bank of Asia Nepal Ltd.                | 2007/10/12               | Kathmandu                 | 700.00                                    |
| 24    | Development Credit Bank Ltd.           | 2001/01/23               | Kamaladi, Kathmandu       | 301.00                                    |
| 25    | NMB Bank Ltd.                          | 1996/11/26               | Babarmahal, Kathmandu     | 1000.00                                   |

*Source: Nepal Rastra Bank's Banking & Financial Statistics, Mid July 2008*

### **1.1.2 Introduction of Non-Performing Assets**

Since, banking sectors are the backbone of a country's economy. Commercial banks exist to mobilize the financial resources by investing the same in a profitable manner. The resources may include capital funds consisting of shareholder's equity, money deposited by the people, borrowings and profit capitalization. Any competent bank means the utilization of the resources on optimum way increasing the revenues and reducing its costs. Therefore, the profit here should be adequate to meet its costs of funds as well as these should be same margin left over as the reward for risk bearing. Hence, some profits are always desirable for their continued survival.

Among all available financial resources mobilized by banks, big amounts of resources are being utilized on loan and advances. The return from loan floatation is higher than the return from any other activities, commercial bank are concentrating their financial activities for their management of loans and advances. By virtue of principle for higher return, higher risk should be taken and vice versa. Since, numbers of commercial banks are being increasing there is also high competition.

Economic condition is not in good condition as well as no any new investments avenues are being explored. The competition among the banks is just to share from the small and same size of the cake.

The marginal opportunity for getting avenues for loan floatation has compelled the banks to finance without being choosy quality of the loans and advances can not be maintained to the desirable level if there is no choice whether to finance or not. Once,

loan is given it is supposed that the re-payment of interest or principle shall have to be served without any impediment. It will be very difficult when resources can't not be utilized properly when the loans provided to the clients can't be regular and if there is a cumulative overdue outstanding. Loans are provided by banks for different purposes by taking some collateral. There may be various reasons behind the loans that turn irregular from regular one. One of the reasons may be economic condition of the country that has global and far-reaching impact. If economy of the country functions weak, it will be possible for smooth operation of banking business.

Satisfactory level of return on investment is the pre-requisite for the financial sector to be groomed. The other factors that turn the good loan into bad are the attitude of the borrower, types and quality of collateral taken and legal complications created by the borrower during the loan recovery process.

So, due to such factors mentioned above reduction of NPA has always been a major problem for every commercial bank and in recent days, NPA management has been top priority for banks. Once loan is given, proper management of NPA has always been nerve-racking task for banks and whole banking industry now is struggling to get rid of it through various means. Once, the disbursed loan is not paid back timely by clients and becomes overdue it is said to be NPA in terms of banking terminology. Once loan is given, proper management of NPA has always been nerve-racking task for banks and whole banking industry now is struggling to get rid of it through various means.



Therefore, bank should follow loan management process. In banking sector or transaction, an unavoidable ness of loan management and its methodology (working method) is regarded very important. Under this management, many subject matters are considered and thought. For, e.g. there are the subject matters like the policy of loan flow, loan administration, audit loan, renewal of loan, the condition of loan flow, the documents of loan flow, the provision of security, the provision of the payment of the capital and its interest and other such procedures. This management plays a great role in healthy competitive activities.

What sort of credit policy a bank should have is also a very sensitive subject, so it should pay more attention to the loan and advances it provides. The deposits are deposited in a bank, from many sectors such as person's organizations and institutions, which makes the banks more responsible for their functions. The commercial banks are inspired with the motive of gaining profit. To fulfill this objective, they should widely manage and improve its banking sector. They must pay much more attention to the flow of loan. Regarding loan policy, it should make clear to its policy and view. In fact, the bank should follow the credit policy, which would match the economic policy of the Nepal Rastra Bank or country to more and more profit. Otherwise, the bank cannot be successful in its goal.

Hence, the bank should pay its attention to make its investment wide and to lead the bank towards the way of economic consolidation by creating the good environment to recover the amount with the interest. The operation of the banking institution has been governed by the government rules and regulations, international industry norms,

relevant acts, memorandum of association (MOA), article of association (AOA), instruction given at the time of getting intent and directives issued by central bank from time to time. Similarly, the expectations are supposed to confine their activities within the stated framework.

**Table 1.2**

**The Non-Performing to Total Gross Loan Status of Individual Bank  
(Rs. In million)**

| S.N        | Name of Bank                                | Mid-<br>July<br>2003                       | Mid-<br>July<br>2004                       | Mid-<br>July<br>2005                       | Mid-<br>July<br>2006                       | Mid-<br>July<br>2007                       | Mid-Jan<br>2008                            |
|------------|---|--|--|--|--|--|--|
|            |   | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) |
| 1.         | Nepal Bank Limited                          | 60.47                                      | 53.74                                      | 49.64                                      | 25.11                                      | 14.60                                      | 14.02                                      |
| 2.         | Rastriya Banijya Bank                       | 66.15                                      | 57.64                                      | 52.99                                      | 45.34                                      | 26.43                                      | 27.03                                      |
| 3.         | NABIL Bank Limited                          | 5.54                                       | 3.35                                       | 1.32                                       | 1.25                                       | 1.12                                       | 1.08                                       |
| <b>4.</b>  | <b>Nepal Investment Bank Limited</b>        | <b>1.98</b>                                | <b>2.47</b>                                | <b>2.69</b>                                | <b>2.30</b>                                | <b>2.12</b>                                | <b>1.69</b>                                |
| 5.         | Standard Chartered Bank Nepal Ltd.          | 4.13                                       | 3.77                                       | 2.69                                       | 2.12                                       | 1.83                                       | 1.48                                       |
| <b>6.</b>  | <b>Himalayan Bank Limited</b>               | <b>10.08</b>                               | <b>8.88</b>                                | <b>7.44</b>                                | <b>6.14</b>                                | <b>3.53</b>                                | <b>3.16</b>                                |
| 7.         | Nepal SBI Bank Limited                      | 11.71                                      | 6.25                                       | 6.54                                       | 6.32                                       | 0.46                                       | 4.34                                       |
| 8.         | Nepal Bangladesh Bank Limited               | 12.73                                      | 10.81                                      | 19.04                                      | 12.27                                      | 35.13                                      | 38.72                                      |
| <b>9.</b>  | <b>Everest Bank Limited</b>                 | <b>2.20</b>                                | <b>1.72</b>                                | <b>1.63</b>                                | <b>1.20</b>                                | <b>0.76</b>                                | <b>0.64</b>                                |
| 10.        | Bank of Kathmandu Limited                   | 8.67                                       | 6.66                                       | 4.49                                       | 2.52                                       | 2.20                                       | 2.44                                       |
| <b>11.</b> | <b>Nepal Credit &amp; Commerce Bank Ltd</b> | <b>20.63</b>                               | <b>12.72</b>                               | <b>8.46</b>                                | <b>11.09</b>                               | <b>30.63</b>                               | <b>25.82</b>                               |
| 12.        | Lumbni Bank Limited                         | 11.57                                      | 7.36                                       | 15.23                                      | 31.97                                      | 19.85                                      | 14.93                                      |
| 13.        | Nepal Industrial & Comm. Bank Ltd.          | 6.66                                       | 3.92                                       | 3.78                                       | 2.60                                       | 1.10                                       | 0.84                                       |
| <b>14.</b> | <b>Macchapuchhre Bank Limited</b>           | <b>2.08</b>                                | <b>0.98</b>                                | <b>0.39</b>                                | <b>0.28</b>                                | <b>1.12</b>                                | <b>1.67</b>                                |
| 15.        | Kumari Bank Limited                         | 1.70                                       | 0.76                                       | 0.95                                       | 0.90                                       | 0.73                                       | 0.85                                       |
| <b>16.</b> | <b>Laxmi Bank Limited</b>                   | <b>0.00</b>                                | <b>0.00</b>                                | <b>1.63</b>                                | <b>0.65</b>                                | <b>0.35</b>                                | <b>0.30</b>                                |
| 17.        | Siddhartha Bank Limited                     | 0.00                                       | 1.61                                       | 2.58                                       | 1.35                                       | 0.34                                       | 0.32                                       |
| 18.        | Agricultural Development Bank Ltd.          | --   | --   | --   | 21.23                                      | 16.50                                      | 18.58                                      |
| 19.        | Global Bank Limited                         | --   | --   | --   | --   | 00   | 00   |
| 20.        | Citizen Bank International Ltd.             | --   | --   | --   | --   | --   | --   |
|            | <b>Total</b>                                | <b>28.80</b>                               | <b>22.77</b>                               | <b>18.94</b>                               | <b>14.22</b>                               | <b>9.65</b>                                | <b>8.94</b>                                |

Source: Banking and Financial Statistics of Nepal Rastra Bank, Mid July, 2008

*(Note: Agricultural Development Bank Limited doing Commercial Transaction)*

## 1.2 Focus of the Study

NPA may be defined as the bad debt. NPA in terms of banking sector consists of those loans and advances, which are not performing well and likely to turn as bad loans.

Among the functions of CB, one of the functions is to provide loan. A Commercial Bank provides loans to a person, company and institutions, etc. A bank can earn a lot of profit from it. A bank is capable to gain benefit in its banking development by receiving the interest as per law and its internal policies. It provides the loan by accepting the security of debtor. A bank can flow the loan against a third person's guarantee or with the pledge of the third person. A bank provides loan based on agreement or deed of loan. It provides loan based on following deed securities.

- ) With the pledge of goods
- ) With the pledge of gold and silver
- ) With the security of immovable property
- ) With the security of other similar goods

Despite these precautions, also some banks are not performing well. NPA as per current directives of NRB central bank of Nepal has been categorized as classified loans and advances according to their nature and overdue timings. NPA has high, impacts on the financial institutions. On the one hand, the investment becomes worthless as expected return cannot be realized and while on the other, total profitability is directly affected due to the provisioning required for the risk mitigation. The existence of the bank can be questioned on this situation. Thus,

interest along with principal has to be recovered timely and without any obstacles. NPA's problem arises due to irregularities in distribution of loans are also a problem in banking sector. A bank should provide loan into the productive and fair procedure. In addition to it, loan should be granted against the pledge, guarantee or similar types of security on the completions of legal procedures. The loan given in such a way will not have any possibility of being lost in future. If the debtor fails to repay in fixed time limit, the bank can recover the principal amount and interest by applying the legal process. It is unfortunate that the banks are getting in more problems as they:

- ) Grant a large sum of loan in defective security,
- ) Take the commission while granting loan,
- ) Show unnecessary slowness in providing loan,
- ) Provide the loan in absence of appropriate security,
- ) Do not start the legal action, if the loan is not returned on stipulated time.

Therefore, the principal amount and interest of the loan given by a bank is lost and cannot be recovered.

NRB categorized NPA as classified loans and advances. For the probable loss on lending, which cannot be recovered even after liquidation of security held with banks, NRB has directed Commercial Banks to maintain loan loss provisioning according to aging basis for mitigation. The loan loss provision is to be maintained by debiting profit account. Thus, as the quality of loan degrades the ratio of loan loss provision is increased affecting the profitability of the banks. This study will be focused on the relationship of NPA on profitability of the commercial bank.

Management of NPA has led the banks towards the meticulous recovery action, which ultimately may cause auctioning of the collateral held with bank's custody. In 2007 year, 80 big industrialists were black listed for not paying loan in fixed time. Therefore, such collateral will be burden for banks. Due to adverse economic situation of the country and perception, build up among the people that the properties under auction are always over evaluated. There is less participation of the bidder during auction. Such situation compels the banks to accept the security on its own name. Continuous acceptance of the ownership has now created another problem by piling up the volume of Non Banking Assets (NBA). As the major chunks of NBA are fixed in nature, the funds supported to be rolled over are being tied up on fixed asset, which is heating the liquidity of the banks.

This study is focused on the Non-Banking Assets, which are non-performing assets of Commercial Bank. It is confined to analyze the implication of NPA on the profitability of the banks. Nepal Investment Bank, Himalayan Bank, Laxmi Bank and Macchapuchchhre Bank are the sample banks for this study.

### **1.3 Statement of the Problem**

The banking sector has been becoming a victim of huge Non-Performing Asset. Non-performing assets problem has been remained a striking issue of the Nepalese Commercial Banks. High level of NPL indicates the systemic crisis in the financial system. It is an indicator of insolvency, credit crunch, and abnormality. Economic growth cannot be guaranteed without financial development. Legal hurdles, political instability, and strong opposition from defaulters remain the major stumbling block in

reducing the level of NPA. Financial reform cannot realize its intended objectives unless the problem of NPA is resolved.

Lending carries credit risk which arises from the failure of borrower to fulfill its contractual obligation during the course of transaction. It is well known fact that the bank and financial institution in Nepal face the problem of swelling Non-performing assets and issue is becoming more and more unmanageable. The problem is to identify the matter related to the NPAs of the selected commercial bank Nepal Investment Bank, Himalayan Bank, Everest Bank, Nepal Credit and Commerce Bank, Macchapuchchhre Bank and Laxmi Bank. There is a strong correlation between financial development and economic growth and financial development is not possible without a prudent and sound financial system. NPL below 5% is a prerequisite for the stable financial system.

Nepal Rastra Bank's banking and financial statistics of June 2008 shows the levels of Non-performing assets in Nepalese commercial banks. From the data given below the position of Bad Loan can be determined.

**Table 1.3**

**The Non-Performing to Total Gross Loan Status of Individual Bank**

**(Rs. In million)**

| S.N | Name of Bank                                | Mid-July<br>2003                           | Mid-<br>July<br>2004                       | Mid-<br>July<br>2005                       | Mid-<br>July<br>2006                       | Mid-<br>July<br>2007                       | Mid-<br>Jan<br>2008                        |
|-----|---|--|--|--|--|--|--|
|     |   | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) | NPL to<br>Total<br>Gross<br>Loan<br>(In %) |
| 1.  | Nepal Bank Limited                          | 60.47                                      | 53.74                                      | 49.64                                      | 25.11                                      | 14.60                                      | 14.02                                      |
| 2.  | Rastriya Banijya Bank                       | 66.15                                      | 57.64                                      | 52.99                                      | 45.34                                      | 26.43                                      | 27.03                                      |
| 3.  | NABIL Bank Limited                          | 5.54                                       | 3.35                                       | 1.32                                       | 1.25                                       | 1.12                                       | 1.08                                       |
| 4.  | <b>Nepal Investment Bank Limited</b>        | <b>1.98</b>                                | <b>2.47</b>                                | <b>2.69</b>                                | <b>2.30</b>                                | <b>2.12</b>                                | <b>1.69</b>                                |
| 5.  | Standard Chartered Bank Nepal Ltd.          | 4.13                                       | 3.77                                       | 2.69                                       | 2.12                                       | 1.83                                       | 1.48                                       |
| 6.  | <b>Himalayan Bank Limited</b>               | <b>10.08</b>                               | <b>8.88</b>                                | <b>7.44</b>                                | <b>6.14</b>                                | <b>3.53</b>                                | <b>3.16</b>                                |
| 7.  | Nepal SBI Bank Limited                      | 11.71                                      | 6.25                                       | 6.54                                       | 6.32                                       | 0.46                                       | 4.34                                       |
| 8.  | Nepal Bangladesh Bank Limited               | 12.73                                      | 10.81                                      | 19.04                                      | 12.27                                      | 35.13                                      | 38.72                                      |
| 9.  | <b>Everest Bank Limited</b>                 | <b>2.20</b>                                | <b>1.72</b>                                | <b>1.63</b>                                | <b>1.20</b>                                | <b>0.76</b>                                | <b>0.64</b>                                |
| 10. | Bank of Kathmandu Limited                   | 8.67                                       | 6.66                                       | 4.49                                       | 2.52                                       | 2.20                                       | 2.44                                       |
| 11. | <b>Nepal Credit &amp; Commerce Bank Ltd</b> | <b>20.63</b>                               | <b>12.72</b>                               | <b>8.46</b>                                | <b>11.09</b>                               | <b>30.63</b>                               | <b>25.82</b>                               |
| 12. | Lumbni Bank Limited                         | 11.57                                      | 7.36                                       | 15.23                                      | 31.97                                      | 19.85                                      | 14.93                                      |
| 13. | Nepal Industrial & Comm. Bank Ltd.          | 6.66                                       | 3.92                                       | 3.78                                       | 2.60                                       | 1.10                                       | 0.84                                       |
| 14. | <b>Macchapuchchhre Bank Limited</b>         | <b>2.08</b>                                | <b>0.98</b>                                | <b>0.39</b>                                | <b>0.28</b>                                | <b>1.12</b>                                | <b>1.67</b>                                |
| 15. | Kumari Bank Limited                         | 1.70                                       | 0.76                                       | 0.95                                       | 0.90                                       | 0.73                                       | 0.85                                       |
| 16. | <b>Laxmi Bank Limited</b>                   | <b>0.00</b>                                | <b>0.00</b>                                | <b>1.63</b>                                | <b>0.65</b>                                | <b>0.35</b>                                | <b>0.30</b>                                |
| 17. | Siddhartha Bank Limited                     | 0.00                                       | 1.61                                       | 2.58                                       | 1.35                                       | 0.34                                       | 0.32                                       |
| 18. | Agricultural Development Bank Ltd.          | --   | --   | --   | 21.23                                      | 16.50                                      | 18.58                                      |
| 19. | Global Bank Limited                         | --   | --   | --   | --   | 00   | 00   |
| 20. | Citizen Bank International Ltd.             | --   | --   | --   | --   | --   | --   |
|     | <b>Total</b>                                | <b>28.80</b>                               | <b>22.77</b>                               | <b>18.94</b>                               | <b>14.22</b>                               | <b>9.65</b>                                | <b>8.94</b>                                |

Source: Banking and Financial Statistics of Nepal Rastra Bank Mid- July, 2008



As of mid-January 2008, NPL of the Nepalese banking system is 8.94%, which is far higher than the international standard. In case of Nepal Investment Bank level of NPA in Mid July 2003 was 1.98% but in the year 2007 it has been increased to 2.12% and in mid Jan 2008 it has been decreased to 1.69% which indicates that bank's is trying its best to manage its Non performing assets. But in case of Himalayan Bank in 2003 level of NPA was 10.08% but after 5 years i.e. in 2007 it has been decreased to 3.53% and in mid Jan 2008 it has been decreased to 3.16%. That means bank is trying to control the NPA level. Similarly, in EBL the level of NPA was 2.20% in the year 2003 but slowly in 2007 it has been decreased to 0.76% and in mid Jan 2008 it decreased to 0.64%. This bank is also trying to control the level of non performing assets.

But in case of Nepal Credit & Commerce Bank, the trend is fluctuating in 2003 it was 20.63%, in 2004 12.72%, in 2005 8.46%, in 2006 it reached to 11.09%, which has been again reached to 30.63%. It means that there is some loophole or management has not done significant effort for its NPA management which has led the bank to backwardness. From 11.09% it has increased to 30.63%. The difference in one year is 19.54%, this difference initiated to select this bank for the study. But in mid Jan 2008 its NPA is decreased to 25.82%.

In case of Macchapuchchhre Bank Limited range of NPA is not so fluctuating. It was 2.08% in 2003, it decreased to 0.98% in 2004, in 2005 it was 0.39% and in 2006 0.28% but in 2007 it increased to 1.12%. Again in mid Jan 2008 it has been increased to 1.67%. There is also difference in levels of NPA in 1 year. What is the reason behind this increment in NPA level is the main research question.

Laxmi Bank Limited had started its operation in 2002.12.24. In 1<sup>st</sup> and 2<sup>nd</sup> year the level of NPA was Nil. But in 2005 it was 1.63% and in 2006 it decreased to 0.65% and in 2007 it decreased to 0.35%. Similarly, in mid Jan 2008 it has been decreased to 0.30%. Why banks are unable to implement proper policies regarding NPA management. The study is also focused on the level of NPA of joint ventured banks like NIBL, HBL & EBL, NCC and non-joint ventured banks like MBL & LBL. Nepal Investment Bank is joint- ventured with Credit Agricole Indoseuez Bank of France. Himalayan Bank with Habib Bank of Pakistan, Everest Bank with Punjab National Bank of India and Nepal Credit and Commerce Bank is joint-ventured with Bank of Ceylon, Srilanka. But Machapuchchhre Bank and Laxmi Bank has not done partnership with other foreign banks.

Fluctuating trend of NPA, means that Nepalese Commercial Bank have not formulated their investment policy in an organized manner. The implementation of policy is not effective. The credit extended by the CB to agricultural and industrial sector is not satisfactory to meet the present growing need. Government policy changes/ International laws/ Agreement such as SAFTA/ WTO etc also affect the level of NPA in banks. Granting loan against insufficient deposit, overvaluation of goods pledged, land and building mortgaged, risk averting decision regarding loan recovery and negligence in recovery of overdue loan is some of the basic loopholes and the result of unsound investment policy sighted in the bank.

So, the bank has to meet various challenges, this study will be helpful to the bank to identify and solve some of its weakness and problem. In every organization, the resources are scare and out of this scare resource the objective of the organization are

to be accomplished. Increase in revenue and control over expenditure significantly contributes to improve the profit as well as the overall financial performance of an organization by the help of the best utilization of resources.

This study is based on the following research question regarding NPA with special reference to Nepal Investment Bank, Himalayan Bank, Laxmi Bank and Macchapuchhre Bank, Everest Bank and Nepal Credit and Commerce Bank.

- ) What is the level of Non-Performing Assets in selected Commercial Bank?
- ) What is the position of credit risk in selected Commercial Banks?
- ) What are the true causes of Non-Performing Assets increment in selected Commercial Banks?
- ) What are the efforts made to recover the Non-Performing Assets in selected Commercial Banks?

#### **1.4 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, general objective of this study is to analyze and identify the impact cause and consequences of NPA. Besides this, there are some specific objectives that are listed below:

- ) To examine the level of non-performing assets in selected commercial banks
- ) To evaluate the relationship between loan & advances and total deposit, loan loss provision and total loan & advance.
- ) To measure the ratio of credit risk of selected commercial banks.
- ) To measure the returns on loan and advances of selected commercial banks.

### **1.5 Importance of the Study**

Loan and advances are the most profitable of all the assets of a bank. These assets constitute primary sources of income to the bank. It means interest earned from such loan and advances occupy major space in income statement of the bank. As a business institution, a bank aims at making huge profit. Since loan and advances are more profitable than any other assets, banks are willing to lend as much fund as possible. However, bank should be careful about the safety of such loan and advances. It should be reminded that most of bank failures in the world due to the shrinkage in the value of loan and advances. Hence, loan is known as risky asset. Risk of non-repayment of loan is known as credit risk or default risk. Performing loan/assets has multiple benefits while non-performing assets/loan erodes even existing capital.

Success of any bank does not depend upon how much money a bank is able to lend but it depends upon the quality of loan. Therefore, success of any bank depends upon the amount of performing loan/assets. Performing assets are those loans that repay principal and interest to the bank from the cash flow it generates.

Almost every commercial bank is facing the problem created by NPA. Therefore, NPA management is the most important work to these banks. This study on NPA will have significant contribution to investigate the issues more systematically. This study will have both academic as well as practical significance. The finding and conclusion of the study will add to the literature of NPA in general and review the previous findings. The study will be helpful for the banking industry to identify and to trace the contributing factors causing NPA and reduce its level.

Total non-performing assets in Nepalese banking sector are about 35 billion, while it is even worse in case of the two largest banks Nepal Bank Limited and Rastra Banijay Bank. In case of private owned banks and joint ventures bank, level of NPA is a bit low but it is also not considered good in banking management. Therefore, Nepal Rastra Bank (NRB) has made a provision regarding classification of loan and advances and loan loss provisioning for Nepalese commercial bank since 2057/58. Under this provision, a bank is required to classify their loan and advances based on overdue aging schedule. It is also required to maintain loan loss provision in accordance to the NRB's directives for Nepalese commercial banks.

This study will be helpful for the regulating authority to know existing recovery problem to have some modification of directives, laws and other processing. It will be significant to find out degree of NPA, to find out factors influencing the proper management of NPA. It will be also helpful to find out the efforts made by commercial bank to recover loan and finally it will be helpful to the researchers, bankers, shareholders, depositors and management's students.

### **1.6 Limitations of the Study**

Present study is a milestone in exploratory study in searching the NPA problems and its solutions in Nepalese financial sector. Each study has its own limitation. No study can be free from constraints, therefore the following limitation of the study is considered during the preparation of this report:

- ) The research focuses only on the non-performing assets of selected C.B. So, various other aspects of the banks remain unexplored.

- ) The period of 5 years trend is considered. The study is made from fiscal year 2003/2004 to 2006/2007 only. Research result is based solely on the available data from the bank (published). Moreover the study is made for 5 years only; the performances of other years are ignored.
- ) Hence, analysis is fully depending upon bank's information it is based on secondary data and it is assumed that the figure depicted reflects their actual position.
- ) It is assumed that the findings and conclusions shall be relevance for whole banking industry but might not be representative for the specific bank.
- ) Limited time and resources are another limitation of this study to reach into the specific aspects of the issues.
- ) Statistical tools are used for analysis. Hence, the drawbacks and weakness of those tools are the limitation in this study.

### **1.7 Organization of the Study**

This report will be presented into five chapters that are as follows:

#### **Chapter - I Introduction**

This chapter gives the introductory framework of the study with the brief conceptual classification 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, limitation of the study and organization of the study.

## **Chapter - II    Review of Literature**

This chapter consists of review of books, journals and other relevant materials such as origin and concept of bank, concept of commercial bank, and evaluation of banking sector in Nepal. This chapter 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.

## **Chapter - III    Research Methodology**

It deals with methodology of the study i.e. research carried out in this size and shape. For this purpose various financial tool and statistical tools are defined will be used for the analysis of the presented data.

It covers on research design, sources of data, population and sample, data collection technique, financial and statistical tools used, etc. Sources of data for the study are secondary data. Data are collected from the bank's annual reports, journals, websites and other sources under study.

## **Chapter - IV    Data Presentation and Analysis**

Data presentation and analysis is the main component of this study. This chapter attempts to analyze and evaluate data with the help of analytical tools and interprets and results obtained. This chapter deals with the secondary data classification, tabulation, analysis using the tool and techniques. Similarly, it includes the analysis, interpretation of the secondary data and information collected through various sources.

## **Chapter - V Summary, Conclusion and Recommendations**

The final and last chapter contains the summary of the whole study. Conclusions of the study have been presented and at last, suitable and concrete measures are suggested in the form of recommendations.



## **CHAPTER - II**

### **REVIEW OF LITERATURE**

This chapter is related to examine and review some related books, articles, published and unpublished different economic journals, bulletins, magazines, newspapers and websites. This chapter has been divided into the following parts-

#### 2.1 Conceptual Framework

#### 2.2 Review of Related Studies

##### 2.2.1 Review of Journal & Articles

##### 2.2.2 Review of Thesis

#### 2.3 Research Gap

### **2.1 Conceptual Framework**

This heading defines the meaning and concept of the term used in the study:

#### **2.1.1 Origin and Concept of Bank**

“As early as 2000 BC, the Babylonians had developed a banking system, using their temples as banks. From those foundations Greek banking institutions had been emerged. When the Romans conquered the Greeks, the temple of priests no longer acted as financial agents. The Romans with their organizational abilities introduced rules & regulations for the conduct of private banking and calculated to instill the at-most confidence in the industry was seen thereafter and it was only in 12<sup>th</sup> century that some banks were established in Venice and Geneva. During this period there was a boom in banking business in Florence” (Khubcatiandani, 2002: 222).

“The traces of rudimentary banking are found in the Chaldean Egyptian and Phoenician history” (Vaidya, 1999: 115).

According to Alfred Marshall, in Greece, the temple of Delphi and other safer places acted as store houses for the precious metals before the days of coinage, and private purpose and interest, though they paid none themselves. Private money changers began with the task of reducing many metallic currencies, more or less exactly, to a common unit of value, and went on to accept money on deposit at interest and to lend it out at higher interest.

“So far the present system is concerned, the word bank is said to be of Germanic origin cognate with the French word banque and the Italian word, banca, both meaning bench. In fact this word may have derived its meaning from the practice of Jewish money changers of Lombardy, a District in North Italy, who in the middle ages used to do business sitting on benches in the market place. In case such an interpretation is provided then it also support from a number of other derivations of the word such as the French word ‘banko rotta bith’ which means broken bench” (Gupta, 1998: 96).

“Modern banking made its first appearance in medieval Italy, despite strong Christian prohibitions against Usury (the charging interest) according to the Canon Law, Florence, Genoa and Lucca became the centre of finance and trade in twelfth and thirteenth centuries” (Gupta, 1994:166).

“In England, banking had its origin with the London goldsmiths who, in the 17<sup>th</sup> century began to accept deposits from merchants and others for safe keeping of money and other valuables, crude money changing were present during the reign of Elizabeth I (1533 AD- 1603 AD), and the practice developed whereby merchants would deposit money (coins) in the tower of London which served as the British mint. The next stage in the banking arises when the goldsmith becomes a money-lender” (Paul, 1996: 111)

Fractional reserve banking must have developed shortly after the goldsmith entered the banking business because periodically they computed balance sheet or as they called it “casting Up Ye shop.”

“The concept of modern commercial bank came into existence by the emergence of the bank of England in 1694 with a capital of 1.2 million of pound by a group of wealthy London merchants and financiers. Since, at that time there was no concept of Joint Stock Company it was necessary to obtain a special charter from the crown to pool their money in common venture. King William III was too pleased to grant a Royal charter to bank of England because in return a capital subscribed of 1.2 million pound was lent to him to finance his war against France. The charter also gave the new bank the right to issue notes payable on demand up to amount of the loan to the king” (Joshi, 2001: 55).

It is clear from above definitions that a bank is an institution, which accepts deposits from the public and in turn advances loans by creating credit. However, other

institutions only accept deposits and cannot create credit. According to U.S law, any institution offering deposits subject to withdrawal on demand and making loans of a commercial or business nature is a bank. In conclusion, banks are those institutions that offer the widest range of financial services, like credit savings and payments services and perform the widest range of financial function of any business firm in the economy.

Bank of Venice set up in 1157 is the first commercial bank. The beginning commercial bank's functions were confined accepting deposit and giving loan. However, their functions have, now increased manifold. Commercial banks are found operating through the world. Nepal Bank Limited established on 30<sup>th</sup> Kartik 1994 B.S, is the first commercial bank in Nepal (Dahal & Dahal 2002: 36).

### **2.1.2 Concept of Commercial Banks**

Among all banks the commercial banks play significant contribution in the financial system of the country. They pool together the savings of the community and arrange it to productive field. They supply the financial needs of modern business through various means. They accept deposits from public on the condition that they are repayable on demand or on short notice. Their business is confined to financing the short term needs of trade and industry such as working capacity financing. They can not finance in fixed assets.

As per commercial bank act 2031 B.S, "A Commercial bank is one which exchange money, deposits money, accepts deposits, grant loan and performs commercial banking function and which is not a bank meant for co-operative, agriculture, industries or for such specific purpose" (Commercial Bank Act 2031 B.S).

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

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

“Nepal has been ruled over by many rulers like Kirati, Lichchhavi, Malla, Rana and Shahs. Mostly Kirati, Lichhavi and Malla regimes were concerned with the construction of temples, Pati, Pouwa, Chautari, etc. at that period neither the people nor the government were interested to think about the economic development of the country. According to ancient “Vanshawali” in fourteenth century, the rular of the Kathmandu Jayasthiti Malla segregated the local domiciles into 64 different classes according to profession they had undertaken. Tankadhari was one of those classes who used to deal in coins and precious metals such as gold. These tankadharis were

said to have carried out the borrowings and lending on money (coins). Hence, Tankadharis can be regarded as the traditional bankers of Nepal” (Singh & Khadka, 2056: 23).

After a longtime, during the Rana regime, only handful of Prime Minister’s thought about the economic development of the country. They established some officers in 1993 B.S. ‘Tejarath Adda’ were established during the tenure of Prime Minister Ranodip Singh Rana as a first institutionalized credit house. Tejarath Adda provided loan under the security of gold and silver to the government employees and public. The government established its various branches and sub-branches at different places of the country for the sake of benefits of people. In the overall development of the banking system in Nepal, the Tejarath Adda may be regarded as the father of modern banking institution and for a quit long time it tendered a good service to government employee as well as to the general public” (Shrestha, 1995: 59).

The government also implemented the rules against the vast interest rate taken by money lenders. Thus, the government 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 Limited in 1994 B.S as the first commercial bank of Nepal. This bank was established under Nepal Bank Act 1994 B.S.

At the beginning, 49% of ownership belongs to promoters as well as general public and remaining belongs to government. The incorporation of Nepal Bank Limited is the real starting of the banking institution in Nepal. Nepal Bank Limited 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. Beside it also acted as Central Bank for more than three decades.

Nepal Rastra Bank established in 14<sup>th</sup> Baisakh 2013 B.S under Nepal Rastra Bank Act 2012 B.S as the Central Bank of Nepal. It is totally owned by government. NRB is heavily assisting for the whole development of whole economy. It is giving timely directives to all financial institutions operated and conducted in all over the country.

After a long period, the second commercial bank namely Rastriya Banijya Bank (RBB) has been established in 2022 B.S with cent percent government ownership. This bank has been established under the RBB Act 2021 B.S. Both NBL and RBB have made a remarkable contribution by providing reliable banking services to the Nepalese people. Its contribution is well noted in terms of capital formation to 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 2033 B.S. to cover the vast field of financial sector. This act has helped to emerge number of commercial bank with a view to maintain the economic interest in comfort of the public in general facilitated to provide loan for agriculture, industry and trade and make a available banking services to the country and people.

Along vacuum in the banking sector got some rays of hope only when the government forwarded the economic liberalization policy in 2039 B.S. and decided 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” (Singh & Khadka, 2056: 20).

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. Now-a-days, joint venture banks are playing dynamic and vital role in economic development of the country.

The Nepal Arab Bank Limited is the first joint venture bank established in 2041 B.S. and started its operation with modern banking services. In the same way, Nepal Investment Bank Limited is the second joint-venture bank established in 2042 B.S. with an objective to encourage efficient banking services and facilities. Likewise Standard Chartered Bank, another joint venture bank is operated under the direction of Indian management.

With the satisfactory result of joint-venture banks, Nepalese promoters are highly encouraged and as a result, commercial banks are being introduced with entire domestic investment. At present, Nepal Industrial & Commercial Bank (NIC), Lumbini Bank Limited (LBL), Machhapuchhre Bank Limited (MBL), Kumari Bank Limited (KBL), Laxmi Bank Limited (LBL) and Siddhartha Bank Limited (SBL)



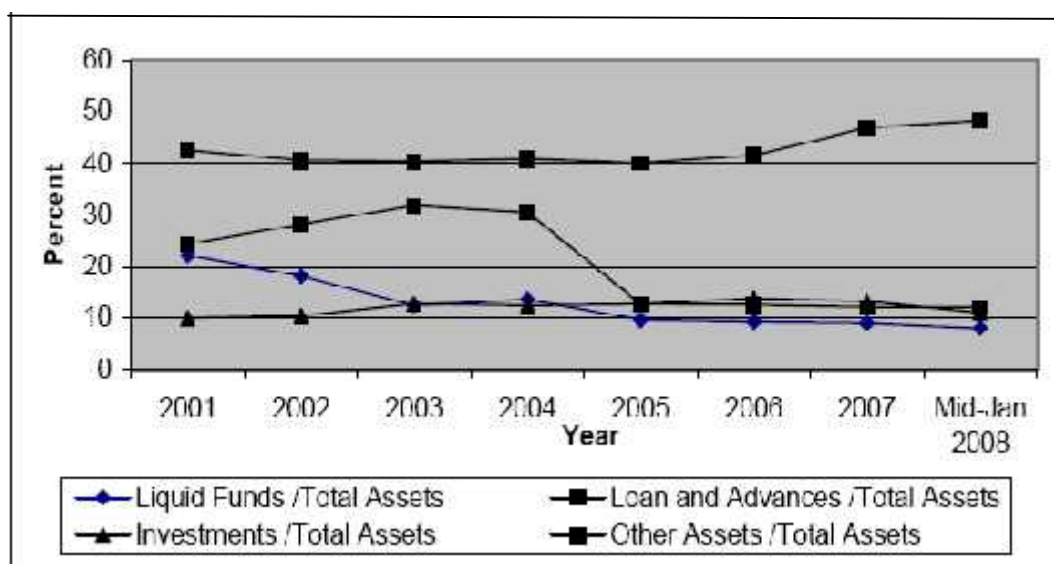
came into operation with cent percent domestic investment by Nepalese promoters which are the plus point of development of banking history of Nepal. Now, there is a strong competition between commercial banks for their existence so that the growing needs of the customers can easily be achieved.

### **2.1.3 Highlights on Performing of Nepalese Commercial Bank**

- J The number of commercial bank branches operating in the country reached to 574 in mid Jan 2008. Of the total bank branches more than 46.34 percent i.e. 266 bank branches are concentrated in the central region. In the eastern, western, mid-western and far-western region 122, 117, 38 and 31 bank branches are in operation respectively.
- J The total sources of fund of commercial bank increased by higher rate of 14.18 percent in mid Jan 2008 compared to 9.53 percent in the same period of the last year. At end of the mid Jan 2008, the total sources of fund of the commercial banks reached to Rs. 557142.3 million. It was Rs. 487970.3 million in mid July 2007.
- J The composition of sources of fund shows that the proportion of total deposit stood more than two third. As of mid Jan 2008, it constituted the 67.31 percent. Similarly borrowing held the 3.09 percent and capital fund 0.69 percent in the same year. In the mid July 2007, proportions of deposit, borrowing and capital fund to the total sources of fund were 67.16 percent, 2.61 and -0.85 percent respectively.
- J In the first six months of current fiscal year deposit mobilization of commercial bank increased by 11.12 percent compare to 6.73 percent growth in the same

period of last year. In mid Jan 2008 it reached to Rs.375035.7 million from Rs. 337497.2 in the last year. On an average 10.98 percent annual growth rate was observed during the 2001 to 2007 period. During the first six months of 2007/08, the current, saving and fixed deposits were accelerated by higher rate of 13.0 percent, 10.21 percent and 6.63 percent compared to the respective percentage of 6.30, 6.59 and 6.55 in the same period of the last year.

**Figure (a): Trend of Commercial Banking Assets Components/ Total Assets**



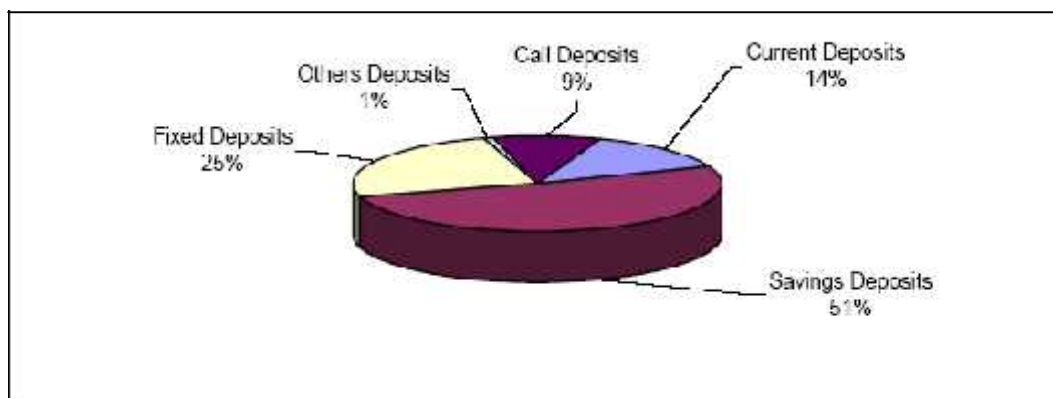
- ) Of the components of total deposit, saving deposit constituted the highest share of 51.35 percent followed by fixed deposit 24.80 percent, current deposit 13.57 percent and call deposit 9.34 percent in the first six months of current fiscal year. In the last year the respective share of saving, fixed, current and call deposit were 51.77 percent, 25.84 percent, 13.34 percent and 7.99 percent.
- ) The borrowings constituted 3.09 percent of total liabilities in mid-Jan 2008. It was 2.60 percent in the last year. During the first six months of 2007/8 the borrowing increased by higher rate of 35.03 percent over 10.26 percent in the

same period of last year. By the end of mid Jan 2008 it reached to Rs.17216.6 million from Rs. 12750.4 million in mid July 2007.

) As against the continued negative figure of capital fund of commercial banks, the remarkable achievement has been observed in the first six months of current fiscal year and turned to positive of Rs.3826.7 million. It was negative of Rs.4149.5 million in mid July 2007.

) Loans and advances, the major component of uses of fund, constituted the 48.86 percent in mid Jan 2008. Similarly, investment and liquid funds, another component of assets, registered the 18.10 percent and 8.12 percent in the same period. In the mid July 2007 the respective share of loan and advances, investment and liquid funds were 46.66 percent, 19.06 percent and 8.98 percent.

**Figure (b): Composition of Total Deposit of CBs in mid-Jan 2008**



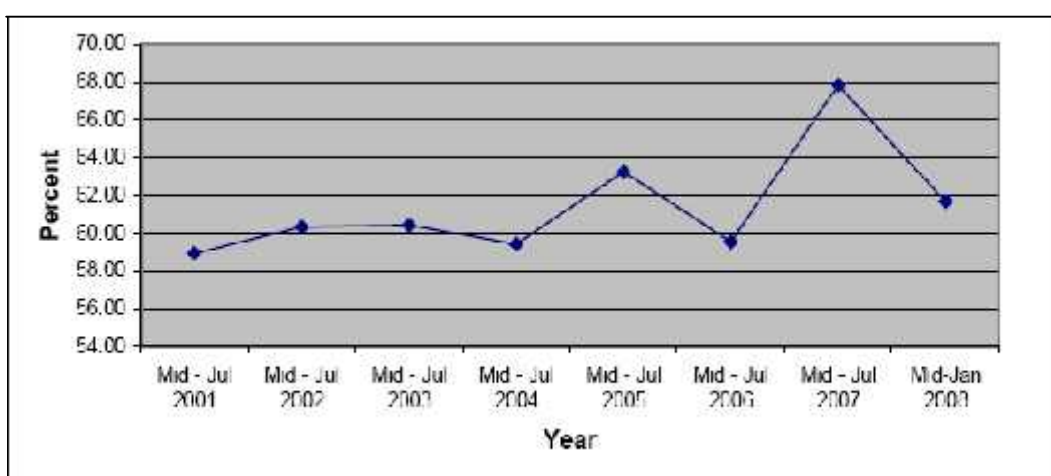
) During the first six months of current fiscal year, the loans and advances increased by slower rate of 17.51 percent compare to 21.35 percent in the last year. By the end of mid Jan 2008 the total outstanding amount of loans and advances of commercial bank reached to Rs.272364.0 million. It was Rs. 213142.4 million in mid Jan 2

- ) The aggregate investment in the first six months of 2007/08 increased by higher rate of 7.84 percent compared to 1.13 percent in the same period of last year. At the end of mid Jan 2008, it reached to Rs. 100860.5 million. It was Rs.93530.8 million in mid July 2007.
- ) Liquid funds increased by 2.65 percent and reached to Rs.45258.1 million in mid Jan 2008 from Rs. 44089.7 million in mid-July 2007.
- ) The sector wise loans and advances of the commercial banks in the first six months of current fiscal year 2007/08 reached to Rs.272284.3 million. Out of these, the production sector constituted the highest share of 26.79 percent followed by wholesale & retailers 18.63 percent, construction 9.33 percent, service industries 7.66 percent, finance, insurance & fixed assets 6.80 percent agriculture 5.09 percent transportation, communication & public services 5.35 and consumable loan 3.13 percent.
- ) Subsequent decision of NRB to phase out the priority sector credit, it is not mandatory for commercial banks to provide such credit from the fiscal year 2007/08. However, under the micro credit program these commercial banks have to provide minimum of 3.0 percent of their outstanding credit to the deprived sector from the current fiscal year 2007/08.
- ) During the first six months of current fiscal year 2007/08 the deprived sector credit provided by commercial banks increased by 33.08 percent and reached to Rs. 9106.5million. It was Rs. 6842.0 million in mid-July. The ratio of deprived sector credit to total credit (six months ago) inched up to 3.93 percent in mid Jan 2008 over 3.24 percent in mid July 2007. Out of the total outstanding of

deprived sector credit in the mid Jan, 2008, direct investment constituted 32.15 percent and rest were delivered through indirect channel.

) In mid Jan 2008, the credit/deposit ratio of the commercial banks expanded by 3.95 point to 72.62 percent from 68.67 percent in mid July 2007. Higher growth rate of private sector credit compared to deposit collection contributed to increase in this ratio.

**Figure (c): Credit/ Deposit Ratio of Commercial Banking System**



) In the first six months of current fiscal year, net profit of the commercial banks increased by 24.43 percent compared to same period of the last year. These banks earned Rs. 4225.6 million during this period. In the last year it was 3395.9 million.

) In contrast to negative capital adequacy structure of the commercial banks till mid July 2007, these banks has gained the remarkable improvement over it and maintained Rs. 5067.4 million positive at the end of the first six months of current fiscal year. In mid Jan 2008, the proportion of capital fund to risk weighted assets i.e. capital adequacy stood at 1.47 percent over -0.07 percent in mid July 2007.

**Table 2.1 (a)****Soundness Indicators of Commercial Banking System:**

| Indicators                              | Mid July |       |        |       |       |       |       | Mid Jan |
|---|----------|-------|--------|-------|-------|-------|-------|---------|
|   | 2001     | 2002  | 2003   | 2004  | 2005  | 2006  | 2007  | 2008    |
| Profitability (Rs. in million)          | -7843    | -9428 | -3317  | 3707  | 5205  | 79888 | 88300 | 4225.6  |
| NPL as Percentage of Total Loan         | 29.3     | 30.4  | 28.8   | 22.8  | 18.94 | 14.22 | 9.65  | 8.94    |
| Total Capital Fund as Percentage of RWA | -5.49    | -9.88 | -12.04 | -9.07 | -6.33 | -5.30 | 0.17  | 1.47    |

) The proportion of non-performing loan to total gross loan of commercial banks declined by 5.14 point and remained to 8.94 percent in mid Jan 2008 over 14.08 percent in mid July 2007. At the end of mid Jan 2008, the total amount of NPL of commercial banks slightly inched up to Rs. 24360.0 million compared to Rs.24215.85 million in mid July 2007 (NRB's Banking and Financial Statistics, 2007).

**2.1.4 Loan and Advances**

Loan and advances are the most profitable of all the assets of a bank. Banks universally seek after the asset. This asset constitute primary source of income to banks. According to Dr. Walter Leaf "In the item of advances to customer', we have reached the central portion of the activity of bank." Here the banker is brought into direct relation with public. His capacity and judgment and his usefulness to the community is judged by the way he lends the money left with him by the depositors. As, the business institution, a bank aims at making a huge profit since loan and advances are more profitable. However, he has to be careful about the safety of such loan and advances. In the words of Dr. Leaf the bankers', has to timber liberality with caution.

If he is too liberal, he may easily impair his profits by bad debts, if he is too timid, he may fail to obtain an adequate return on the fund, which are confined to him for use. It is by his capacity in lending that a bank manager is judged (Radhaswamy & Vasudevan, 1979: 550).

Loans and advances dominate the asset side of the balance sheet of any bank. Similarly, earnings from such loans and advances occupy major space in the income statement of the bank. Lending can be said to be the *raison d'être* of a bank. However, it is very important to be remembered that most of the bank failures in the world are due to shrinkage in the value of loans and advances. Hence, loans are known as risky assets. Risk of non-repayment of loans is known as credit risk. Risk of non-repayment of loans is known as credit risk or default risk" (Dahal & Dahal, 2002:114).

Commercial banks collect deposits from depository customers and provide this money as loans to borrowing customers charging some additional interest. In other words, banks play the role of mediator in the economy. Banks do so to convert their liabilities into assets. Thus, loans and advances are the assets of the bank. Interest income on such loans is the primary source of income of commercial banks. To spread the depositors' funds to the borrowers, banks have to analyze properly and take adequate collateral for the safety purpose as providing loans is a risky business. Banks have to manage the proper portfolio so that the impact of market failure of any sector will be least. Loans may be of different types such as Overdraft, Import Loan, Term Loan, Personnel Loan, Home Loan, Auto Loan, etc.

The profitability of the bank depends upon the extent to which it grants loan and advance to customers. Loans are granted in the form of overdraft, cash credits and direct loans against adequate security. The banks should have to take in consideration safeties of loan and advances at the time of lending but not only on profitability. At the time of lending the loan, the banks should carefully study the lending sectors and make a sound policy for rendering loan. The policy should contain the Credit Deposit Ratio (CDR), the bank wishes to maintain CD Ratio is very much influenced by the behaviors of bank's liabilities. The higher the volatile deposits and volatile borrowings lower the volume of loan and vice versa.

### **2.1.5 Loan Classification**

Loan that is provided by the bank has to be monitored and reviewed time to time under the prescribed time format by central bank. Commercial banks have to review their portfolio and grade them based on the risk and other relevant control majors. This helps banks to monitor the quality of their loan portfolio and to take remedial action for down graded loans to protect the situation of further deterioration. Most of the countries have laid down the practice of loan classification in connection with the period of loan payment default. However, different countries may have different classification. In Nepal, NRB, at present, has classified the loans into four categories viz Pass, Substandard, Doubtful and Loss.

### **2.1.6 Past Due Loan**

Any principle or interest under any loans, have been treated as past due loan if these principal/interest have not been served on time that is fixed as per the contract of the bank with customer.



### **2.1.7 Performing Loan**

Principal with interest, that have been served in prescribed period to the bank from cash flow it generates are categorized as performing loan. In other words, performing loan are the productive assets that generate some profits. Loans have the certain time to return its principal with its interest. If loan is repaid with its interest on time, it is known as the performing loan. It is the most profitable assets of banks. It helps in the rapid growth of banking sector in this competitive business age. Better performing loan are the symbol of success of banks. However, many banks are suffering from the non-repayment of loan amount. Different country may have different policy to classify the performing loans. In the context of Nepal, loans that have fallen under 'pass' category, are treated as performing loan.

### **2.1.8 Non Performing Assets /Loan (NPAs/NPL)**

An asset is classified as non-performing assets (NPAs) if the borrower does not pay the dues in the form of principal and interest for a period of 180 days then the loans are classified as non-performing one. In other words, loans which are not performing as per the prescribed time of the bank are called non-performing loan. The payment period varies from nation to nation, some countries show the loans to past dues very shortly and some may have little bit relax policy. However, default status would be given to a borrower if dues were not paid for 90 days. If any advances or credit facilities granted by bank to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status (Source: [www.indianfoline](http://www.indianfoline)).

In Nepalese context also, if the loans are past due since three months, it should be reported as non-performing loans. In other words, loans classified under substandard, doubtful and loss categories are regarded as non-performing loans. The loan amount that does not covered by the collateral after selling is known as non-banking assets (NBA). Non-performing assets also includes the suspend interest it is the interest, which becomes receivable. Unutilized assets and those investments that do not generate any cash or incomes to the bank are also non-performing assets (NPAs). The proper management of those assets to generate income is known as management of non- performing assets.

Most of the commercial banks are facing the problem of NPAs. We know that the some banks are closed down due to the uncontrollable NPAs. In USA, 1016 commercial banks were declared as unsuccessful (bankruptcy) from 1985 to 1990 and 27 banks from 1995 to 2001. However, Nepalese commercial banks have not faced this type of problem until now but they have to take step towards it. For this, appropriate amount of bad and doubtful debts is made provision from their incomes/ profits.

NPLs create problems for the banking sector's balance sheet on the asset side. They also create a negative impact on the income statement as a result of provisioning for loan losses. Ultimately, a riskier loan portfolio combined with lower net income makes new lending more difficult, often resulting in slower credit growth. A high level of NPLs in bank means worst management of bank that will reduce the popularity of bank. If not properly handled, resolution of NPL burdens can also create

moral hazard incentives for banks and borrowers alike. Banks can always rely on a centralized Asset Management Company (AMC) to accept transfer of their bad loans, even if these resulted from their own recklessness. Borrowers on the other hand, can be made to believe that once their debts go to a government agency that has limited incentive and inadequate legal powers to run after defaulters, then they are essentially freed from their obligation to pay. These moral hazard incentives perpetuate a non-repayment culture and non-aversion to risk. Consequently, the cycle of bank collapse and recapitalization, of crisis and restructuring goes on. Thus, it is difficult to estimate the true cost to the economy of attempting to remedy financial sector instability.

There are various causes to increasing NPAs in banking sector. They are:

- ) Lack of transparent and clear policy to mobilize the assets productively.
- ) Lack of effective forecasting or deviation between expectation and actual outcomes of the business.
- ) Wrong choice of project and business to lend the fund.
- ) Lack of supervision, monitoring and control.
- ) Lack of proper information and communication between banks and customer.
- ) Wrong valuation of accepted collateral by the bank to the loan.
- ) Lack of step towards the decrease or sell the NPAs, which is not useful to the bank.
- ) Lack of training and seminars to build the smart human resources.
- ) Get loss from the operation of the business/project by the customer of the bank.
- ) Depression of the economy of the country due to the insecurity and instability of the business environment.

- J Lack of proper policy and act to return the expired loan.
- J Political instability of the country and lack of proper laws and order.

Non- performing assets have direct impact on profitability. The NPAs has negative impacts on the profitability of the bank. Non-Performing assets are the idle assets of the banks, which do not generate any return for the banks. Thus, we can say that the NPAs reduce the profitability of the banks due to becoming the idle resources. Not only it reduces the profitability of the banks but also it may be the causes for losing the customer's faiths and supports.

NPA has affected the profitability, liquidity and competitive functioning of public and private sector banks and finally the psychology of the bankers in respect of their disposition towards credit delivery and credit expansion. Increasing Non-Performing Assets has the direct effects to banks, investors and customers. It has also negative impact to the economic health and business of country (Batra and Dass, 2003:6).

They are internal and external effects:

### **Internal Effects**

One of the effects may be, bank cannot mobilize the non-performing assets for increasing the profitability and banks have to make provision for doubtful debts from their profits and other sources. That is why the profit of the banks decreases or occurs losses. As a result, share capital also becomes capital erosion and capital inadequacy. In the present context, capital adequacy ratio of Nepal, India, UAE and Indonesia are 11%, 12.6%, 12.7% and 21.4% respectively. The central bank of the country can take action to their banking activities which banks have lower capital or capital adequacy

ratio. For e.g. Nepal Development Bank Ltd. is suffering the same problem that cannot take deposit due to the action of Nepal Rastra Bank.

When the Non-Performing assets increases, the banks have to increase the amount of provision for doubtful debts and when the loan is repaid, the profit treated as profit. If the provision for doubtful debts crosses 5% of the total loan amount, the bank have to pay income tax as profit. Therefore, it has direct effect to cash flow of bank. As a result, the employment of human resources and profit of the bank has also affected.

### **External Effects**

The banks accept deposits from the public and provide loan to the operation of business and other purposes. When the loan does not return with its interest, it becomes Non-Performing Assets and banks will not be able to return the deposited amount the banks are loosed public supports and faiths. Not only that much but also the banks have to take loan at a higher rate to pay deposit, which directly affects the profitability of the banks and which leads the bankruptcy and dissolved. It also affects the monetary system and economy of the country.

### **2.1.9 Loan Loss Provision**

There is associated risk in every loan. To minimize the risk from possible losses of these loans bank has to allocate some funds as loan loss provision. Loan Loss Provision is the accumulated funds that are provided as a safeguard to cover possible losses upon classification of risk inherited by individual loans. The level of provisioning is depended upon the level of NPAs and their quality. Increased portion

of NPAs generate additional liability of resources to the financial institutions. In other words, higher the NPA, higher the provision as down graded loans need more provision. One percent provision of total credit is minimum requirement as every pass/good loan to provision by one percent. However, the ratio of provision may differ from nation to nation. In Nepal, NRB has prescribed 1%, 25%, 50% and 100% provision for pass, substandard, doubtful and loss loans respectively. Loan Loss provision made for performing loan is called “general loan loss provision” and loan loss provision made for non-performing loan is called “specific loan loss provisioning”.

#### **2.1.10 Non Performing Assets/Loans (NPAs) in East Asia**

##### **Introduction**

Asian economies were hit by the financial crisis in July 1997. As a result, East Asian countries in 1998 recorded negative growth ranging from 5 to 12 percent. 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 based on 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 non-performing loan (NPLs) problems in the financial and corporate sectors, have not progressed sufficiently. This paper looks into the issues that best East Asian economies, based on the assessment of the 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 concisely was that the government did not take measures to deal with NPLs in a timely manner. Cooperative credit purchasing company was launched in 1993 to buy NPLs, and the Housing Loans Management Company was set up in 1996 to deal with the problem of housing related NPLs. These efforts were inadequate and 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 NPLs in Japan was indeed too little, too late. Japan adopted the policy of waiting for the economic environment to take a favorable turn instead of taking swift, decisive action.

On the other hand, many East Asian countries addressed the problem of NPLs rather swiftly. For e.g. South Korea immediately injected large amounts of public funds into financial institutions. Three years after the financial crisis, the solution to NPLs is progressing relatively well in South Korea and Malaysia, while Thailand and Indonesia are lagging behind. To solve the issue of NPLs, it is necessary to make structural improvements, especially in the financial system and corporate governance that actually caused the NPL problem.

The economic growth rate in each of these countries is projected to a register 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 problem, financial restructuring economic environment.

▪ **Status of Bad-Loan Measures**

The policies adopted by South Korea, Malaysia, Indonesia and Thailand to deal with the problem of NPLs were as follows:

- ) Establishment of assets management companies to gather NPLs
- ) Allocation of public funds to banks and other financial institutions
- ) Creation of a framework for the promotion of autonomous, non-courtroom negotiations between creditors and debtors

These governments either revamped existing organizations or created new ones to implement the above policies in 1998. Further, in Thailand and Indonesia, it was necessary to revise bankruptcy laws, since they were not functioning properly. For this reason, negotiations between creditors and debtors were delayed. For both countries, it was only in 1999 but revised bankruptcy laws were enacted, contributing towards smoother negotiations between creditors and debtors on NPLs.

After three years of the crisis, difference in their growth chart is beginning to emerge. The quarters in which the NPL problem was adequately treated and restructuring of NPLs started to make significant progress and the trend in their bad loan ratio (bank credit in arrears for over three months) are indicated below:



**Table 2.1 (b)**

**Significant Progress and Trend of Bad Loan Ratio**

|                               | <b>Malaysia</b> | <b>South Korea</b> | <b>Thailand</b> | <b>Indonesia</b> |
|-------------------------------|-----------------|--------------------|-----------------|------------------|
| Assets management company     | 1998/3q         | 1998/1q            | None            | 1999/2q          |
| Funds Infusion                | 1998/3q         | 1998/3q            | 1999/1q         | 1999/2q          |
| Promotion of NPL Negotiations | 1998/4q         | 1998/2q            | 1999/2q         | 2000/1q          |
| Bad Loans Ratio (%)           | 18.1 (6)        | 8.4 (6)            | 47.7 (5)        | 8.7              |
|                               | 11.2 (2)        | 8.4 (1999/12)      | 31.3 (7)        | NA               |

Bank are such types of institutions, which deals in money and substitute for money. They deal with credit and credit instruments. The most important think for the bank is good circulation of credit. Fluctuate flow of credit and week decision harms the whole economy and the bank as well. Thus to collect fund effectively and its utilization is the very challenging task for the bank. The decision of an investment of fund may be the question of life and death for the bank. There may be different views of writers in different topic.

**Investment**

H.D Cross, sys in this regard “lending is the essence of commercial banking, consequently the formulation and implementation of sound policies are among the most important responsibilities of bank directors and management. Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit creating function effectively and minimize the risk inherent in any extension of credit” (Crosse, 1963:870).

V.K Bhalla defines “Financial Investment is a form of this general or extended sense of the term.” It means an exchange of financial claims, stock and bonds (collectively termed securities), real estate mortgages, etc. The term “financial investment” is often used by investors to differentiate between the pseudo-investment concept of the customer and the real investment of the businessman. Semantics aside, there is still a difference between an “Investment” in a ticket on a horse and the construction of a new plant, between the pawning of watch and the planting of a field of corn. Some investments are simple transaction among people other involve nature. The later “real” investment, the former is “Financial Investment”. We now turn a closer examination of finance and investment decisions themselves” (Bhalla, 1983:125).

Frank K. Reilly defines investments in this words, “An investment may be defined the current commitment of funds for a period of time to derive a further flow of funds that will compensate the investing unit for the time. The funds are committed, for the expected rate of inflation and also for the uncertainty involved in the future flow of funds” (Reilly, 1986: 92).

James B. Bexkey, expresses his views as “Investment policy fixed responsibilities for the investment disposition of the banks assets in terms of allocating funds for investment and loan and establishing responsibility for day to day management of those assets” (Bexely,1987:12).

“The term investing can cover a wide range of activities. It often refers to investing money certificates of deposits, bonds, common stocks or mutual funds. More knowledgeable investors would include other financial assets such as warrants, puts

and calls future contacts and convertible securities. Investing encompasses very conservative positions and aggressive speculation” (Parker, 1988:53).

According to William F. Sharpe, Gordon T. Alexander and Jeffery V. Baily, “Investment in its broader sense, means the sacrifices of current dollars for future dollars. Two different attributes are generally involved time and risk. The sacrifice takes places in the present and its magnitude as generally uncertain” (Sharpe,1998: 1).

According to I.M Pandey, “In investment decision expenditure and benefits should be measured in cash. In investment analysis, cash flow is more important than accounting profit. It may also be pointed out of that investment decision affects the firm’s value. The firm’s value will increase if investments are profitable and add to the shareholders wealth. Thus, investment should be evaluated on the basis of a criterion, which is compatible with the objectives of the shareholder’s fund maximization. Investments will all to the shareholder’s wealth if it yields benefits in excess of the minimum benefits as per the opportunity cost of capital” (Pandey, 1999:407).

Shakespeare Vaidya in his book “Project Failures and Sickness in Nepal, Challenges to Investors for Investment Risk Management” has discussed about the early warning system for investment risk management. In this book, the author has also envisaged number of examples about crisis created by the banks in the world. As per his view, banking sector cannot ignore any sector of the economy on the basis of its good and bad there is vital role of financial institutions in regards to bad accounts.

“With the growing number of financial institutions, market economy, economic liberalization, etc. Industrial sickness in Nepal has phenomenal proportions in the last few years. Much of the amounts of almost all leading financial institutions are blocked in sick company, which can be witnessed from the auction notice published regularly in newspaper. Credit risk is the first risk, which keeps the bank moving in the market. The loans provided against the securities are simply a promise to pay. If borrowing customers fail to make part or all of their promised interest and principal payments, these defaulted loans and securities result in losses that can eventually erode bank’s capital. Because owner’s capital is usually no more than ten percent of the volume of loans and risky securities, and often much less than that, it cannot absorb too many defaults on loans and securities before bank capital simply becomes inadequate to absorb further losses. At this point, the bank fails and will close.

“Nepalese financial institutions have made significant progress especially during this decade, although they are still far behind the developed markets. In spite of having great risk management i.e. focused on collateral rather than on project, credit culture is a new aspect both to the investors and corporate. Unless we have a credit culture, they will end up nowhere. How to identify a good bank? Huge deposits, high technology, strong marketing, broad branching network etc? Finally we arrive the point – collection of the loans, on the whole, private sector banks have lower non-performing assets (NPAs) than their public sector counterparts. NPAs are the loans that cannot be or have not been recovered. The government owned banks suffer acutely from this, as they have to lend to various priority sectors, at the whims of their political masters and then forget everything about the money forever,”

Finally he concludes “in order to safeguard the banks from the financial crisis likely to be arising from the project failures and sick units, that is, non-performing loans, and the government needs to do a number of things and fast. It must bring a broad rule for poor financial institutions, transferring bad loans to bridge bank or loan recovery agency, removes many non-performing loans from even healthier bank’s balance sheets, beef up regulation, supervision and disclosure, improve ability to banks to sell the collateral that backs soured loans and recapitalize the banking system” (Baidya, 2001: 20-21).

### **Loan and Advances**

KC Shekhar and Lekshmy Shekhar in their book “Banking Theory and Practice” have expressed different aspects of loan and advances. In their view, loan and advances are the most profitable banker’s assets and a banker’s earnings are mainly derived from these assets.

“The item ‘advance and loan’ comes next in the order of liquidity. For all practical purposes, we may say that they are not shiftable. Ofcourse this, this is the most profitable asset and the profit is mainly derived from these assets. As a rule, a commercial banker will generally lead only for short term commercial purposes. It is not his duty to provide long-term loans for investment purposes. Such loans are provided by specialized agencies like industrial banks. The reason advances in support of this view is that in the case of long-term loans the banker will find it difficult to realize them when emergencies arise. For instance, the case of a mortgage, the mortgaged property may cover the loan with a safe margin. But when the bank needs liquid cash most it may find it difficult to convert the mortgaged property into

liquid cash. Herein lays the meaning of the off quoted statement. 'The art of banking lies in knowing the differences between a mortgage and a bill of exchange.'

Certain general principle may be laid down which should guide a banker when he/she is making loan advances. Before granting a secured loan, he should carefully consider the margin of safety offered by the security, possibility of fluctuation in its values and shiftability. If it is an unsecured loan its repayment entirely depends on the credit of the customer and such, the cardinal principles, which a banker should consider are 'character, capacity, and capital' of the customer (Sherkhar & Shekhar, 1999:533).

Bhuwan Dahal and Sarita Dahal in their book "A Hand Book to Banking" have dealt with different aspects of banking. As per their view, banks have gained paramount trust in the public and they are rendering wide range of services covering different strata of society.

They stated that loans and advances dominate the assets side of the balance sheet of any bank and earnings from such loans and advances occupy a major space in income statement. "Most of the banks failures in the world are due to shrinkage in the value of the loan and advances. Hence loan is known as credit or default risk. Performing loans have multiple benefits to the society while non-performing loan erodes even existing capital. If loan is given to viable project not only lenders and borrower but also the whole society gets benefit but society loses its scarce capital if loan is given to the project which is not viable" (Dahal and Dahal, 2002:21).

Hirday Bir Singh in his book “Banking & Insurance, has described that the loan and advances are the necessity for the sound banking program and it helps the bank to increase the profitability of the bank.” He has also stated that the economy slows down or the industries in which the bank has made a substantial portion of its loans develop significant problem, the frequency of loan review should be increased to safeguard the bank from unexpected risk.

“Loan review is not a luxury, but a necessity for a sound bank lending program. It not only helps management stop loan problem more quickly, but also acts as a continuing check on whether loan officers are adhering to the bank’s loan policy. For this reason, and to promote objectivity in the loan review process, many of the largest banks separate their loan review personnel from the loan department and the bank’s board of directors in assessing the bank’s overall exposure to risk and its possible need for more capital in the future. Separate loan review division also helps to detect any mishaps and undue influences in the lending process, if any.” (Singh, 1999:214)

## **2.2 Review of Related Studies**

### **2.2.1 Review of Articles and Journals**

#### **Assets as Liability? NPAs in the Commercial Banks of Indian and Bangladesh Compared**

According to the article of Bettesse and Coelli “Due to the social banking motto of the Government, the problem of non-performing asset (NPA) was not considered seriously in India in the post nationalization (of banks) period.” However, with the recent financial sector liberalization drive, this issue has been taken up seriously by

introducing various prudential norms relating to income recognition, asset classification, provisioning for bad assets and assigning risks to various kinds of assets of a bank. While the Reserve Bank of India (RBI) as well as the banks has begun to pay considerable attention to the NPA problem, there are only a limited number of rigorous studies in the Indian context that look at this issue in some detail. In this project we attempt to look at the determinants of NPA (using a panel data model with a cross section of over 100 banks) by examining some of the external and internal factors like extent of competition, total assets of a bank, size of operations, proportion of rural branches , investment, etc., that can influence NPA. It is of our interest to examine, between various bank groups (viz, SBI, Nationalized banks, Private Banks and foreign banks), which is the most efficient group in the context of recovery of loans and what are the factors that determine this efficiency. For determining efficiency of the different banks in their loan recovery effort, the concept of technical efficiency will be applied, using a frontier production technique (Bettesse and Coelli, 1995: 6).

To have a micro perspective of the problem, this study is seem to be interested in examining the factors that have influence on recovery of loans in small-scale industries sector of the Indian economy. While strategic behaviors of the stakeholders in the agricultural credit market have been well explored, SSI sector has not received much attention in this regard. In this exercise therefore, research is interested in studying the possible strategies available to the different stakeholders (viz., banks, SSIs, large subcontracting firms) in a game theoretic framework and examine the optimality of different strategic moves.



In recent years Bangladesh Bank has been trying to bring prudential norms in line with best international practices. The Central Bank on several occasions defined the Non-Performing loans/leases via its circulars in 2002, 2005 and 2006. Similarly the Central Bank also push for legal changes and established the Money Loan Court in 2003 to change the culture of loan default in our banking sector. In addition, the Central Bank itself implemented a strengthening of its capacity to enhance its own supervising role. In terms of non performing loan in Bangladesh, it came down from 35.6% in 1999 to 18.8% in 2003. There are, however, variations in the performance by types of banks. Though NPL as a percentage of total lending declined, the volume of NPL remained a major concern of the banking sector of Bangladesh. While the origin of the problem of high level of NPAs lies in the quality of managing credit risk and the extent of preventive measures adopted, various factors like real interest rates, directed credit or inflation rate, macro-economic stability, can also effect the level of NPLs. It is important to note that there was no major research on this issue. Further, the Central Bank data shows that nearly 51.4 percent of the NPLs are in the micro and agricultural loans.

#### **“Non-Performing Assets: A Need for Rationalization”**

Deependra Bd. Chhetri (2000) stated in his article titled “Non-performing assets: A Need for Rationalization” that to provide connation of the NPA and its potential sources, implication of NPA in financial sector in the South East Asian Region. He has also given possible measure to contain NPA. “Loan and Advances of financial institutions are meant to be serviced either part of principle of the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan

settlement. Since the date becomes past dues, the loans becomes non-performing asset. The book of the account with lending institution should be effectively operative by means of real transaction effected on the part of the debtor in order to remain loan performing” (Chhetri, 2000: 17).

As per his opinion, the definition of NPA differs from country to country. In some of the developing countries of Asia Pacific Economic Co-operation (APEC) forum, a loan is classified as non-performing only after it has been arrear for at least 6 months. Similarly, it is after three months in India. Loans thus defaulted are classified into different categories having their differing implication on the assets management of financial institution. He also stated that NPAs are classified according to international practice into three categories namely substandard, doubtful and loss depending upon the temporal position of loan default. “Thus the degree of NPA assets depends solely on the length of time the assets has been in the form of none obliged by the loaner. The more time it has elapsed the worsted condition of assets is being perceived and such assets are treated accordingly.”

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

He said that there is serious implication of NPAs, on financial institution. He further added that the liability of credit institution does not limit to the amount declared as NPA but extend to extra amount that requires by regulation of supervisory authority

in the form of provisioning as the amount required for provisioning depends upon the level of NPAs and their quality. As per his view, rising level of NPAs create a psyche of worse environment especially in the financial institution like waiving interest, rescheduling the loan, writhing off the loan, appointing private recovery agent, taking help of tribunals and law of land etc NPAs can be reduced.

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

#### **“NPAs at Nepalese Financial Institutions”**

Bishwambhar Neupane (2001) said in his article titled “NPAs at Nepalese Financial Institutions” that thinking rationally no one shall be surprised to note two of the giant commercial banks of this country such as Nepal Bank Ltd and Rastriya Banijya Bank accounting for the highest number and amount of non-performing assets (NPA) among players in the industry. In general and more specifically, in least developed countries like ours, the larger the size of the credit portfolio the larger the amount of NPAs.

As per his view, “The concept and realization of NPAs in the Nepalese financial sector evolved round about a decade ago along with the notion of prudential

accounting norms. I reckon that ten years time frame should have been more than enough to formulate and implement strategies for identifying and channelising the ever accumulating NPAs at Nepalese financial institution. However, the Nepal Rastra Bank (NRB) seems to have realized the panic only a year ago. As a result, the NRB came up with a nineteen-point strategy, primarily pertaining to ways to tackle NPAs. Some of the measures the NRB has envisaged are formation of an assets reconstruction company, credit rating agencies legal reforms strengthening administrative/monitoring/supervising mechanisms etc, and above all, the recent NRB directives (number 1 to 7). Although the NRB, vis-à-vis the FIs would have been much better off had it come up with all these philosophies some five years ago, better late than never” (Neupane, 2001: 1).

He expressed the one major reason that can be attributed for the already prevalent and ever increasing NPAs is unhealthy competition among the already prevalent and ever increasing NPAs is unhealthy competition among the commercial banks. Since, the size of our economy has remained more or less stagnant over the past half a decade or so, the size of the total pie has not changed much. Every player in the market means business and its primary motto is “making profit”. This has enhanced unhealthy competition among the banks through interest rate reduction, issuing loans irrespective of borrowers’ credibility and authenticity, etc. In course of making their credit portfolios bigger, all the players have been pouring their investments into the same pie thereby over financing the pie. Given this scenario, it is no surprise to discover a good loan turning into an NPA because of over financing.

There is no denying that no capital market around the world can be termed perfect. However, the capital markets are primarily driven by certain norms, which make lots of sense, and every single movement including stock price fluctuation is guided by prudential norms. By contrast, share prices at NEPSE are bound to move upward if a bank registers say Rs. 800 million in profit, an accounting profit it registers.

Even the most profitable sector of the economy, be it a primary source of foreign currency earning, should not be over financed. There should always be an upper limit for any sector that deserves bank financing. The NRB came up with a directive to lesson risk concentration on a single borrower/ single sector of the economy. The directive states that large sectoral concentrations constitute a source of risk. Bank managements shall have adequate internal policies and systems in place to monitor the bank's sectoral exposure. However, if the NRB so directs, judging it necessary, a bank shall have to provide additional capital with a view to providing uniformity in the categorization of various sectors of the economy, NRB's policy of limiting FIs from pouring their lending into a single sector of the economy can be regarded very positive since it is likely to diversify the risk of the total investment evenly and thereby minimize the risk of NPA. NRB shall continue to be more stringent in formulating firm policies in the days ahead too to protect shareholder interests.

At last, even if the banks endeavor to recoup NPAs through the auction of mortgaged property, the legal system and the regulations are so shabby and defaulter friendly that they have to struggle for many years to realize the auction process. Just imagine this process, a borrower, initially, defaults payment, the bank calls back the loan, six

months thereon the concerned authority blacklists the borrower, a 35 days notice goes, to the papers for auction and after that 7days ultimatum and so on and so forth. Hundreds of cases have been lingering in the courts for many years. Inefficient legal provisions, from the point of view of the bankers, have encouraged borrowers to default and contributed more towards enhancing the quantum of NPA in Nepalese Financial Institution.

### **AMC in Nepal a step towards the Development of Financial Infrastructure**

Mr. Bhisma Raj Dhungana in his article titled above has tried to highlight the approach of Asset Management Company for resolving the problem of NPL.

According to him, Assets Management Company (AMC) is a specialized financial intermediary to manage the non-performing and distressed loans of banks and non-bank financial institutions. The functions of AMC are to buy non-performing loans (NPLs) from the financial institutions and take necessary steps to recover the maximum value from the required asset. It deals with bad loans. Therefore, it is also called the manager of "Bad Banks". The concept of Asset Management Company is one of the recent developments in the institutional structures to resolve the problems of non-performing loans (NPLs). However, the financial practitioners have introduced it in the early 1960s and the importance of the same was not widely recognized as it has been today. Many of the crisis-hit Asian countries have established AMCs with wide functional coverage to get rid of the NPLs problem that arose due to economic and financial crisis in late 1990s, and more importantly, they have been able to resolve the problem easily and timely. Consequently, nowadays,

these economies have been able to restore the financial health and payment systems for the banks and non-bank financial institutions to boost up the economic growth.

He also elaborates the importance of AMC in the Financial System. The banking system needs to maintain high quality of assets portfolio all the time and adequate level of liquid assets to ensure uninterrupted payment system. When the quality of assets in the banking system deteriorates the level of non-performing assets rises and banks may face liquidity problem. If the liquidity crisis is severe, this may even lead in liquidation of the bank. Due to the recent financial and economic crisis, especially in South-East Asian nations, bank's faced similar type of situation ultimately resulting in vulnerable level of non-performing loans on their assets total portfolio structure. In such a situation, most of the countries suffering from such crisis have realized the need for the establishment of AMCs in the direction to restructure the banking sector and resolve the problem of NPLs. These AMCs have served as the groundwork for banking institutions to recover its soundness.

From the specialization point of view, to achieve the efficient performance from the financial system, financial institutions need to be operated within their specialized areas. That is why; many specialized financial institutions need to be incorporated that suit the nature of businesses and activities they undertake in the system. The nature of business that commercial banks undertake does not provide them adequate skill and expertise in handling and managing of NPLs efficiently. Therefore, the efficient managers of commercial banks prefer for disposing the NPLs as soon as possible with the objective of holding adequate level of performing loans all the time. This will help them to improve profitability and liquidity positions. Therefore, the

management of NPLs has not been the core business for the commercial banks. On the contrary, AMCs, as specialized institutions, can perform the same task more effectively, efficiently and qualitatively at a relatively low cost in resolving the problems. Acquisition, management (restructuring) and ultimately disposition of NPLs of banks and financially distressed financial institutions have been the core area of business for AMCs.

AMCs are the most important institutions to improve the overall quality of assets of the financial system. AMC buys non-performing loans or distressed loans first and then tries to improve the quality of assets and disposes to the market. The basic approaches applied by the AMCs are 'portfolio fishing' and 'portfolio trawling'. Viable loans are managed under first and non-viable under the second approach. These AMCs can carry out such assignment so easily by adopting various strategies to improve the quality of assets; e.g., debt restructuring, corporate restructuring, assets management techniques and speedy disposition of unviable assets. Moreover, the time factor is most crucial element while recovering the value of NPLs for both banks and AMCs. In this scenario, the speed of recovery is important because time element determines the value of recovery; i.e. the one rupee that has been recovered today will be worth more than one rupee to be recovered tomorrow. The experience of some crisis-hit countries clearly shows that AMCs are efficient in disposing assets in terms of value of recovery, if evaluated through the net present value calculations.

AMCs have been established in many countries in Asia, Europe and America. Especially in Asian countries; Japan, Indonesia, Korea, Malaysia, China, Philippine



and Thailand have already established AMCs. India is in the process of establishing Assets Reconstruction Corporation.

He explains in his article that why an AMC is needed in Nepal: The problem of NPLs has also been a burning issue in the Nepalese banking system since last few years. The level of NPLs has been recorded at 17 percent of total loans and advances of the banking system. The levels of such NPLs within Rastriya Banijya Bank and Nepal Bank Limited have been estimated to be even higher than that of national average of the banking system. The tolerable level of NPL depends on the definition of NPL and requirements of provisions for such loans. Generally, level of NPA should not be in the double-digit figure. The level of NPL in the banking system is high in Nepal and this scenario has clearly revealed the urgency of establishing an AMC as soon as possible. Therefore, the sooner we establish the AMC, the quicker we can resolve the problem. This can be regarded as one of the first efforts on the part of NRB for the development of institutional infrastructure of the financial system in Nepal.

From the above explanation, it becomes clear that the AMC is a prominent force in dealing with NPLs in the financial system. Nepalese financial system does not have any institution that can undertake and manage NPLs and distressed loans of the banking system. Therefore it is the need of the day to establish an AMC as soon as possible. It must be noted that the AMC should be capable of tackling the problems as well as be functional to the task assigned. It must be efficient, practical and solution oriented and enriched with professionals. Moreover, it should be capable of taking necessary steps to enhance the operating environment. It has been observed that in

some countries, the government has been compelled to arrive at the stage of establishing national level AMC on state ownership, sooner or later. Therefore, AMC in national level on government ownership is seen to be effective in terms of economies of scale, efficacy and unbiased performance. So far the life of AMC is concerned, the government generally intends to establish with finite life to achieve quick recovery and to avoid moral hazards; whereas private sector seems to be more profit oriented, aiming at maximizing returns on their investment on the basis of going concern concept. Therefore, to sum up, it can be said that the establishment of AMC structure on government ownership, the board and management consisting only of professionals of the field, setting of transparent functioning procedures and adequate legal power to function it are the needs of the day. (Dhungana, 2001:10)

#### **“Portion of NPA in Commercial Banks- High in Public, Low in Private”**

Narayan Sapkota (2004) has written an article titled “Portion of NPA in Commercial Banks- High in Public, Low in private” which was published in Rajdhani on 19<sup>th</sup> May, 2004. In this article, Mr Sapkota has stated that the problem of NPL is seen less in private banks in comparison to public banks. The NPA of two big nationalized banks being about 60% of the total loans are in very serious situation. He further mentioned that in order to improve this situation and to make healthy banking environment, financial reform program has been brought as its consequences, the management of two banks was handed to foreign company on contract but the ratio of NPL was not reduced.

Even most of the privately owned banks has NPA within international standard, some privately owned bank's NPA is higher than that of international standard. As per

international standard 5% NPA is acceptable. He also states that, Nepal's total NPA of banking sector is 30% which is very high (Sapkota, 2004: 5).

### **“Non –Performing Assets Management”**

In the article by Yogendra Regimi (2005) titled “Non –Performing Assets Management”, the writer stated about the management of NPAs in the commercial banks. He writes, the NPAs includes the non-performing loan, suspend interest and unutilized assets. The increasing NPAs are the emerging problem in commercial banks, which is the main factor of failure of banks,

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

He added that increasing NPAs directly affects to the banks, investors and human resources. Not only that but also it affects the customer, economy of country, and business activities. Increasing NPA has two types of impact. In internal, it affects directly on profitability and human resources and in external, it affects to customers, investors, management and country's economy (Regmi, 2005: 75).

### **NPL Problem: Waiting for Some Solid Actions!**

) NPL problem has remained a striking issue of the Nepalese banking system. As of mid-January 2007, NPL of the Nepalese banking system is 14.08%, which is far higher than the international standard.

- J Though the level of NPL has declined over the past few years, there is much more to be done particularly in case of RBB and NBL whose level of NPL is still 34.08% and 15.64% respectively.
- J High level of NPL indicates the systemic crisis in the financial system. It is an indicator of insolvency, credit crunch, and abnormality. Economic growth cannot be guaranteed without financial development. Studies have shown a strong correlation between financial development and economic growth and financial development is not possible without a prudent and sound financial system. NPL below 5% is a prerequisite for the stable financial system.
- J Past efforts have not completely become futile. The level of NPL has come down in both RBB and NBL. Reform programs have paid but are still far away from the minimum satisfactory standard.
- J What is causing the NPL? Both internal and external factors. Internal factors are risk management deficiencies in the banks and financial institutions, weak corporate governance, poor accounting and auditing standards, poor recovery efforts and asymmetric information and moral hazard problems. External factors causing NPL are lack of financial discipline, weak credit culture, poor legislative framework, political influence and connected lending.
- J What has been done? NRB introduced a number of policies to mitigate the problem of NPL. These are directives on good corporate governance, adequate capital in relation to risk weighted assets, monitoring the concentration of assets, formulating and implementing credit policy, and strengthening the credit information system and blacklisting procedures.

J However, some solid actions are the need of the hour ([www.nrb.org.np/special](http://www.nrb.org.np/special) publication 2007).

**“What is NPA (Non-Performing Asset)?”**

Action for enforcement of security interest can be initiated only if the secured asset is classified as non-performing asset.

NPA means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI.

An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement systems, recovery climate, up gradation of technology in the banking system, etc., it was decided to dispense with 'past due' concept, with effect from March 31, 2001. Accordingly, as from that date, a Non performing asset (NPA) shall be an advance where:

- i. Interest and /or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan,
- ii. The account remains 'out of order' for a period of more than 180 days, in respect of an overdraft/ cash Credit(OD/CC),
- iii. The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,

- iv. Interest and/ or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
- v. Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

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

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

### **‘Out of Order’**

“An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/ drawing power. In case where the outstanding balance in the principal operating account is less than the sanctioned limit/ drawing power, but there are no credits continuously for six months as on the date of balance sheet or credits are not enough to cover the interest debited during the same period, these account should be treated as 'out of order'.

### **Overdue**

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank (Source: [www.helplinelaw.com](http://www.helplinelaw.com)).

### **NPL ASIA: Non-Performing Loan Newsletter**

Activity levels have picked up substantially across the region. Although in Japan, Korea and Taiwan there appears to be limited scope for any major NPL disposals in the near future, the China NPL market is hot. Investors in India are also showing enthusiasm in setting up appropriate investment structures. To reduce selling NPLs via large lots perhaps at a discount. In Malaysia, we expect a catalytic chain of sell-offs this or early next year, and in the Philippines we expect banks and other financial institutions to take action either through auctions or negotiated sales. ([www.pwchk.com](http://www.pwchk.com))

### **Statement by the International Monetary Fund**

“Since the approval of the PRGF (poverty Reduction and Growth Facility) arrangement, significant process has been made in financial and public sector

reforms. In the financial sector, steps were taken on three forms: improved and banking environment (establishing the Debt Recovery Tribunal, issuing strengthened directives for blacklisting defaulters, and promulgating the Banking and Financial Institutions Ordinance), strengthening of the NRB (improving its organizational structure and reducing overstaffing), and restructuring of commercial and development banks (reducing non-performing loans and overstaffing at commercial banks and designing restructuring plans for the major development banks). In the public sector, the prioritization exercise of the MTEF now covers all development spending and preparation is under way to extend the coverage to include regular spending” (www.imf.org).

### **2.2.2 Review of Related Thesis**

Dinesh Khadka (2004) in his thesis “Non-Performing Assets of Nepalese Commercial Banks” with an objective to examine the level of NPAs in total assets, total deposit and total lending of Nepalese Commercial Banks. He also showed that the effects of non-performing assets on Return on Assets and Return on Equity of Nepalese Commercial Banks.

As research methodology simple percentage tool was used as arithmetical tool and Karl Pearson coefficient of correlation was used as a statistical tool. Coefficient was used to find out the correlation between return on total assets (ROA) and non-performing assets (NPAs) and correlation between NPAs and return on shareholder’s equity (ROE) as a statistical tool. As a financial tool Return on Equity (ROE) and Return on Assets has been used. All the sources of data used for the study are secondary data.



He said that despite of being loan advances more profitable those other assets it creates risk of non payment for the bank. Such risk is known as credit risk or default risk. Therefore, like other assets the loan and advances are classified into performing and non-performing assets on the basis of overdue schedule. Escalating level of NPAs has been becoming great problem in banking business in the world. In this context, Nepal cannot be run off from such situation. The level of NPAs in Nepalese banking business is very alarming. It is well known fact that the problem of swelling non-performing assets (NPAs) and the issue is becoming more and more unmanageable day by day. We are well known from different financial reports, newspaper and news that the total NPA in Nepalese banking system is about 35 billion, while it is very worse in case of two largest commercial banks Rastriya Banijya Bank (RBB) and (NBL).

Finally, he concludes that the level of NPA in sampled Nepalese commercial banks is not so alarming. The situation is quite satisfactory. But the increasing trend remain continue in coming days, the situation will be unmanageable and alarming. The CB could not give full attention towards supervising their lending and towards supervising their lending and towards recovering their bad loans perfectly. Level of NPA of Nepal Bangladesh Bank Limited (NBBL), Nepal SBI Bank Limited (NSBIBL) and Bank of Kathmandu (BOKL) seems very unsatisfactory. If the situation is not handled right now, it will be unmanageable and difficult to handle.

In other level of NPA of Nepal Investment Bank and NABIL Bank has been gradually decreasing every year. The NPA of NIBL is least (minimum) than all of other banks at the end of 2059/60. The high degree of negative correlation of different

Commercial Bank between NPA and ROA and NPA and ROE indicates towards the inverse relation between NPA and ROA and NPA & ROE. It means the level of NPA effect the return on shareholder's equity. Therefore, bank should reduce their level of NPA to increase the ROE and ROA.

He recommends that the banks should have to take enough collateral while lending loan, appropriate financial analysis, supervision, monitoring and control should be done. Lastly, those banks having high level of NPA should take immediate action towards recovering their bad loan as soon as possible. In case of default to repay the loan by borrower, the bank should dispose off the collateral taken from the borrower and recover principal and interest amount.

Niva Shrestha (2004) in her study "A study on Non-Performing Loan and Loan Loss Provisioning of Commercial Bank" with reference to Nepal Bank Limited, NABIL Bank Ltd and Standard Chartered Bank Nepal Limited has face an attempt to analyze the various aspects of non-performing loan in the commercial banks. Her main objectives of the study is to find out the proportion of non-performing loan factors lending to accumulation of non-performing loan, relationship between loan and loan loss provision on profitability of Commercial Bank.

She has used different research methodology which is very significant according to her objectives. She has used financial and statistical tools as a research methodology. Ratio analysis was used as a financial tool because it is widely used tool in financial analysis. Arithmetic mean, standard deviation, co-efficient of variation, correlation

coefficient and trend analysis has been used as statistical tools. Sources of data used for study are all secondary data.

She concludes, “Increasing non-performing loan is the serious problem of the banking sector in Nepal. Non-Performing assets directly affects the income flow of the bank. It has been found that NBL has very high portion of non-performing loan resulting to higher portion. Hence, even the bank has the highest investment in the most income generating assets i.e loan and advances, it is in loss. Even the private sector bank like average proportion on non-performing loan during the study period is higher than the acceptable. However in recent two year NABIL’s non-performing loan has shown significant decreased. Among the three banks SCBNL has the least loan loss provision. From these indicators it can be said that SCBNL is the best among the three banks. However, SCBNL seems less oriented towards lending. Hence, the lower percentage of NPL and provisioning of SCBNL is not only due to proper lending function but also due to proper lending function but also due to relatively lower investment in loans and advances” (Shrestha, 2004:99).

Further it is also mentioned that ineffective credit policy, political pressure to lend uncredit worthy borrowers, overvaluation of collateral are the major cause of mounting non-performing assets in government owned banks like NBL. Other factors lending to accumulation of NPAs are weak loan sanctioning process, ineffective credit monitoring and supervision system, economic slowdown, borrower’s misconduct , etc. in addition to this establishing recovery cell hiring Asset Management Company is also measure to resolve the problem of NPL.

She recommended that the factor which leads to non-performing loan is improper credit appraisal system, etc. Besides that negligence in taking information from credit Information Bureau may also lead to bad debts. Hence all three banks are recommended to be more cautious and realistic while granting loans and advances. After advancing loans there should be regular supervision and follow up for proper utilization of loan. It is also recommended that the banks to initiate training and development program for the employees to make them efficient and professional in credit appraisal, monitoring and proper risk management. The regulation regarding loan classification and provisioning is stringent and tighter than the previous. Hence, NRB should not only impose directives but also create supportive environment for the commercial banks. NRB is recommended to strength Credit Information Bureau (CIB) so that banks can get required credit information about the borrowers on time. This help in reducing NPL.

Arun Bhattarai (2006) has carried out “A Study on Non-Performing Assets and Non-Banking Assets of Commercial Banks with the objectives to find out the impact of NPA on profitability of the banks, the relationship of NBA and NPA to analyze the external factors that has significant contribution of the conversion of performing loans into NPA, to find out the internal factors that influences the proper management NPA.

So he has used both secondary and primary sources of data. He has also followed questionnaire method for collecting data. Statistical tool such as correlation analysis was used for analysis of secondary data and in some case financial tool such as ratio analysis was used.

In regard to the creation of high level of NPA, it has been found that relationship of borrower with top management is the major determining factor in lending. Since, loan floatation was made without being choosy and it results the high level of NPA in Commercial Bank are giving least weight on personal integrity of the borrower while floating loan. It is derived that follow up of over due loan and advances in Commercial Bank starts one month later after the maturity of the loan. It proves the poor loan recovery system in CB.

After the analysis it was found that bad intension, 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 loan. Some factors such as lack of portfolio analysis, not being effective credit policy and shortfall on security were also identified as factors affecting in NPA growth. Further, it was found that bad intension weak monitoring and management are the most responsible factor for NPA growth. Likewise, legal provision for recovery as a reason for increment in NPA in Nepalese banks has been found the factor having least impact supervision and monitoring system has been identified as average factor. At the same time, it has been identified that commercial banks gives highest priority to trade sector for lending its resources. Thus, it is found that the service sector is not given much priority.

He concludes that profitability of commercial banks has been affected due to increasing level of NPA. Bad intension, weak monitoring and mismanagement were found the major responsible factors of NPA growth. Lastly, he recommends that

while floating loan to the client there should be strong provision as well as proper attention should be given on the personal integrity of the borrower too. There should be strong follow up system in CB for the recovery of due loans. Strict monitoring and control system should be there for the timely recovery of loans. There should be approach of portfolio management. Lending towards the single sector of economy may create higher level of risk, thus it is recommended that the credit should be floated to the different sectors of the economy. Government has to formulate strong legal system to support the loan recovery process of commercial bank. It is felt that in absence of strong legal system and framework huge loans could be recovered. Willful defaulters should be punished under legal framework and government should help the CB for the recovery of due loans.

Since, NRB is the banker's bank and representative of government to monitor smooth functioning of the financial sector. Now it is high time that Nepal Rastra Bank should effectively monitor and formulate the directives to safeguard the interest of C.B.

Kumar Pradhan (2006) has arrived out in his research "A case study of non-performing assets of CB in Nepal (with special reference to Nepal Bank, Rastriya Banijaya Bank, Nepal Rastra Bank, Everest Bank, Standard Chartered Bank) with an objective to examine out level of NPL and the level of NPA in total assets, total deposits and total lending in selected CB, to evaluate the relationship between loan and loan loss provision in the CB, to present the trend line of the non-performing assets, loan and advances, loan loss provision of selected CB, to analyze the impact of non-performing assets in the performance of CB.

He has used financial and statistical tools as a research methodology. Ratio analysis was used as a financial tool because it is widely used tool in financial analysis. Arithmetic mean, standard deviation, co-efficient of variation, correlation coefficient and trend analysis has been used as statistical tools. The data used for the study are secondary data.

He adds that the finance is the blood of the any organization. Thus, its proper utilization may be caused of success of the business or organization. Today's banking industry is severely affected by the problem of non-performing assets (NPA). It can be concluded that improper credit appraisal system, ineffective credit monitoring and supervision system, economic slowdown, borrower's misconduct, and overvaluation of collateral, political pressures to lend for uncreditworthy parties etc. are the major factors lending to NPA.

He suggests that Nepalese banks have to remain focused in their efforts to recover their spiraling bad loans or NPA to sustain the positive trend of improving asset quality. Better risk management techniques, compliance with the core principles for effective banking supervision, skill building and training and transparency in transactions could be the solutions. Removal of non-performing loans from the banking system even through government or quasi government funds at times is essential.

It is found in his study that RBB has very high portion of NPL resulting higher provision but due to the change in management of RBB in Jan 16, 2003, the provision amount is drastically changed. The loan provision of RBB after change in

management is decreased from Rs 3842 million to Rs 1591 in year 2003 and Rs 11 million in year 2004. RBB and NBL invest most of their resources in the most of income generation assets i.e. loan and advances but they are in loss. Private sectors banks- NBBL, EBL, SCBNL invest least amount of their resources in loan and advances and their profits shows the positive during the study period. Their NPA are also acceptable whereas RBB and NBL have high NPA at the same period. Among them SCBNL is the best bank. And also it can be said that NBBL and EBL are quite satisfactory banks rather than RBB and NBL based on the above findings. The private sector's banks are less interested in lending loan and advances. Thus, it may be caused to get less NPA and loan loss provisioning and vice-versa to the public sector's bank.

He concludes that improper credit policy, political pressure to lend, lack of supervision and monitoring, economic slowdown, overvaluation of collateral are the major cause of occurring NPAs. In recent year, not only the private sector' banks (like NBBL, EBL and SCBNL) but also public sector's banks (RBB and NBL) are trying to maintain their loan and advances to control over becoming the NPA. To overcome the NPA from public bank they should try to recover their loan and interest amount on time and also make a suitable loan loss policy.

He recommends that banks should take serious action of recovering the bad loans. And also they should take remedial actions for new loans. It is also recommended that bank should provide loan amount of loan from their resources. They should invest their resources in the most income generating sources. It is harmful to the bank to decrease the loan loss provision without decrease in the loan and advances amount. It



is recommended that the bank should have to increase the provision amount to recover the bad loans.

Manju Kajree (2006) has carried out in her thesis “Central Bank guidelines on Non-Performing loans in Nepal, A case study on NABIL bank” with an objective to find out whether NRB guidelines are actually being implemented in case of NPL, to analyze the investment on share and debenture, to make the trend value analysis of deposit utilization and its projection for next five years. According to her, “Loan and Advances is one of the important terms in investment, while concerning about the loan and advances, one must not forget about the situation of Non-Performing Loan because it gives long term effect.

To achieve the objectives of the study she has used various financial, statistical and accounting tools as a research methodology. Simple analytical statistical tools such as percentage, Karl Pearson’s coefficient of correlation analysis have been used for the analysis. Time series and least square method have been also used. For financial analysis financial tools such as ratio analysis has been used. Sources of data used for analysis are secondary data collected from annual reports of respective banks, NRB directive, bulletins, newspaper’s articles, magazines,etc.

NRB has issued various directives to project the bank being bankruptcy. NRB has made all the existing commercial banks to raise the capital fund to minimum Rs. 1000 million by the July 2009. It has made a provision of single borrower limit to reduce the risk. To inject the confidence in depositor regarding the safety of their deposited

fund, NRB has also set a rule of cash reserve requirement. Similarly, NRB has made all the CB not to increase the interest rate spread with the maximum of 5%. Commercial Banks can't charge the interest rate more than 5% than they give to the depositors. To improve the quality of assets of CB and to be safe from the default of the loan repayment, NRB has directed CB to classify their loans on the basis of overdue aging and make loan loss provision there to. The performance of NABIL regarding deposit collection, granting loan and advances and investment and net profit are in increasing trend. Hence, to survive in this competitive market and to earn profit, banks need to keep optimum relation between deposit and credit policy. Deposit collection procedure and to mobilization should go together.

She concludes that the performance of NABIL regarding deposit collection, granting loan and advances and investment is quite satisfactory. NABIL has efficiently utilized its equity capital. The bank is also successful to maintain profit. The bank must maintain its high profit margin for well being in future.

It can be concluded that total deposit collection and total loan & advance are increasing year by year. The case of growth rates of net profit is also satisfactory. It is found that NABIL has followed the NRB directives for loan loss provision in case of growth rates of net profit is also satisfactory.

She recommended to NABIL Bank to maintain 25% loan loss provision of substandard loan and to maintain 50% loan loss provision of doubtful loan as per the NRB directives. To get success in this competitive banking environment deposit money must be utilized as loan & advances. Loan and advances is the largest item of

the bank in asset side. While granting the loan it should be borne in mind that large number of borrowing customers may benefit from the bankers' fund. Negligence in administering these assets could be the main cause of liquidity crisis in the bank and one of the main reasons of a bank's failure. Regarding non-performing loan it is found substandard and doubtful loans are decreasing but bad loan is fluctuating. So, NABIL must try to decrease bad loan as well. She recommends bank to implement a sound collection policy which should ensure rapid identification of fake loans, immediate contact with borrower and continual follow up until a loan is recovered in full.

Jay Lal Neupane (2006) in his study "Study on Non-Performing Loan and Loan Loss provisioning of CB (with reference to NBL, RBB & NABIL) aimed to analyze the guidelines and provision pertaining to loan classification and loan loss provision and to analyze the impact of loan loss provision on the profitability of commercial banks. According to him "the banking business is very risky and required strong provision to protect the depositor's money while disbursing the loans. Proper classification of loans and adequate loan loss provisioning strengthens the financial health of the banks and also reflects the true picture of bank's assets."

As a research methodology both financial and statistical tools have been used. Financial tools were used to find out the strength and weakness of the firm by properly establishing relationship between the items of the balance sheet and profit and loss account such as ratio analysis, credit deposit ratio, etc. Statistical tools were used to facilitate the analysis and interpretation of numerical data such as mean, standard deviation, coefficient of variation, correlation coefficient, trend analysis, etc.

He has pointed out the problems of CB as “commercial bank /financial institutions have been facing several problems like lack of smooth functioning of economy different policies and guidelines of NRB, political instability, security problem, poor information system, over liquidity caused by lack of good lending opportunities, increasing non-performing assets, etc. in the present context where Nepalese Banks are facing the problem of increasing NPAs, more amounts have to be allocated for loan loss provision. He had concluded that ineffective credit policy, political pressure to lend non-viable projects, overvaluation of collateral and even without collateral disbursement is the major cause of mounting non-performing assets in government owned banks like RBB. In addition lending factors of accumulating NPAs are poor security system and economic recession willful defaulters etc. Proper classification and close review of loans enable banks to monitor loan portfolio and take remedial step to safeguard deterioration of its credit quality. Further more, establishment of strong recovery cell hiring Asset Management Company, implementation of proper rules and laws are also essential to solve the problem of NPL. Present NRB directives are more effective than previous as a result proper classification of loans and adequate provisioning for the future distress situation.

It is recommended that banks should have proper information system to gather required information of borrowers and their business so that preventive measure can be applied before downgrading the borrowers. By the availability of sufficient information of the borrower if indicates borrowers activities and business is not good, necessary precautions can be taken on time. As this is an age of information, banks should update with various business related information.

## **2.5 Research Gap**

Going through the review of literature it has been found that various researches have been found on banking sector but most of the previous works are concentrated on the financial performance of banking sector. From the study it has been found that increasing non-performing loan followed by increased loan loss provision is one of the challenges faced by CB in the present context. Some researches were done in which matters relating to loan loss provisioning has been discussed but no research was found in detailed analysis. Although, some research has been done on "the relationship between Non-performing assets & Non-banking assets". Another on Loan Loss Provisioning and another on Non-performing assets of established banks as Nepal Bank Ltd, Rastriya Banijaya Bank, Nepal Bangladesh Bank, Everest Bank Ltd, and Standard Chartered Bank Nepal Ltd. Central bank's guidelines on Non-performing loans in Nepal have also been researched.

But actual picture of NPA level has not been shown clearly and also actual cause of NPA. Hence, an attempt has been made to fill this research gap by taking reference of Nepal Investment Bank Limited, Himalayan Bank Limited, Everest Bank Limited, Nepal Credit & Commerce Bank Limited, Laxmi Bank Limited, Macchapuchre Bank Limited. This research will be able to deliver some of the critical facts that have been faced by the Nepalese banking industry, present issues, latest information and data regarding Bank's NPAs and their level, ratios data and real picture of NPA of Nepalese commercial banks.

Difference from other thesis: This study has tried to find out the level of non-performing assets of both joint ventured and non-ventured bank. Among the sample banks of the study NIBL, HBL, EBL & NCC are joint-ventured with Credit Agricole Indosuez Bank of France, Habib Bank of Pakistan, Punjab National Bank of India and Bank of Ceylon of Srilanka respectively. This study is also focused on the level of NPA of those banks which has started its operation earlier and are established in financial sector and it has also tried to find out level of Non- performing assets of new bank like Laxmi Bank Ltd. Which has started its operation from April 2002 only and completed five years.

## **CHAPTER - III**

### **RESEARCH METHODOLOGY**

#### **Introduction**

The nature of research conducted even in a common topic may vary considerably such as social research, scientific research or business research. Thus, the research work in a common topic may be employed on the basis of available resources in different ways and consequently leads to different results.

Because of dynamic nature of society, the results of research in the same topic for a particular period of time becomes false for other period due to the factors like education, urbanization, employment, development in transportation, communication, etc. for e.g. The response of individuals towards the consumer goods produced by a factory, if observed excellent in a research may not necessarily remain the same in other research works. The reasons for such results are different factor like taste, habit, substitution, income, etc which are closely related to the individuals.

But, science is based on real and verifiable conclusion. Therefore, once verified/examined results remain same for other time too. The social and business researches lack the valid conclusions. Hence, it is necessary to employ scientific methods of research in the same topic.

Research is essentially a systematic inquiry seeking facts through objectives verifiable methods in order to discover the relationship among them and to deduce from them broad principles or laws. This is method of defining and refining

problems, formulating hypothesis or suggested solution, collecting, organizing and evaluating data, making decisions and making conclusions. “Research is the process of a systematic and in-depth study or search of any particular topic, subject or area of investigation backed by the collection, compilation, presentation and interpretation of relevant details or data. It is a careful search or inquiry in to any subject matter, which is an endeavor to discover or find out valuable facts which will be useful for further application or utilization.” (Joshi, 2001: 96).

Research Methodology depends on the various aspects of the research project. The size of the project, the objective of the project, importance of the project, time frame of the project, impact of the project in the project in the various aspects of the human life, etc, are the variables that determine the research methodology of that particulars project.

“Research Methodology refers to the various sequential steps to adopt by a researcher in studying a problem with certain objectives in view,” (Kothari, 1989). In other words, Research Methodology describes the methods & proves applied in the entire aspect of the study.

### **3.1 Research Design**

Research is a plan for the collection and analysis of data. It is specific presentation of the various steps in research process such as research problem, presentation of problems, formulation of hypothesis, conceptual clarity, and methodology, survey of literature and documentation, bibliography, data collection, testing of hypothesis,



interpretation, presentation and report writing. In other words, research design is the specification of methods and procedures for acquiring the information needed. Meaning of research in the words of scholars is as follows.

“A research design is the arrangement of conditions for collection & analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure” (Kothari, 1992: 22).

Research is the plan, structure & strategy of investigations conceived so as to obtain to research questions & to control variances. It is the arrangement of conditions for collection & analysis of data. “A research design is the specification of methods and procedures for acquiring the information needed. It is the overall operational pattern of framework, of the project that stipulates what information is to be collected from which source by what procedures. If it is good design, it will ensure that the information obtained is relevant to the research questions and that it was collected by objective and economical procedures” (Paul, Donald & Tull, 1999:135).

“Research design is like a philosophy of life; no one is without one, but some people are more aware of theirs and thus able to make more informed and consistent decisions. Similarly, every type of empirical research has an implicit, if not explicit, research design. Because a design always exists, it is important to make it explicit, to get it out in the open where its strengths, limitations and implications can be clearly understood”.

Research design is the definite procedure and techniques, which guides the study and the ways to do the study. This in fact is the specific presentation of the various steps in research process. These steps include the selection of a research problem, presentation of the problem, methodology, survey of literature, data collection, interpretation and presentation, report writing and bibliography.

The main objective of research design is to make analysis in non-performing assets of commercial banks in Nepal and provide valuable recommendation. In other words, this research is aimed at studying the non-performing assets of commercial banks. This will follow analytical and descriptive research design. And it also analyzes the composition of trend of non-performing assets, loan recovery and profitability condition of commercial banks. The design for this research is made by collection of information from different sources by using various financial statistical tools.

### **3.2 Population and Sample**

The term 'population' for research means all the member of any well defined class of people, event or object. It means that the entire group of people, events or things of interest that a researcher wished to investigate. A representative part of population selected from it with the objective of investigating its properties is called sample. For purpose of study, the random sampling had been used to analysis about total member, number and inters group number.

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

**Table 3.1**  
**Total Population of Commercial Banks and Sample Banks**

| No.       | Names                                       | Operation Date (A.D.) | Head Office                       | Paid up Capital (Rs. In Million) |
|-----------|---|-----------------------|-----------------------------------|----------------------------------|
| 1         | Nepal Bank Limited                          | 1937/11/15            | Kathmandu                         | 380.4                            |
| 2         | Rastriya Banijya Bank                       | 1966/01/23            | Kathmandu                         | 1172.30                          |
| 3         | Agriculture Development Bank Ltd.           | 1968/01/02            | Kathmandu                         | 9278.00                          |
| 4         | NABIL Bank Limited                          | 1984/07/16            | Kathmandu                         | 689.20                           |
| <b>5</b>  | <b>Nepal Investment Bank Limited*</b>       | <b>1986/02/27</b>     | <b>Kathmandu</b>                  | <b>1203.00</b>                   |
| 6         | Standard Chartered Bank Nepal Ltd           | 1987/01/30            | Kathmandu                         | 620.80                           |
| <b>7</b>  | <b>Himalayan Bank Limited*</b>              | <b>1993/01/18</b>     | <b>Kathmandu</b>                  | <b>1013.50</b>                   |
| 8         | Nepal SBI Bank Limited                      | 1993/07/07            | Kathmandu                         | 874.50                           |
| 9         | Nepal Bangladesh Bank Limited               | 1993/06/05            | Kathmandu                         | 744.10                           |
| <b>10</b> | <b>Everest Bank Limited*</b>                | <b>1994/10/18</b>     | <b>Kathmandu</b>                  | <b>831.40</b>                    |
| 11        | Bank of Kathmandu Limited                   | 1995/03/12            | Kathmandu                         | 603.10                           |
| <b>12</b> | <b>Nepal Credit and Commerce Bank Ltd.*</b> | <b>1996/10/14</b>     | <b>Siddharthanagar, Rupendehi</b> | <b>1275.80</b>                   |
| 13        | Lumbini Bank Limited                        | 1998/07/17            | Narayangadh, Chitawan             | 750.00                           |
| 14        | Nepal Industrial & Commercial Bank Ltd.     | 1998/07/21            | Biaratnagar, Morang               | 792.00                           |
| <b>15</b> | <b>Machhapuchhre Bank Limited*</b>          | <b>2000/10/03</b>     | <b>Pokhara, Kaski</b>             | <b>821.70</b>                    |
| 16        | Kumari Bank Limited                         | 2001/04/03            | Kathmandu                         | 900.00                           |
| <b>17</b> | <b>Laxmi Bank Limited*</b>                  | <b>2002/04/03</b>     | <b>Birgunj, Parsa</b>             | <b>732.00</b>                    |
| 18        | Siddhartha Bank Limited                     | 2002/12/24            | Kathmandu                         | 790.00                           |
| 19        | Global Bank Ltd.                            | 2007/01/02            | Birgunj, Parsa                    | 700.00                           |
| 20        | Citizens Bank International Ltd.            | 2007/6/21             | Kathmandu                         | 560.00                           |
| 21        | Prime Bank Ltd                              | 2007/9/24             | Kathmandu                         | 700.00                           |
| 22        | Sunrise Bank Ltd.                           | 2007/10/12            | Kathmandu                         | 700.00                           |
| 23        | Bank of Asia Nepal Ltd.                     | 2007/10/12            | Kathmandu                         | 700.00                           |
| 24        | Development Credit Bank Ltd.                | 2001/01/23            | Kamaladi, Kathmandu               | 301.00                           |
| 25        | NMB Bank Ltd.                               | 1996/11/26            | Babarmahal, Kathmandu             | 1000.00                          |

*Source: Nepal Rastra Bank, Banking and Financial Statistics, Mid-July 2008)*

*(Note: Name of Bank denoted by \* are Sample Banks)*

A total number of 20 banks were licensed and commercial banks with head office in Kathmandu valley were 14 in number. The commercial banks of Nepal can be categorized into two type namely public sector and private sector. Public commercial bank includes two banks; Nepal Bank Ltd. and Rastriya Banijya Bank and private bank states other remaining 18 banks. Out of the total population, following six banks are drawn as samples for this study.

1. Nepal Investment Bank Ltd.
2. Himalayan Bank Ltd.
3. Everest Bank Ltd.
4. Nepal Credit and Commerce Bank Ltd.
5. Machhapuchchhare Bank Ltd.
6. Laxmi Bank Ltd.

Among the banks Nepal Investment Bank Ltd, Himalayan Bank Ltd and Everest Bank Ltd have come on long way in banking history and achieved certain rewards and its head offices are in Kathmandu valley. On the other hand, Nepal Credit and Commerce Bank Ltd, Macchapuchre Bank Ltd. and Laxmi Bank Ltd is on developing stages and has its head offices outside valley. Main objective of this research is to find the level of NPA among different stages of banks.

### **3.3 Sources of Data**

This study is mainly based on secondary data. The data relating to the non-performing assets, published articles, books, newspaper, web sites and annual reports of concerned banks are the secondary sources of data. In this study, secondary data were taken from annual reports of related banks, annual reports of Nepal Rastra Bank,

bulletins and Nepal Rastra Bank Samachar, newspapers and magazines, different websites, libraries, unpublished thesis and journals.

All the secondary data are compiled, processed & tabulated in the time series as per the need and objectives. Similarly, various data & information are collected from economic, journals & research works from various sources, academic books, various articles published in the news paper, world wide web; the internet.

### **3.4 Data Processing Procedures and Analysis**

After collection of research data, an analysis of data and interpretation result are necessary. Applying different financial and statistical tool made data analysis. Further to represent the data in simple form bar diagrams and graphs have also been used.

#### **3.4.1 Financial Tools**

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

“Financial analysis is the use of financial statement to analyze a company’s financial position and performance and to assess future financial performance” (Wild Subramanyam and Halsey, 2003:13).

##### **3.4.1.1 Ratio Analysis**

Ratio analysis is a tool of scanning the financial statement of the firm. Its ratio is simply one number expressed in terms of another and such it expresses the numerical

or quantitative relationship between two variables. Through this one comes to know that in which areas operation the organization is strong and in which areas it is weak. Ratio analysis is the widely used tool of financial analysis. In financial analysis, a ratio is used as a benchmark for evaluating the financial position of the firm. Ratio analysis reflects the relative strengths and weakness of organization. “Ratios help to summarize large quantities of financial data and to make quantitative judgment about the firm’s financial performance. The relationship between two accounting figures expressed mathematically is known as financial ratios” even though there are many ratios, only those ratios have been calculated which are related to the subject matter. Following ratios have been computed and analyzed in this study.

#### **Loan and Advances to Total Assets Ratio**

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

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

### **Loan and Advances to Total Deposit Ratio (CD Ratio)**

The main objective of commercial banks is to make deposits and lend it in the secure field. The loan and advance to total deposit ratio shows the relationship between the loan and advance and total deposit. It shows how much fund of deposit is provided as loan and advance. This ratio is used to find out how successfully the banks are utilizing their deposited fund on credit or loan for profit generating purpose as loans and advances yield high rate of return. Higher CD Ratio implies the better utilization of total deposits and better earning. Hence, 70% to 80% CD Ratio is considered as more appropriate. This ratio can be calculated as follows:

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

### **Non-Performing Assets to Total Loans and Advances Ratio**

This ratio determines the non-performing assets in the total loan and advances portfolio. Greater ratio implies the bad quality of loan of the bank. Hence, lower non-performing assets to loans and advances ratio are preferable. As per international standard only 5 % NPA is allowed but in the context of Nepal 10% NPA is acceptable. It is calculated as under:

$$\text{NPA to Total Loans and Advances Ratio} = \frac{\text{Non – Performing Assets}}{\text{Total Loans and Advances}}$$

### **Provision Held to Non-Performing Assets Ratio**

This ratio describes the proportion of provision held to non-performing assets of the bank. This ratio measures up to what extent of risk inherent in NPA is covered by the total loan provision. Higher ratio signifies that the banks are safeguard against future

contingencies that may create due to non-performing assets. So, higher the ratio better is the financial strength of the bank. This ratio is calculated as follows:

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

### **Non-Performing Assets to Total Assets**

This ratio indicates the ratio between the non-performing assets and total assets. Higher NPA to total assets ratio implies the bad effects in banks performance and it decreases the profitability of the bank and lower ratio implies the better performance of the bank and it increases the profitability of banks. This ratio can be calculated as follows:

$$\text{NPA to Total Assets} = \frac{\text{Non-Performing Assets}}{\text{Total Assets}}$$

### **Return on Loans and Advances**

This ratio indicates how efficiently the bank has employed its resources in the form of loans and advances. It is the ratio of net profit and total loans and advances. It is the ratio of net profit which is obtained after all types of deduction like employee bonus, tax, provision, etc. hence, this ratio measures bank's profitability with respect to loans and advances. Higher the ratio better is the performance of the bank. It is calculated as below:

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

### **Risk Ratios**

Risk taking is the prime business of bank's investment management. It increases effectiveness and profitability of the bank. These ratios indicate the amount of risk



associated with the various banking operations, which ultimately influences the banks investment policy.

The following ratios are evaluated under this topic:

### **Credit Risk Ratio**

Credit risk ratio measures the possibility that loan will not be repaid or that investment will not give profit. Credit risk ratio is expressed as the percentage of non-performing loan to total loan and advances. Here, total loan and advances by total assets derives this ratio.

This can be started as,

$$\text{Credit Risk Ratio} = \frac{\text{Total Loan and Advances}}{\text{Total Assets}}$$

### **3.4.2 Statistical Tools**

Statistical tools are the mathematical techniques used to facilitate the analysis and interpretation of numerical data. “Statistical Analysis is one particular language, which describes the data and makes possible to talk about the relation and the difference of the variables of organization. In this study following statistical tools are used.

#### **Arithmetic Mean**

The arithmetic mean or simple mean of a set of observation is the sum of all the observation divided by the number of observation (Bajracharya, 1996:177). It is the

best value which represent to the whole group. Mean is the arithmetic average of a variable. Arithmetic mean of a series is given by:

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

Where,

X = sum of the variable 'X'

N = No. of observation

### **Standard Deviation**

The standard deviation is the absolute measure of dispersion in which the drawback present in other measure of dispersion as it satisfied most of the requisites of a good measure of dispersion (Bajaracharya, 1996:177). Standard deviation is defined as the positive square root of the mean of square of the deviation takes from the arithmetic mean. It indicates the ranges and size of deviance from the middle or mean. It measures the absolute dispersion. Higher the standard deviation higher will be the variability and vice versa.

Dispersion measures the variation of the data from the central value. In other words, it helps to analyze the quality of data regarding its variability. It can be;

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

### **Co-efficient of Variation (CV)**

Standard deviation is the absolute measure of dispersion. The relative measure of dispersing based on the standard deviation is known as the measurement of co-efficient of standard deviation. The percentage of measure of co-efficient of standard deviation is called co-efficient of variation (Shrestha and Silwal, 2002:315). Less CV is the more uniformity and consistency and vice versa. Only standard deviation is not appropriate to compare two pairs of variables but also CV is capable to compare two variables independently in terms of their variability. It is calculated as under:

$$\text{Co-efficient of Variation (CV)} = \frac{S}{\bar{X}} \times 100$$

### **Correlation Co-efficient (r)**

Correlation is defined as the association between the dependent variable and independent variable. It is a method of determining the relationship between these two variables. If the two variables are so related change in the value of independent variable cause the change in the value of dependent variable then it is said to have correlation coefficient (Sunity and Silwal, 2000:325).

$$\text{Correlation Co-efficient (r)} = \frac{N\sum XY - \sum X \sum Y}{\sqrt{N\sum X^2 - (\sum X)^2} \sqrt{N\sum Y^2 - (\sum Y)^2}}$$

The Karl Pearson Coefficient of Correlation always falls between  $-1$  to  $+1$ . The value of correlation of coefficient in  $-1$  signifies the negative correlation and in  $+1$  signifies the positive correlation coefficient.

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

If,  $r < 0$ , there is negative relationship between the variables

If,  $r > 0$ , there is positive relationship between the variables

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

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

The correlation coefficient gives the actual relationships but sometimes it may give the error. The reliability of the correlation coefficient ( $r$ ) can be checked with the help of probable error (PE). It is calculated as under:

$$\text{Probable Error (PE)} = 0.6745 \times \frac{(1-r^2)}{\sqrt{N}}$$

Where,  $r$  = correlation coefficient

$N$  = no. of observation

### **Decision:**

If  $r > 6 \text{ PE}$ , the correlation is significant and reliable

If  $r < 6 \text{ PE}$ , the correlation coefficient is insignificant and there is no evidence of correlation.

### **Trend Analysis**

A series formed from a set of statistical data arranged in accordance with their time of occurrence is said to be a time series. It is one of the statistical tools, which indicates the improvement or decrement of the financial situation. It helps to determine the

future values of the variables. The way from which the maximum information can be drawn from the figure collected is known as the analysis of time series.

$$Y = a + bX$$

Where,

Y = Trend value

a = Y intercept

b = slope of trend line of the amount of change in Y variable that is an associate with change in 1 unit in X variable

X = Time variables

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

$$Y = Na + b \sum X \dots\dots\dots (i)$$

$$\sum XY = a \sum X + b \sum X^2 \dots\dots\dots (ii)$$

Where, N = number of years

But for simplification, if the time variables is measured as a deviation form its mean I.e. mid point is taken as the origin, the negative value in the first half of the series balance out the positive values in the second half so that  $\sum X = 0$ . The values of constants a and b can easily be determined by using following formula.

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

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

## **Diagrammatic and Graphical Representation**

Picture speaks itself, no need to explain. It is also one of the tools that helps in the interpretation of the data and present the findings of the study. The various bars, charts and graphs are also used to present the data and data analysis in this study.

## **CHAPTER - IV**

### **DATA PRESENTATION AND ANALYSIS**

In this chapter, raw form of data which are collected from various sources are processed and changed into an understandable presentation using financial as well as statistical tools supported by diagrams and graphs as mentioned in the previous chapter. Similarly, the process of transforming of data is called analysis for the examination and interpretation of the data to draw conclusion. Therefore, this chapter is the heart of the study as all the findings, conclusions and recommendations are going to be derived from the calculations and analysis done in this section.

The use of secondary data is much extensive which were collected through records of annual reports. Different financial and statistical tools were used to analyze ratio, correlation and trend of the selected bank's data.

#### **4.1 Ratio Analysis**

##### **4.1.1 Loan and Advances to Total Assets Ratio**

The ratio of loan and advances to total assets measures, the volume of loan and advances in the capital structure of total assets of any commercial bank. Loan and advances of any commercial banks represent the major portion in volume of total assets. The high degree of ratio indicates the good performance of the bank in mobilizing its fund through lending function. In other side, the high degree is the representative of low liquidity ratio. By lending certain amount of money to the customers banks can earn good interest which will directly affect the profitability of

the bank. Although granting loan and advances always carries a certain degree of risk it will also give good profit, as where there is risk there is high return. Thus, this asset of banking business is regarded as risky assets. Hence, this ratio is indicative of low productivity and high degree of safety in liquidity and vice versa.

The table presented below, shows the loan and advances to total assets ratio for last 5 years

**Table 4.1**  
**Loan and Advances to Total Assets Ratio (%)**

(In Million)

| Banks | Particulars | Mid-July |         |          |          |         | Mean  | S.D  | C.V  |
|-------|-------------|----------|---------|----------|----------|---------|-------|------|------|
|       |             | 2003     | 2004    | 2005     | 2006     | 2007    |       |      |      |
| NIBL  | L & A       | 5922     | 7339    | 10453    | 13178    | 17769   | 61.36 | 3.6  | 5.87 |
|       | TA          | 9164     | 13464   | 16391    | 21732    | 28074   |       |      |      |
|       | Ratio       | 64.62    | 54.51   | 63.77    | 60.64    | 63.29   |       |      |      |
| HBL   | L & A       | 10844.60 | 12919.6 | 13451.17 | 15761.97 | 17793.7 | 49    | 2.84 | 5.80 |
|       | TA          | 24198    | 25730   | 28871    | 30580    | 34315   |       |      |      |
|       | Ratio       | 44.82    | 50.21   | 46.59    | 51.54    | 51.85   |       |      |      |
| EBL   | L & A       | 5050     | 6096    | 7900     | 10136    | 14099.9 | 63.43 | 1.8  | 2.8  |
|       | TA          | 8193     | 9820    | 12074    | 16294    | 21433   |       |      |      |
|       | Ratio       | 61.40    | 62.08   | 65.43    | 62.21    | 65.79   |       |      |      |
| NCC   | L & A       | 3396     | 4437    | 5934     | 5837     | 5084    | 62.66 | 4.29 | 6.85 |
|       | TA          | 5638     | 7616    | 8698     | 8641     | 8619    |       |      |      |
|       | Ratio       | 60.26    | 58.26   | 68.22    | 67.55    | 59      |       |      |      |
| MBL   | L & A       | 1495.86  | 2540.79 | 5130.22  | 6068.90  | 7326.20 | 69.92 | 5.98 | 8.56 |
|       | TA          | 2399.86  | 3448.63 | 6456.46  | 9069.8   | 10897.2 |       |      |      |
|       | Ratio       | 62.33    | 73.68   | 79.46    | 66.91    | 67.23   |       |      |      |
| LBL   | L & A       | 775.94   | 1750.93 | 2726.14  | 4280.11  | 6437.45 | 72.74 | 4.83 | 6.64 |
|       | TA          | 1104.31  | 2602.9  | 3886.18  | 5282.9   | 8582.69 |       |      |      |
|       | Ratio       | 70.26    | 67.27   | 70.15    | 81.02    | 75      |       |      |      |

*Source: Annual Report Respective Banks*

The above table 4.1 exhibits the loan & advances to total assets of six banks namely NIBL, HBL, EBL, NCC, MBL and LBL for five consecutive years. The ratio of Loan



& Advances to Total Assets of NIBL was decreased to 10% from 2003 to 2004 but gradually increased in 2005, again decreased in 2006 & in 2007 also the ratio increased. This shows that bank has fluctuating trend in the ratio of Loan & Advances to Total Assets. Likewise, in HBL also the trend is decreasing increasing. The ratio of Loan & Advances to Total Assets in 2003 was 44.82% which reached to 51.85% in 2007. The trend is similar in case of EBL & NCC. But in case of MBL & LBL the trend is different. Ratio of Loan & advances to Total Assets in 2003 was 62.33% which increased in 2004 & 2005, decreased in 2006 again increased in 2007.

The mean ratio of NIBL, HBL, EBL, NCC, MBL & LBL are 61.36%, 49%, 63.43%, 62.66%, 69.92% & 72.74% respectively. Hence, Laxmi Bank has the highest proportion of loans & advances in the total assets structure followed by NIBL, HBL, EBL, and NCC & MBL. This refers that HBL has the lowest degree of investment in risky assets. The Management of HBL is risk averse they have invested higher proportion of their risky assets in risk free or nominally risky assets like Treasury Bills, Debentures, National Saving Bonds (NSBs), etc.

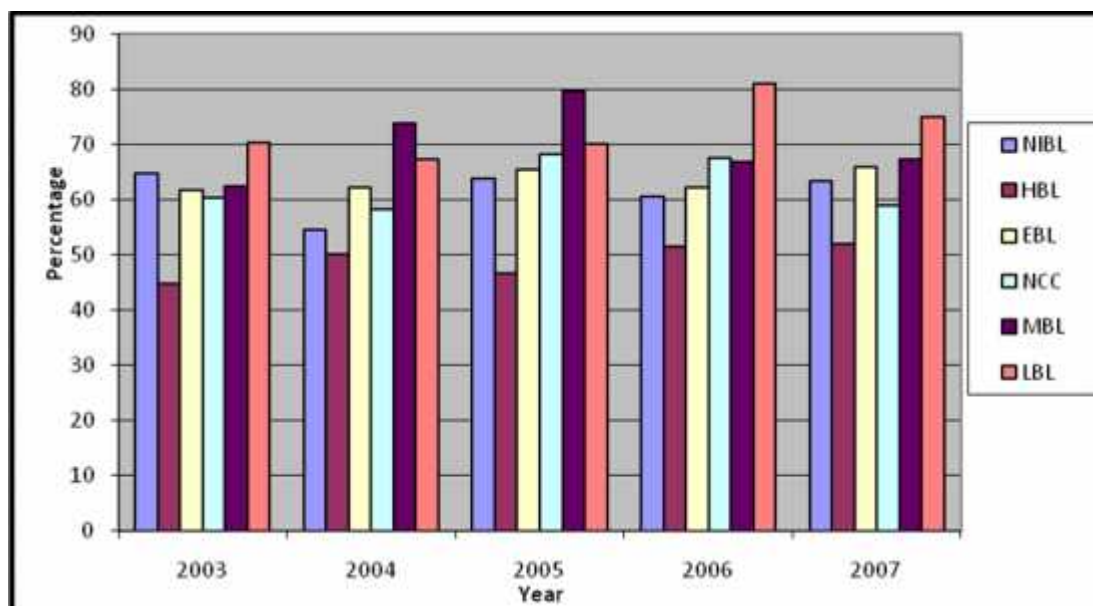
The standard deviation of NIBL, HBL, HBL, NCC and MBL & LBL are 3.6%, 2.84%, 1.8%, 4.29%, 5.98% & 4.83% respectively. It is also seen that total loan & advances to total assets of NIBL, EBL, NCC, MBL & LBL has higher proportion of their assets in risk bracket where as HBL has comparatively high liquidity available with this bank but lower portion of assets is low income generating.

If we see the Standard Deviation (S.D) & Co-efficient of Variation (C.V) of the ratio of these banks we can see that the MBL has the highest S.D and C.V of 5.98% and

8.56% respectively. This means it has highest variability in the portion of loan & advances in total assets. Similarly, EBL has the least S.D of 1.8% & C.V of 2.8% which shows the EBL has the most consistency in the proportion of loan & advances in total assets.

In conclusion, we can say that EBL shows the managed trend of loan & advances in total assets which means it disburse loan according to the size of growth of assets. Likewise, NIBL has the most volatile trend of flowing loan. It has not a constant policy of putting credit in certain ratio with total assets and other banks have moderate policy regarding proportion of loan & advances to total assets. The above loan & advances to total assets ratio can be presented in bar diagram also, which is as follows.

**Figure 4.1**  
**Loan and Advance to Total Assets Ratio (%)**



From the above figure, it can be interpreted that the LBL has the highest loan and advance to total assets ratio than others and HBL has the least loan and advance to

total ratio during the period of study. The ratio of NIBL shows the fluctuating trend similarly, HBL also shows decreasing increasing trend. The trend is similar in case of EBL and NCC. But, the trend is different in case of MBL and LBL. The ratio of Loan and Advances to Total Assets in 2003 of MBL was 62.33% which increased in 2004 and 2005, decreased in 2006 again increased in 2007. Similarly, in case of LBL also ratio decreased in 2004, increased in 2005 and 2006 and again increased in 2007.

#### **4.1.2 Loan & Advances to Total Deposits Ratio**

Loan & Advances to Total Deposits Ratio indicates the portion of deposit utilized as lending. This ratio is also called credit deposit ratio (C.D Ratio). Credit Deposit Ratio is the most important to analyze the banks utilization of their deposit & to know the liquidity position of the banks. The core banking function is to mobilize the funds obtained from the depositors to borrowers and earn profit and CD ratio is the fundamental parameter to ascertain fund deployment efficiency of commercial bank. In other words, this ratio is calculated to find out how successfully the banks are utilizing their total deposits on credit or loans & advances for profit generating purpose as loans & advances yield high rate of return. Greater CD Ratio implies the better utilization of total deposits and better earning, however liquidity requirements also needs due consideration. Hence, 70% to 80% C.D Ratio is considered by dividing total credit or loans & advances by total deposits of the bank.

**Table 4.2**  
**Loan and Advances to Total Deposit Ratio (%)**

(In Million)

| <b>Banks</b> | <b>Particulars</b> | <b>2003</b>   | <b>2004</b>   | <b>2005</b>  | <b>2006</b>  | <b>2007</b>  | <b>Mean</b>  | <b>S.D</b>  | <b>C.V</b>   |
|--------------|--------------------|---------------|---------------|--------------|--------------|--------------|--------------|-------------|--------------|
|              | L & Adv            | 5922          | 7339          | 10453        | 13178        | 17769        |              |             |              |
| <b>NIBL</b>  | T.D                | 7923          | 11706.3       | 14255        | 18927        | 24489        |              |             |              |
|              | <b>Ratio</b>       | <b>74.74</b>  | <b>62.69</b>  | <b>73.33</b> | <b>69.63</b> | <b>72.56</b> | <b>70.59</b> | <b>4.29</b> | <b>6.07</b>  |
|              | L & Adv            | 10844.6       | 12919.6       | 13451.17     | 15761.97     | 17793.7      |              |             |              |
| <b>HBL</b>   | T.D                | 21003         | 22761         | 24831        | 26456        | 29903        |              |             |              |
|              | <b>Ratio</b>       | <b>51.63</b>  | <b>56.76</b>  | <b>54.18</b> | <b>59.58</b> | <b>59.50</b> | <b>56.33</b> | <b>3.08</b> | <b>5.47</b>  |
|              | L & Adv            | 5050          | 6096          | 7900         | 10136        | 14099.9      |              |             |              |
| <b>EBL</b>   | T.D                | 6695          | 8064          | 10098        | 13803        | 19098        |              |             |              |
|              | <b>Ratio</b>       | <b>75.43</b>  | <b>75.59</b>  | <b>78.23</b> | <b>73.43</b> | <b>73.83</b> | <b>75.30</b> | <b>1.69</b> | <b>2.25</b>  |
|              | L & Adv            | 3396          | 4437          | 5934         | 5837         | 5084         |              |             |              |
| <b>NCC</b>   | T.D                | 4294          | 5960          | 6630.1       | 6620         | 6500         |              |             |              |
|              | <b>Ratio</b>       | <b>79.09</b>  | <b>74.45</b>  | <b>89.50</b> | <b>88.17</b> | <b>78.21</b> | <b>81.89</b> | <b>5.90</b> | <b>7.20</b>  |
|              | L & Adv            | 1495.86       | 2540.79       | 5130.22      | 6068.9       | 7326.2       |              |             |              |
| <b>MBL</b>   | T.D                | 1778.7        | 2754.6        | 5586.5       | 7893.3       | 9475         |              |             |              |
|              | <b>Ratio</b>       | <b>84.09</b>  | <b>92.24</b>  | <b>91.83</b> | <b>76.89</b> | <b>77.32</b> | <b>84.48</b> | <b>6.68</b> | <b>7.91</b>  |
|              | L & Adv            | 775.94        | 1750.93       | 2726.14      | 4280.11      | 6437.45      |              |             |              |
| <b>LBL</b>   | T.D                | 691.8         | 1684.3        | 3028.6       | 4444.3       | 7611.7       |              |             |              |
|              | <b>Ratio</b>       | <b>112.16</b> | <b>103.96</b> | <b>90.01</b> | <b>96.30</b> | <b>84.57</b> | <b>97.40</b> | <b>9.81</b> | <b>10.07</b> |

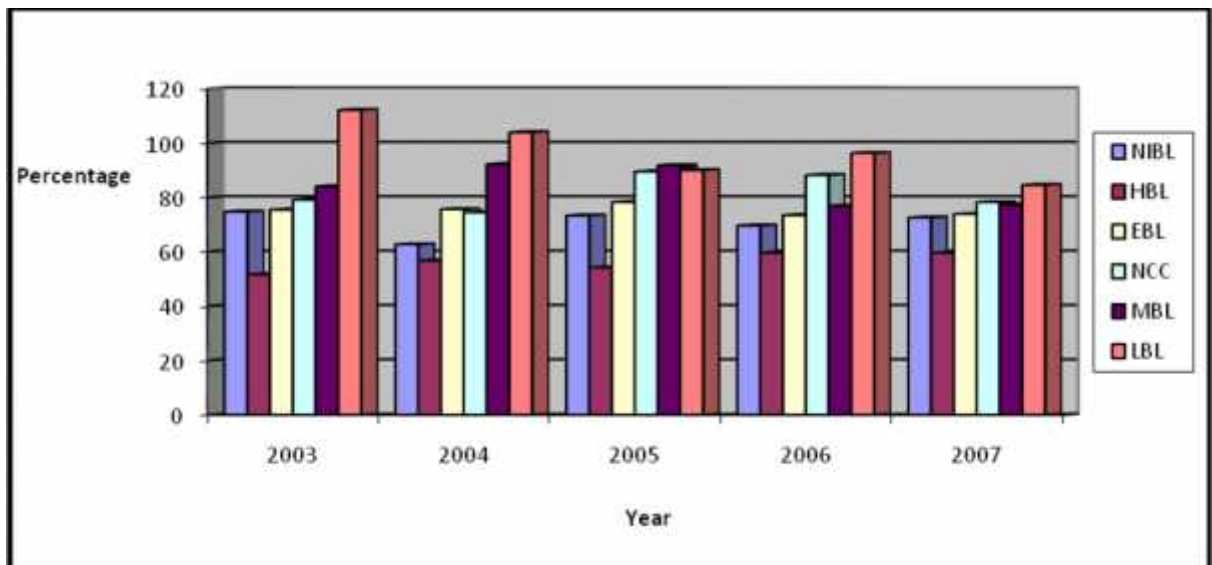
*Source: Annual Report Respective Banks*

The above table 4.2 exhibits the Loan and Advances to Total Deposit of banks for 5 consecutive years. This ratio shows the fluctuating trend in all six banks. The overall ratio of six banks has been ranged from 51.63% of HBL in the year 2003 to 112.16% of Laxmi bank in 2003.

The mean ratio of NIBL, HBL, EBL, NCC, MBL & LBL are 70.6%, 56.33%, 75.30%, 81.89%, 84.47%, 97.40% respectively.

Hence, among the six banks Laxmi bank has the highest proportion of loans and advances in the total deposit followed by NIBIL, EBL, HBL, and MBL & NCC. It signifies that it has the highest average Credit deposit ratio of 97.40% which is highest in banking industry. Likewise NCC & MBL have also 81.89% & 84.47% respectively of average Credit Deposit Ratio which is higher than recommended of 75%. But, in case of NIBL, HBL, and EBL it is 70.6%, 56.33%, 75% respectively which indicates enough liquidity available with these banks. It is also seen that HBL has low investment in the form of loans and advances other than five banks. That means management of HBL is risk averse as they have invested higher proportion of their deposits in risk free or nominally risky assets like treasury bills, debentures, National Saving Bonds (NSBs), etc. The standard deviation of NIBL, HBL, EBL, NCC, MBL & LBL are 4.12%, 3.05%, 1.69%, 5.84%, 6.7%, 9.83% respectively. Thus, it signifies that Laxmi has higher deviation with higher degree of variation in this ratio then after MBL also has higher ratio. Even though this ratio is least of EBL, it has the consistent ratio and the least deviation during the study period. Likewise, HBL's ratio which is 3.05% can be considered as low deviation in comparison to other banks. And NIBL and NCC are moderate in terms of deviation and variation during the study period. The above loan and advances to total deposit ratio can be presented in bar diagram also which is as follows.

**Figure 4.2**  
**Loan and Advance to Total Deposit Ratio (%)**



From the above figure, it can be interpreted that the LBL has the highest percentage of loan and advances to total deposit ratio from 2003, 2004, 2006, 2007 year but in the year 2005 MBL has highest ratio. Ratio of HBL, EBL is in continuous trend. But NIBL and NCC has fluctuating trend. In average LBL has the greater loan provider among them which renders highest amount of its total deposit in loan and advances with higher risk and return. HBL has the least ratio, which indicates that the bank renders low amount of its total deposit in loan and advances. It means, the LBL is the risk seeker bank and the HBL is risk adverse bank. As compared to other three moderate banks the EBL has the greater risk taker and others are in average. The ratio of NIBL, EBL, NCC, and MBL lies between 70% to 80%. Thus, they have suitable loan and advances to total deposit ratio than other banks.

#### **4.1.3 Non-Performing Assets to Total Loan and Advances Ratio**

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

The table (4.3) presented below exhibits the ratio of non-performing assets to loan and advances of 6 banks NIBL, HBL, EBL, NCC, and MBL & LBL for 5 consecutive years.

**Table 4.3**

**Non-Performing Assets to Total Loan and Advances Ratio (%)**

| <b>Banks</b> | <b>Particulars</b> | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>Mean</b> | <b>S.D</b> | <b>C.V</b> |
|--------------|--------------------|-------------|-------------|-------------|-------------|-------------|-------------|------------|------------|
| NIBL         | NPA                | 117.09      | 181.44      | 280.87      | 302.94      | 376.1       |             |            |            |
|              | L & Adv            | 5922        | 7339        | 10453       | 13178       | 17769       |             |            |            |
|              | Ratio              | 1.98        | 2.47        | 2.69        | 2.30        | 2.12        | 2.31        | 0.25       | 10.89      |
| HBL          | NPA                | 1093        | 1147.46     | 1001.35     | 948.69      | 629.8       |             |            |            |
|              | L & Adv            | 10844.6     | 12919.6     | 13451.17    | 15761.97    | 17793.7     |             |            |            |
|              | Ratio              | 10.08       | 8.89        | 7.44        | 6.01        | 3.54        | 7.20        | 2.28       | 31.68      |
| EBL          | NPA                | 111.19      | 104.76      | 128.81      | 121.85      | 107         |             |            |            |
|              | L & Adv            | 5050        | 6096        | 7900        | 10136       | 14099.9     |             |            |            |
|              | Ratio              | 2.20        | 1.71        | 1.63        | 1.20        | 0.76        | 1.50        | 0.49       | 32.54      |
|              | NPA                | 700.83      | 600.05      | 519.26      | 665.91      | 1568.7      |             |            |            |
| NCC          | L & Adv            | 3396        | 4437        | 5934        | 5837        | 5084        |             |            |            |
|              | Ratio              | 20.63       | 13.52       | 8.75        | 11.40       | 30.85       | 17.03       | 7.95       | 46.71      |
|              | NPA                | 31.1        | 24.98       | 19.86       | 16.99       | 82.2        |             |            |            |
| MBL          | L & Adv            | 1495.86     | 2540.79     | 5130.22     | 6068.9      | 7326.2      |             |            |            |
|              | Ratio              | 2.08        | 0.99        | 0.39        | 0.28        | 1.12        | 0.98        | 0.64       | 66.30      |
|              | NPA                | 0           | 0           | 44.49       | 27.78       | 23.1        |             |            |            |
| LBL          | L & Adv            | 775.94      | 1750.93     | 2726.14     | 4280.11     | 6437.45     |             |            |            |
|              | Ratio              | 0           | 0           | 1.63        | 0.64        | 0.36        | 0.53        | 0.60       | 114.26     |

*Source: Annual Report Respective Banks*

The table shows that the NCC has the highest ratio through out the study period and also shows the decreasing trend.

From the above table it is seen that NCC has highest ratio through the study period and NIBL shows the least ratio during the study period. NIBL bank has increasing trend of NPA. HBL, EBL, NCC has fluctuating trend but level of NPA of NCC in the year 2007 has increased to 1568.7 from 665.9 which shows that bank is unable to manage its credit and bank has not tried to recover bad debts. MBL has also same condition as NCC. Level of NPA from 2006 i.e. 16.99% has increased to 82.20 which indicates banks failure in the recovery of bad-debts. In case of Laxmi bank level of NPA in 2003 & 2004 has remained Nil because it was its initial period of operation. In 2005 it was 44.49 million but in 2006 & 2007 it has been decreased to 27.78 and 23.10 million respectively that mean bank has implemented effective credit management. And it has also made effort on recovering bad debts through establishment of Recovery Cell. The overall ratio has been ranged from 1.12% of MBL in 2007 to 30.86% of NCC in 2007.

The mean NPA to Total loan & advances ratio of NIBL, HBL, EBL, NCC, and MBL & LBL are 2.3%, 7.19%, 1.50%, 17.04%, .0.97% & 0.53% respectively. The ratio of NCC is significantly high in comparison to other banks and portrays the critical condition of the banks. NPL of HBL is near to the acceptable standard of 10% i.e. 7.19% but NIBL, EBL, MBL & LBL have lower NPA as prescribed by international standard i.e. 5%.

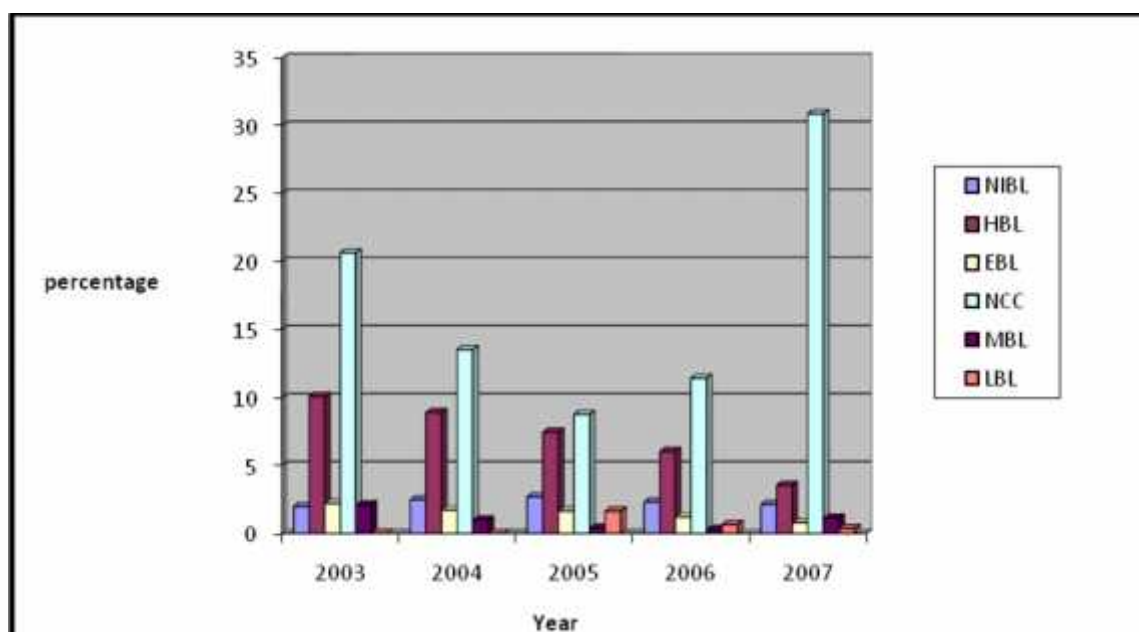


The standard deviation of NIBL, HBL, EBL, NCC, and MBL & LBL are 0.25, 2.27, 0.49, 7.96, 0.64, 0.60% respectively. Thus, it signifies that NIBL has the least deviation among six banks. HBL, EBL & LBL are moderate in terms of deviation. NCC has the highest deviation. LBL has highest variation i.e. 10.81% during the study period. Since, NPA is one of the causes of banking crisis; NCC should give serious attention to this matter.

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

**Figure 4.3**

**Non- Performing Assets to Total Loan and Advances Ratio (%)**



Above figure shows that NCC has the highest NPAs to total loan and advances ratio during the study period with the increasing trend. The LBL has the least ratio except in year 2005. The HBL and EBL also maintain its ratio at minimum level with

decreasing trend. The ratio of NIBL is in constant trend. The ratio of MBL is in decreasing trend but in the year 2007 it has been increased.

#### 4.1.4 Provision Held to Non-Performing Assets Ratio

This ratio shows the proportion of loan loss provision to non-performing assets of the banks. Every bank should have to make provision for the loan to minimize the risk of non-recovering the loan from the customer on time. Thus, this ratio measure up to what extent of risk inherent in NPL is covered by the total loan loss provision. From this ratio it can be concluded that which bank make safeguard for the future contingencies. Higher ratio indicates that the banks are safeguarded against future contingencies that may create due to non-performing loan. Thus, higher ratio shows better financial position of bank and lower ratio shows weak in financial position.

**Table 4.4**

#### **Provision Held to Non-Performing Assets Ratio (%)**

| <b>Banks</b> | <b>Particulars</b> | <b>2003</b>   | <b>2004</b>   | <b>2005</b>   | <b>2006</b>   | <b>2007</b>   | <b>Mean</b>   | <b>S.D</b>   | <b>C.V</b>   |
|--------------|--------------------|---------------|---------------|---------------|---------------|---------------|---------------|--------------|--------------|
|              | <b>LLP</b>         | 150           | 208           | 327           | 402           | 483           |               |              |              |
| <b>NIBL</b>  | <b>NPA</b>         | 117.09        | 181.44        | 280.87        | 302.94        | 376.1         |               |              |              |
|              | <b>Ratio</b>       | <b>128.17</b> | <b>114.64</b> | <b>116.42</b> | <b>132.7</b>  | <b>128.42</b> | <b>124.06</b> | <b>7.17</b>  | <b>5.78</b>  |
|              | <b>LLP</b>         | 203           | 186.23        | 147.13        | 88.59         | 90.69         |               |              |              |
| <b>HBL</b>   | <b>NPA</b>         | 1093          | 1147.46       | 1001.35       | 948.69        | 629.8         |               |              |              |
|              | <b>Ratio</b>       | <b>18.57</b>  | <b>16.22</b>  | <b>14.70</b>  | <b>9.34</b>   | <b>14.4</b>   | <b>14.65</b>  | <b>3.04</b>  | <b>20.74</b> |
|              | <b>LLP</b>         | 141           | 212           | 281           | 335           | 418           |               |              |              |
| <b>EBL</b>   | <b>NPA</b>         | 111.19        | 104.76        | 128.81        | 121.85        | 107           |               |              |              |
|              | <b>Ratio</b>       | <b>126.81</b> | <b>202.37</b> | <b>218.15</b> | <b>274.93</b> | <b>390.65</b> | <b>242.58</b> | <b>87.85</b> | <b>36.21</b> |
|              | <b>LLP</b>         | 306           | 446           | 592           | 1257          | 1415          |               |              |              |
| <b>NCC</b>   | <b>NPA</b>         | 700.83        | 600.05        | 519.26        | 665.91        | 1568.7        |               |              |              |
|              | <b>Ratio</b>       | <b>43.67</b>  | <b>74.33</b>  | <b>114.01</b> | <b>188.76</b> | <b>90.20</b>  | <b>102.19</b> | <b>48.95</b> | <b>47.90</b> |
|              | <b>LLP</b>         | 6.47          | 15.98         | 22.907        | 34.703        | 165.49        |               |              |              |
| <b>MBL</b>   | <b>NPA</b>         | 31.1          | 24.98         | 19.86         | 16.99         | 82.2          |               |              |              |
|              | <b>Ratio</b>       | <b>20.79</b>  | <b>63.97</b>  | <b>115.34</b> | <b>204.26</b> | <b>201.33</b> | <b>121.14</b> | <b>73.09</b> | <b>60.34</b> |
|              | <b>LLP</b>         | 6.518         | 9.74          | 5.503         | 15.63         | 22.76         |               |              |              |

|            |              |    |    |              |              |              |              |              |               |
|------------|--------------|----|----|--------------|--------------|--------------|--------------|--------------|---------------|
| <b>LBL</b> | <b>NPA</b>   | 0  | 0  | 44.49        | 27.78        | 23.1         |              |              |               |
|            | <b>Ratio</b> | -- | -- | <b>12.37</b> | <b>56.26</b> | <b>98.53</b> | <b>33.43</b> | <b>38.57</b> | <b>115.38</b> |

*Source: Annual Report Respective Banks*

The above table 4.4 exhibits the ratio of Provision Held to Non-Performing Loan of NIBL, HBL, EBL, NCC, and MBL & LBL for five consecutive years. The figure represented in the above table shows that EBL has the highest ratio through the study period. The overall ratio has been ranged from 9.34 of HBL in 2006 to 390.65% of EBL in 2007.

The mean ratio of NIBL, HBL, EBL, NCC, MBL and LBL are as follows 124.06, 14.59, 243, 102.19, 121.14 & 33.43 respectively. Ratio of EBL is comparatively higher than other five banks. Laxmi bank has least ratio of provision. Among six banks, NIBL, EBL, NCC and MBL have the highest ratio of provision and HBL and LBL has the lowest ratio of provision during study period.

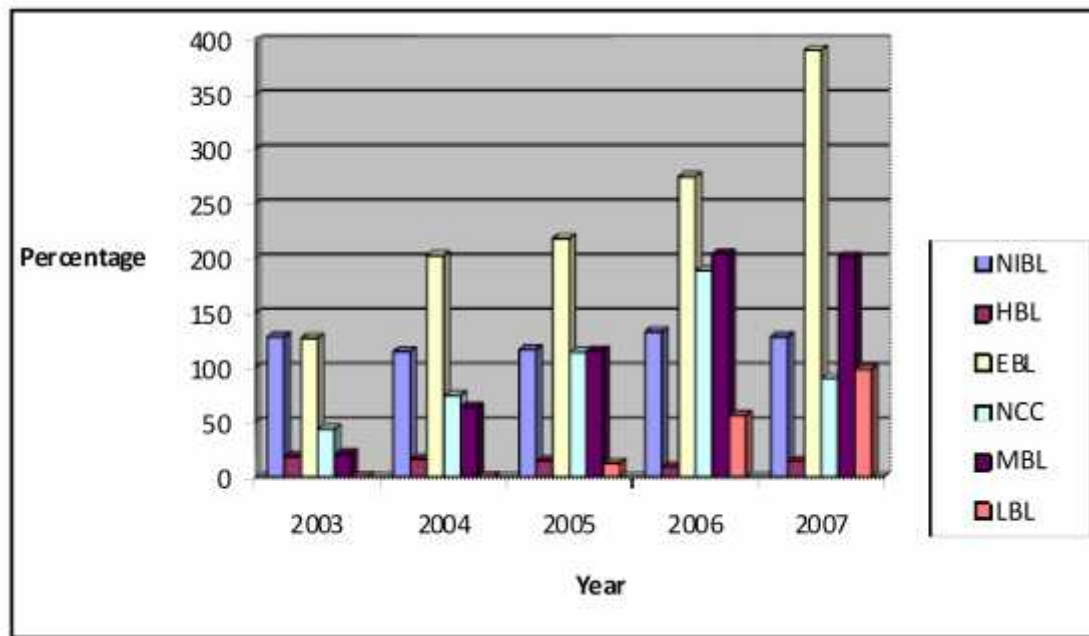
The standard deviation of NIBL, HBL, EBL, NCC, MBL & LBL are 7.17, 3.038, 87.858, 48.95, 73.09, 38.57 respectively. Thus, it signifies that HBL has the least deviation and degree of variation in this ratio and EBL has the highest deviation but not the highest degree of variation in this ratio during the study period.

From the table it can be said that EBL has the greater loan loss provision for the NPA in increasing trend. Similarly, MBL and EBL have also loan loss provision for the NPA in increasing trend. But in case of NCC ratio of loan loss provision for NPA is in fluctuating trend.

Thus, it is signified that EBL has highest deviation and LBL has the highest variation. NIBL and EBL have the moderate in terms of variability during the study period. The above Provision Held to NPA Ratio can be presented in bar diagram also, which is as follows:

**Figure 4.4**

**Provision Held to Non-Performing Assets Ratio (%)**



From the above the figure we can see the EBL has the highest ratio of Provision Held to NPA except in year 2003. The ratios of NIBL are in continuous trend of loan loss provision. The ratio of HBL is least in comparison to other five banks. Ratio of NCC is in increasing trend except in the year 2007. In case of MBL ratio is in increasing trend and in case of LBL there was no non-performing assets. But, from the year 2005 it has started to increase slowly up to year 2007. As a whole EBL has the better ratio as comparison to other banks.

#### 4.1.5 Non-Performing Assets to Total Assets Ratio

This ratio represents the proportion between the NPA and total assets of banks. It shows how much assets is non-performing or idle in the total assets of banks. Higher NPAs to Total Assets Ratio indicates the worst performance, which reduces the profitability of the banks. Lower ratio indicates the better performance and higher profitability of the banks. Thus, lower NPAs to Total Assets Ratio are better for the banks that exhibit the better profitability.

**Table 4.5**

#### Non- Performing Assets to Total Assets Ratio (%)

(in Million)

| Banks       | Particulars      | 2003         | 2004        | 2005        | 2006        | 2007        | Mean         | S.D         | C.V           |
|-------------|------------------|--------------|-------------|-------------|-------------|-------------|--------------|-------------|---------------|
|             | <b>NPA</b>       | 117.09       | 181.44      | 280.87      | 302.94      | 376.1       |              |             |               |
| <b>NIBL</b> | <b>T. Assets</b> | 9164         | 13464       | 16391       | 21732       | 28074       |              |             |               |
|             | <b>Ratio</b>     | <b>1.28</b>  | <b>1.35</b> | <b>1.71</b> | <b>1.39</b> | <b>1.34</b> | <b>1.41</b>  | <b>0.15</b> | <b>10.89</b>  |
|             | <b>NPA</b>       | 1093         | 1147.46     | 1001.35     | 948.69      | 629.8       |              |             |               |
| <b>HBL</b>  | <b>T. Assets</b> | 24198        | 25730       | 28871       | 30580       | 34315       |              |             |               |
|             | <b>Ratio</b>     | <b>4.52</b>  | <b>4.46</b> | <b>3.47</b> | <b>3.10</b> | <b>1.84</b> | <b>3.48</b>  | <b>0.99</b> | <b>28.42</b>  |
|             | <b>NPA</b>       | 111.19       | 104.76      | 128.81      | 121.85      | 107         |              |             |               |
| <b>EBL</b>  | <b>T. Assets</b> | 8193         | 9820        | 12074       | 16294       | 21433       |              |             |               |
|             | <b>Ratio</b>     | <b>1.36</b>  | <b>1.07</b> | <b>1.07</b> | <b>0.75</b> | <b>0.50</b> | <b>0.95</b>  | <b>0.30</b> | <b>31.20</b>  |
|             | <b>NPA</b>       | 700.83       | 600.05      | 519.26      | 665.91      | 1568.7      |              |             |               |
| <b>NCC</b>  | <b>T. Assets</b> | 5638         | 7616        | 8698        | 8641        | 8619        |              |             |               |
|             | <b>Ratio</b>     | <b>12.43</b> | <b>7.88</b> | <b>5.97</b> | <b>7.71</b> | <b>18.2</b> | <b>10.44</b> | <b>4.43</b> | <b>42.46</b>  |
|             | <b>NPA</b>       | 31.1         | 24.98       | 19.86       | 16.99       | 82.2        |              |             |               |
| <b>MBL</b>  | <b>T. Assets</b> | 2399.86      | 3448.63     | 6456.46     | 9069.8      | 10897       |              |             |               |
|             | <b>Ratio</b>     | <b>1.30</b>  | <b>0.72</b> | <b>0.31</b> | <b>0.19</b> | <b>0.75</b> | <b>0.65</b>  | <b>0.39</b> | <b>59.81</b>  |
|             | <b>NPA</b>       | 0            | 0           | 44.49       | 27.78       | 23.1        |              |             |               |
| <b>LBL</b>  | <b>T. Assets</b> | 1104.305     | 2603        | 3886.18     | 5282.9      | 8582.6      |              |             |               |
|             | <b>Ratio</b>     | <b>0</b>     | <b>0</b>    | <b>1.14</b> | <b>0.53</b> | <b>0.27</b> | <b>0.39</b>  | <b>0.43</b> | <b>109.78</b> |

Source: Annual Report Respective Banks

The table (Table 4.5), presented above, exhibits the Non-Performing Assets to Total Assets Ratio of five years of six banks. NCC has the ratio with fluctuating trend, where at the same time Laxmi Bank has the decreasing trend. Likewise, MBL has decreasing trend except in the year 2007, EBL has decreasing trend and MBL has decreasing trend. In NIBL also the trend is fluctuating. In the same way HBL has decreasing trend. EBL has highest ratio among five banks. From the table, it can be concluded that LBL has the better performance with higher profitability whereas HBL & NCC has bad performance with lower profitability on the same period. EBL, NIBL, MBL has also quite satisfactory ratio and performance on the basis of this ratio. The ratio is ranged from 0.27% of Laxmi in the year 2007 and 18.20% of NCC in the year 2007.

The mean ratio of NIBL, HBL, EBL, NCC, MBL and LBL are 1.41, 3.52, 0.95, 10.44, 0.65, 0.39% respectively. The mean ratio of Laxmi has the lower ratio all over the period that indicates the greater profitability and the performance to recover the loan and its interest during the study period. NCC has the highest ratio, which shows the bad performance and lower profitability on its assets. NIBL, EBL & HBL has moderate ratio at the same period. Among, moderate ratio, HBL has the greater ratio, which is quite lower than the highest ratio of NCC. EBL has also quite satisfactory ratio, MBL has also satisfactory ratio which is little higher than lowest ratio of Laxmi Bank.

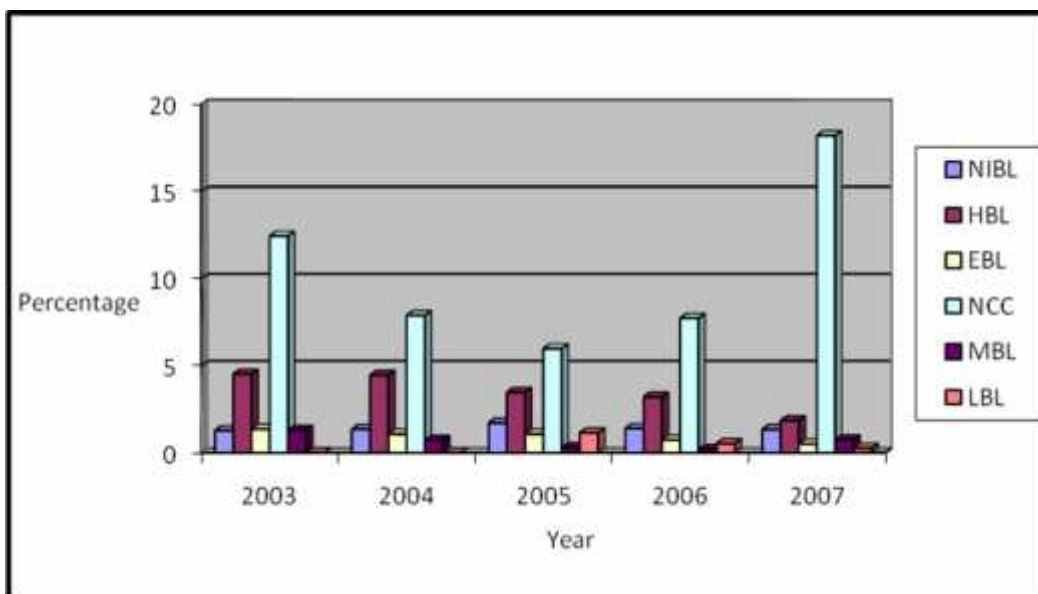
The standard deviation of NIBL, HBL, NCC, MBL and LBL are as follows 0.152, 0.99, 0.29, 4.43, 0.39 & 0.43% and co-efficient of variations are 10.89, 28.42, 31.20,

42.46, 59.81, and 109.78% respectively. NCC has highest deviation and MBL has highest variation. It signifies that MBL has the greater variability in this ratio. EBL has the least deviation and Laxmi has least variability during the study period.

The above Non-Performing Assets to Total Assets Ratio can be presented in bar diagram also, which is follows:

**Figure 4.5**

**Non- Performing Assets to Total Assets Ratio (%)**



From the above figure, it can be explained that NCC shows the highest ratio decreasing trend in the year 2003, 2004 and 2005 but in 2006 and 2007 the ratio has been increased. The NCC bank is trying to manage its non-performing assets. NIBL has continuous trend of ratio, HBL has decreasing trend of NPA to Total Assets Ratio. Similarly, EBL has also decreasing trend except in the year 2004 and 2005. MBL has fluctuating trend of NPAs to Total Assets Ratio. And lastly, LBL has decreasing trend of NPAs to Total Assets Ratio.

#### 4.1.6 Return on Total Loan and Advances

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

**Table 4.6**  
**Return on Total Loans and Advances Ratio (%)**

(In Million)

| Banks       | Particulars                | 2003        | 2004        | 2005         | 2006         | 2007        | Mean         | S.D         | C.V            |
|-------------|----------------------------|-------------|-------------|--------------|--------------|-------------|--------------|-------------|----------------|
|             | <b>Net Profit/Loss</b>     | 117         | 153         | 232          | 351          | 501         |              |             |                |
| <b>NIBL</b> | <b>Loan &amp; Advances</b> | 5922        | 7339        | 10453        | 13178        | 17769       |              |             |                |
|             | <b>Ratio</b>               | <b>1.98</b> | <b>2.08</b> | <b>2.22</b>  | <b>2.66</b>  | <b>2.82</b> | <b>2.35</b>  | <b>0.33</b> | <b>14.05</b>   |
|             | <b>Net Profit/Loss</b>     | 212.132     | 263.052     | 308.28       | 457.46       | 491.82      |              |             |                |
| <b>HBL</b>  | <b>Loan &amp; Advances</b> | 10894.2     | 13081.7     | 13245        | 15516        | 17672       |              |             |                |
|             | <b>Ratio</b>               | <b>1.95</b> | <b>2.01</b> | <b>2.33</b>  | <b>2.95</b>  | <b>2.78</b> | <b>2.40</b>  | <b>0.40</b> | <b>16.74</b>   |
|             | <b>Net Profit/Loss</b>     | 94          | 144         | 171          | 237          | 296         |              |             |                |
| <b>EBL</b>  | <b>Loan &amp; Advances</b> | 5050        | 6096        | 7900         | 10136        | 14100       |              |             |                |
|             | <b>Ratio</b>               | <b>1.86</b> | <b>2.36</b> | <b>2.16</b>  | <b>2.34</b>  | <b>2.10</b> | <b>2.17</b>  | <b>0.18</b> | <b>8.40</b>    |
|             | <b>Net Profit/Loss</b>     | 82          | 3.41        | -5.2         | -571         | 116         |              |             |                |
| <b>NCC</b>  | <b>Loan &amp; Advances</b> | 3322        | 4418        | 5934         | 5837         | 5084        |              |             |                |
|             | <b>Ratio</b>               | <b>2.47</b> | <b>0.08</b> | <b>-0.09</b> | <b>-9.78</b> | <b>2.28</b> | <b>-1.01</b> | <b>4.51</b> | <b>-447.66</b> |
|             | <b>Net Profit/Loss</b>     | 15.307      | 46.689      | 84.87        | 134          | 57.93       |              |             |                |
| <b>MBL</b>  | <b>Loan &amp; Advances</b> | 1494.1      | 2541.7      | 5051.4       | 6033.4       | 7281.3      |              |             |                |
|             | <b>Ratio</b>               | <b>1.02</b> | <b>1.84</b> | <b>1.68</b>  | <b>2.22</b>  | <b>0.80</b> | <b>1.51</b>  | <b>0.52</b> | <b>34.87</b>   |
|             | <b>Net Profit/Loss</b>     | 1.034       | 10.45       | 26.465       | 35.385       | 65.58       |              |             |                |
| <b>LBL</b>  | <b>Loan &amp; Advances</b> | 764         | 1701        | 2700.8       | 4274.3       | 6527.5      |              |             |                |
|             | <b>Ratio</b>               | <b>0.14</b> | <b>0.61</b> | <b>0.98</b>  | <b>0.83</b>  | <b>1.01</b> | <b>0.71</b>  | <b>0.32</b> | <b>44.98</b>   |

*Source: Annual Report Respective Banks*

The table 4.6 presented above exhibits the ratio of return on loans and advances of NIBL, HBL, EBL, NCC, and MBL & LBL for five consecutive years. The table represents that HBL has the highest ratio through the period then EBL has and then

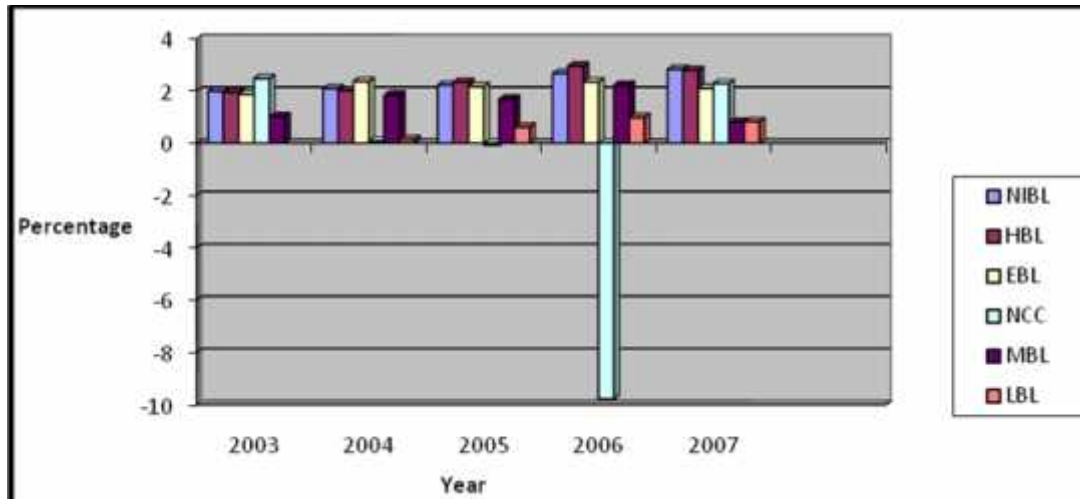


NIBL has the highest ratio through the study period. NIBL, HBL shows increasing trend and EBL shows increasing trend in 2004 and then decreasing and increasing and again decreasing in 2007. EBL has satisfying moderate ratio with fluctuating ratio. MBL has also decreasing ratio except in the year 2007. Similarly, LBL has also fluctuating trend. NCC bank is in loss for two years, it shows the negative returns. But, it has been recovered in the year 2007 which shows positive returns. The overall ratio has been ranged from (0.087) % of NCC in 2005 to 2.95% of HBL in 2006.

The mean ratio of NIBL, HBL, EBL, NCC, MBL and LBL are 2.35%, 2.404%, 2.165%, -1.008%, 1.5128%, 0.7123%, respectively. The mean ratio of HBL has the highest ratio and LBL has lowest ratio among six banks. The standard deviation of NIBL, HBL, EBL, NCC, MBL and LBL are 0.33%, 0.402%, 0.181%, 4.514% and 0.3209% respectively and co-efficient of variation are 14.05,16.74,8.4,-447.659, 34.85 respectively. Thus, it signifies that the higher return and EBL has least degree of variation in this ratio. Among, all banks, NIBL is moderate in terms of deviation and variability. Thus, it can be concluded that even though LBL has the highest exposure on loans and advances, the bank has failed to earn return on loans and advances.

The above return on total loans and advances ratio can be presented in bar diagram also, which is as follows:

**Figure 4.6**  
**Return on Total Loans & Advances (%)**



From the above graph, it can be interpreted that NCC has negative returns except in the 2003, 2004 and 2007. HBL has highest return with consistent ratio. NIBL & EBL have moderate return at the same period. In case of MBL and LBL return on Loan and Advances is satisfactory. It can also be concluded that NCC is trying to make return if this trend is continued they will make profit in future years.

## 4.2 Correlation Analysis

### 4.2.1 Correlation between Loan Loss Provision and Loan & Advances:

The correlation between loan loss provision (LPP) and loan & advances show the degree of relationship between these two items. How a unit increment in loans and advances affect the loan loss provision is measured by this correlation. Here, loans and advances is independent variable and loan loss provision is dependent variable.

**Table 4.7**

**Correlation between Loan Loss Provision and Loan & Advances**

| Banks | Correlation Coefficient ( r ) | Probable Error (P.E) | 6*PE   |
|-------|-------------------------------|----------------------|--------|
| NIBL  | 0.2282                        | 0.2859               | 1.7154 |

|            |         |        |        |
|------------|---------|--------|--------|
| <b>HBL</b> | -0.9201 | 0.0463 | 0.2778 |
| <b>EBL</b> | 0.98    | 0.012  | 0.072  |
| <b>NCC</b> | 0.59    | 0.1963 | 1.1778 |
| <b>MBL</b> | 0.63    | 0.1114 | 0.6684 |
| <b>LBL</b> | -0.89   | 0.063  | 0.378  |

The above table explains the relationship between loans and advances and loan loss provision. The correlation of NIBL, HBL, NCC and LBL are 0.2282, -0.9201, 0.59 and -0.89 which are less than 6PE and even lesser than PE, the correlation coefficient are insignificant. In other words, the total LLP of NIBL, NCC, HBL and LBL are not correlated with the loans and advances during the study period. The correlation coefficients of HBL and LBL are negative as the loans and advances during the study period. The correlation coefficients are negative as the loans and advances are decreasing but LLP is increasing due to increment in non-performing loans of LBL. The correlation coefficient of NIBL, EBL, NCC and MBL are 0.2282, 0.98, 0.59, and 0.63 respectively. There are positive correlation between loan loss provision and loan and advances of NIBL, EBL, NCC and MBL but they are less than 6 PE. Thus, correlation coefficient are said to be insignificant. As a whole there are not significant correlation coefficient of banks between LLP and loan & advances during the study period. It seems NIBL, EBL, NCC and MBL are more significant and reliable than HBL and LBL because they have greater correlation coefficient than PE.

#### **4.2.2 Correlation between Loan Loss Provision and Non- Performing Assets**

The correlation between LLP and NPA shows the relationship of them. How a unit of LLP effect the NPA is exhibited by this correlation. In this case, NPA is the

independent variable and LLP is the dependent variable. As earlier mentioned NPL are the loan falling on the category of substandard, doubtful and loss loan and the respective provisioning requirement is 25%, 50% and 100% respectively. Higher the NPL higher will be the provisioning amount.

**Table 4.8**

**Correlation between Loan Loss Provision & NPA**

| <b>Banks</b> | <b>Correlation Coefficient (r)</b> | <b>Probable Error (P.E)</b> | <b>6*P.E</b> |
|--------------|------------------------------------|-----------------------------|--------------|
| <b>NIBL</b>  | 0.21                               | 0.29                        | 1.73         |
| <b>HBL</b>   | 0.76                               | 0.13                        | 0.76         |
| <b>EBL</b>   | 0.12                               | 0.30                        | 1.78         |
| <b>NCC</b>   | 0.69                               | 0.16                        | 0.95         |
| <b>MBL</b>   | 0.95                               | 0.03                        | 0.18         |
| <b>LBL</b>   | 0.10                               | 0.30                        | 1.79         |

The above table shows the relationship between LLP & NPA. All selected banks for study shows the positive relationship between them, which means increment in NPA which leads to increment in LLP. The correlation coefficients of HBL, NCC & MBL are 0.76, 0.69 & 0.95 respectively. The P.E of HBL, NCC & MBL is 0.13, 0.30 and 0.03 and 6 P.E are 0.76, 1.78 and 0.18 respectively. Since, the correlations coefficients of six banks are greater than 6 times the value of P.E, the correlation coefficient are significant and reliable. In other words, the total LPP of HBL, NCC & MBL are highly correlated with non-performing assets during the study period and increase in LLP of banks are due to increase in NPA. The correlation of NIBL is 0.21 and P.E &

6P.E are 0.29 and 1.73 respectively. It is less than the 6 times the value of P.E. Similarly, EBL is 0.69 and PE and 6 PE are 0.16 and 0.95 respectively. Hence, there is positive correlation between NPA and LLP of NIBL, EBL and LBL but correlation coefficient are not significant. From this table, it can be also seen that HBL, NCC & MBL have the high degree of NPA in comparison to NIBL, EBL & LBL.

#### 4.2.3 Correlation Between Loan and Advances and Total Deposit

This correlation shows the relationship between the loan and advances and total deposits. Deposit is one of the major items of assets of balance sheet of commercial banks. In this case, the deposit is the independent variable and loan and advances is the dependent variable. It shows how a unit increase in deposit impact in the volume of loan and advances is exhibited by this correlation coefficient.

**Table 4.9**

**Correlation between Loan and Advances and Total Deposit**

| <b>Banks</b> | <b>Correlation Coefficient (r)</b> | <b>Probable Error (P.E)</b> | <b>6*P.E</b> |
|--------------|------------------------------------|-----------------------------|--------------|
| <b>NIBL</b>  | 0.034                              | 0.3013                      | 1.8076       |
| <b>HBL</b>   | 0.64                               | 0.1781                      | 1.0686       |
| <b>EBL</b>   | 0.045                              | 0.3010                      | 1.806        |
| <b>NCC</b>   | 0.931                              | 0.0402                      | 0.2412       |
| <b>MBL</b>   | 0.99                               | 6.0027                      | 36.0162      |
| <b>LBL</b>   | 0.57                               | 0.2036                      | 1.2216       |

The above table shows the correlation coefficient, Probable Error (P.E) & 6 P.E. From this table, correlation coefficient between Loan & Advances and Total Deposit of all six banks are seen positive. The correlation of NIBL, HBL, NCC, MBL and LBL is less than its 6 PE i.e. 0.034, 0.64, 0.045, 0.99, 0.57 respectively and its PE are

0.3013, 0.1781, 0.3010, 6.0027, 0.2036 respectively. It shows the positive relationship but is not significant and reliable. The correlations of HBL, NCC and MBL have positive correlation with highly correlated to loan and advances. The correlations of HBL, NCC & MBL are 0.64, 0.93 and 0.99 respectively. The P.E is 0.1781, 0.0402 and 6.0027 respectively and 6 P.E 1.0686, 0.2412 & 36.0162 respectively. Among these three, NCC & MBL are the highly significant and reliable than HBL. In other words, the loan & advances increases with the increment of total deposits in the banks.

#### 4.2.4 Correlation between Non-Performing Assets and Loan & Advances

This correlation coefficient shows the degree of relationship between the NPA and Loan & Advances. The NPA is independent variable and loan & advances is dependent variable. It shows how a unit of change of loan & advances effects to the NPA & what is the relation of them. It means how it affects the NPA due to change (increase or decrease) of loan & advances of banks.

**Table 4.10**

#### **Correlation between Non-Performing Assets and Loan & Advances**

| <b>Banks</b> | <b>Correlation Coefficient (r)</b> | <b>Probable Error (P.E)</b> | <b>6*P.E</b> |
|--------------|------------------------------------|-----------------------------|--------------|
| <b>NIBL</b>  | 1.401                              | -0.29                       | -1.74        |
| <b>HBL</b>   | -0.31                              | 0.27                        | 1.62         |
| <b>EBL</b>   | -0.044                             | 0.3011                      | 1.8066       |
| <b>NCC</b>   | 3.1296                             | -2.6528                     | -15.9168     |
| <b>MBL</b>   | 2.7                                | -1.8974                     | -11.3844     |
| <b>LBL</b>   | 0.49                               | 0.23                        | 1.38         |

The table shows the correlation coefficient between NPA and Loan & Advances, probable error & 6 times probable error. The correlation of NIBL, NCC and MBL shows positive correlation but negative PE & 6 PE which is insignificant. Similarly,

HBL and EBL show negative correlation between NPA & Loan & Advances which is also insignificant. But, LBL has correlation coefficient 0.49 which is also insignificant.

#### 4.2.5 Correlation between Non- Performing Assets & Total Assets

The correlation coefficient shows the degree of relationship between the NPA and total assets for the study period. In this correlation coefficient Non-Performing Assets is an independent variable and total assets is dependent variable. It shows how a unit or change in total assets affects the NPA.

**Table 4.11**

**Correlation between Non-Performing Assets & Total Assets**

| <b>Banks</b> | <b>Correlation Coefficient (r)</b> | <b>Probable Error (P.E)</b> | <b>6*P.E</b> |
|--------------|------------------------------------|-----------------------------|--------------|
| <b>NIBL</b>  | 0.96                               | 0.024                       | 0.144        |
| <b>HBL</b>   | -8.31                              | -20.53                      | 123.18       |
| <b>EBL</b>   | -0.031                             | 0.3014                      | 1.8084       |
| <b>NCC</b>   | 0.228                              | 0.2860                      | 1.716        |
| <b>MBL</b>   | 0.54                               | 0.2137                      | 1.2822       |
| <b>LBL</b>   | 0.85                               | 0.0837                      | 0.5022       |

The above table shows the relationship between the NPA & Total assets for five consecutive years. HBL & EBL shows negative relationship with insignificant result. Laxmi Bank shows the positive relationship but that is also insignificant because it has lesser 6 times value of PE than correlation coefficient. NCC & MBL has Correlation less than 6 PE which is significant.

#### 4.3 Trend Analysis

Trend analysis is the essential tools for analyzing the data of selected banks in suitable manner. It helps to forecast the future value of banks or future expectation of different variables on the basis of past relevant data. It informs the future values of different variables. It shows the behavior of the variables. It is based on the assumption that past tendencies continues in the future. In this study, its data are presented for five years from year 2003 to 2007 and forecast is done on the basis of these trend lines.



### 4.3.1 Trend analysis of Loan & Advances

The trend analysis of loans and advances shows the behavior of providing the loans and advances of commercial banks. It helps to calculate the future loan & advances of banks. The following table shows the loan & advances for five years.

**Table 4.12**

**Trend Values of Loans & Advances**

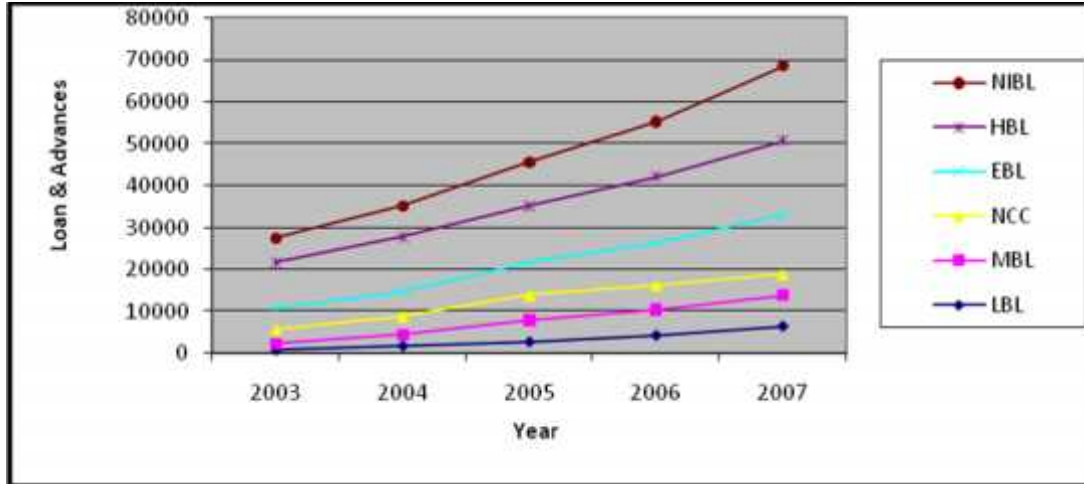
| <b>Year</b> | <b>NIBL</b> | <b>HBL</b> | <b>EBL</b> | <b>NCC</b> | <b>MBL</b> | <b>LBL</b> |
|-------------|-------------|------------|------------|------------|------------|------------|
| 2003        | 5922        | 10844.60   | 5050       | 3396       | 1495.86    | 775.94     |
| 2004        | 7339        | 12919.6    | 6096       | 4437       | 2540.79    | 1750.93    |
| 2005        | 10453       | 13451.17   | 7900       | 5934       | 5130.22    | 2726.14    |
| 2006        | 13178       | 15761.97   | 10136      | 5837       | 6068.90    | 4280.11    |
| 2007        | 17769       | 17793.7    | 14099.9    | 5084       | 7326.20    | 6437.45    |

The above table shows that six banks shows increasing trend continuously. HBL is the higher loan provider among the banks which has also decreasing trends of loan & advances during the study period. NCC is the moderate loan provider, which has increasing trends but in year 2007, it is decreasing. NIBL has also increasing trend of loan & advances but not as much as HBL. LBL is the lowest loan provider among the banks. It has the increasing trends continuously.

The above table can be seen in figure also, which is presented below.

**Figure 4.7**

**Trend Line of Loan & Advances**



The above fig shows the same thing which is already mentioned above on the basis of table. All the banks have increasing trend except NCC in the year 2007. It can be seen that NCC lend the higher amount of its resources in the form of loan & advances. It is trying to decrease it. Hence, its loan & advances shows decreasing trend. On the other side, NIBL, HBL, EBL, MBL & LBL has increasing trend of loans and advances as it has lower ratio of bad loans as all are emerging trend private sector bank.

#### **4.3.2 Trend Analysis of NPA**

The trend analysis of non-performing assets shows that the behavior of NPA in the banks. It means that it shows the increasing and decreasing trends of NPA. The following table presents the trend values of NPA for six consecutive years, which is presented below:

**Table 4.13**

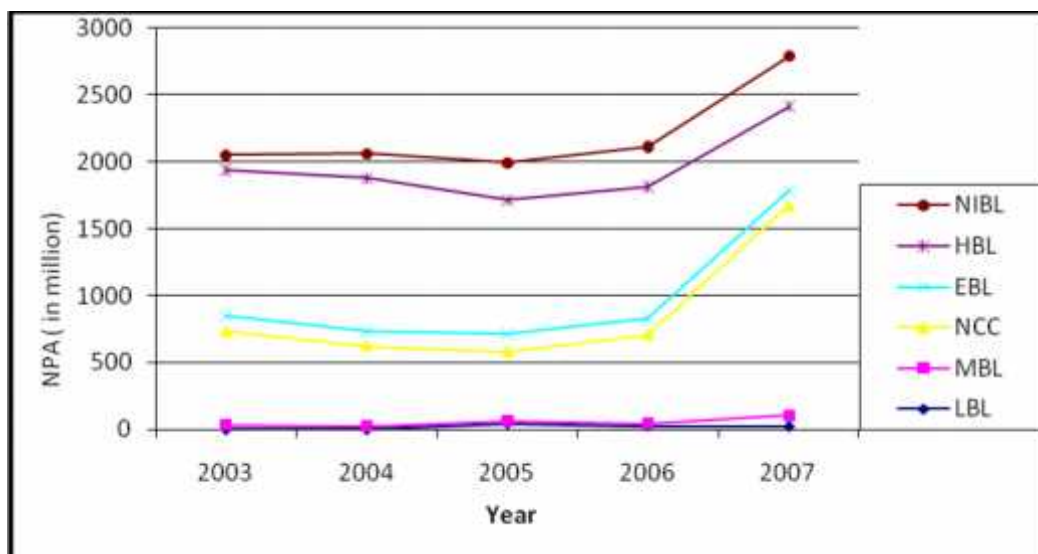
**Trend Values of NPA**

| Year | NIBL   | HBL     | EBL    | NCC    | MBL   | LBL   |
|------|--------|---------|--------|--------|-------|-------|
| 2003 | 117.09 | 1093    | 111.19 | 700.83 | 31.10 | 0.0   |
| 2004 | 181.44 | 1147.46 | 104.76 | 600.05 | 24.98 | 0.0   |
| 2005 | 280.87 | 1001.35 | 128.81 | 519.26 | 19.86 | 44.49 |
| 2006 | 302.94 | 978.69  | 121.85 | 665.91 | 16.99 | 27.78 |
| 2007 | 376.10 | 629.80  | 107.0  | 1568.7 | 82.20 | 23.10 |

The above table can be seen in fig. also, which is presented below:

**Figure 4.8**

**Trend Line of Non-Performing Assets**



The above table & figure shows the trends of NPA of commercial banks for five consecutive years. HBL has the highest NPA with comparison to other banks. It shows the decreasing trend of NPA except in year 2004 which may be caused by decreasing in loan and advances of bank. NCC has second highest NPA during the study period. It is in decreasing trend for first four years and in 2007 it has been

increased. NIBL is trying to maintain the NPA at a same ratio as it is increasing in small ratio. EBL has increasing decreasing trend. MBL has decreasing trend for first four years but it has increased in 2007. But in case of LBL the trend is decreasing. For this analysis it can be concluded that NIBL is maintaining its NPA by not providing loan & advances in large number. HBL is not maintaining its NPA that means it is providing loan & advances without proper analysis and NCC also doing the same but EBL and MBL is trying to maintain its NPA. Laxmi bank is also doing the same as MBL & EBL.

### 4.3.3 Trend Analysis of Loan Loss Provision

The trend analysis of the loan loss provision shows the trend of loan loss provision of banks that how they are making provisioning for safety of their loan & advances. It shows the loan loss provisioning behavior of banks. The following table presents the trend values of loan loss provision for five consecutive years which is presented below:

**Table 4.14**

#### **Trend values of Loan Loss Provision**

| <b>Year</b> | <b>NIBL</b> | <b>HBL</b> | <b>EBL</b> | <b>NCC</b> | <b>MBL</b> | <b>LBL</b> |
|-------------|-------------|------------|------------|------------|------------|------------|
| 2003        | 150         | 203        | 141        | 306        | 6.465      | 6.518      |
| 2004        | 208         | 186.23     | 212        | 446        | 15.98      | 9.75       |
| 2005        | 327         | 147.13     | 281        | 592        | 22.91      | 5.503      |
| 2006        | 402         | 88.59      | 335        | 1257       | 34.70      | 15.63      |
| 2007        | 483         | 90.69      | 418        | 1415       | 165.49     | 22.76      |

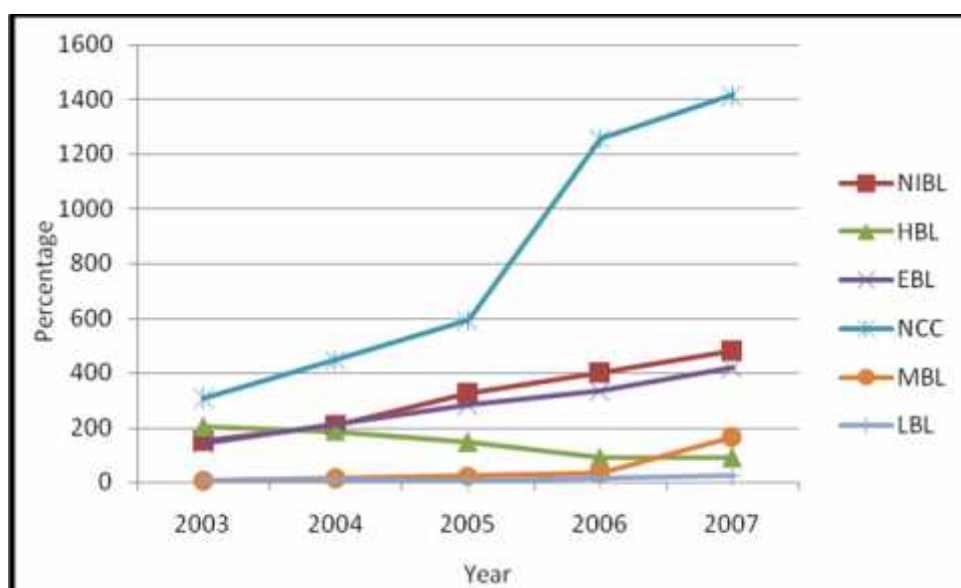
From the above table, it can be concluded that NCC has the highest loan loss provision because they have the highest loan & advances amount in the same period. LLP of NIBL is in decreasing trend, HBL is also in decreasing trend. But, EBL is in

increasing trend. In case of MBL the trend is fluctuating. LBL has least loan loss provision because this bank is providing the lower loan & advances amount than other banks.

The above table can be seen in fig also, which is presented below:

**Figure 4.9**

**Trend Line of Loan Loss Provision**



The above figure also shows the trend of loan loss provision of selected banks for five consecutive years. NCC shows the highest LLP, which are increasing, NIBL, EBL also shows increasing trend, HBL shows decreasing trend. MBL also shows increasing trend. But, LBL shows increasing decreasing trend.

#### 4.4 Major Findings of the Study

This study is fully based on the secondary data of related banks. From the above data analysis of concerned banks, the following major findings have been obtained.

) The average loan and advances to total ratio of NIBL, HBL, EBL, NCC, MBL & LBL are found to be 61.36%, 49%, 63.43%, 62.66%, 69.92%, 72.74% respectively during the study period. The relatively low ratio of HBL is the indication of risk adverse attitude of the management or they have the policy of investing low in the risky assets like loan & advances. It has the higher proportion of their investment in risk free assets like Treasury bills, National saving bonds, etc. LBL has highest ratio among them but issued to highest loans and advances are not generating the target profits. MBL has highest degree of standard deviation and variation while NIBL has most consistent ratio. EBL & NCC have the moderate mean, deviation and variability.

) The loan & advances to Total Deposit or Credit Deposit Ratio shows how successfully the bank uses their collected fund in loan & advances. It means that it indicates the mobilization of resources. The average CD ratio of NIBL, HBL, NCC, MBL & LBL at the time of study period are 70.6%, 56.6%, 75.30%, 81.89%, 84.47% & 97.40% respectively. LBL has the highest average ratio but the HBL has relatively lower ratio. The average ratio of NIBL, EBL, NCC, and MBL are relatively moderate. Even though EBL has moderate ratio its standard deviation and variation are least during the period of the study whereas at the same period LBL has highest deviation and variation.

) The average ratio of Non-performing Assets to Total Loan & Advances indicates the proportion of performing assets & total loan & advances. The average ratio

of NIBL, HBL, EBL, NCC, MBL & LBL are as follows: 2.312%, 7.23%, 2.87%, 17.04%, 3.94% & 2.342% respectively. That means 97.69%, 92.77%, 97.13%, 82.96%, 96.06% & 97.66% are performing loan. Hence, NCC has significantly higher proportion of the non-performing loan in the total loan portfolio and this ratio, which exhibits the critical condition of the bank. And HBL also has relatively the higher ratio of NPA to Total Loan & Advances while NIBL has the least ratio. It shows that HBL & NCC have higher ratio of NPA to Loan & Advances.

) The average ratio of provision held to non-performing loan of NIBL, HBL, EBL, NCC, MBL & LBL are 124.06, 14.59, 243, 102.19, 121.14, 33.43% respectively. EBL has highest ratio in comparison to other banks, which indicates that the bank did not keep the adequate provision for NPA. NIBL, MBL & NCC also has higher ratio, it also makes provision for the high amount for NPA. Among them EBL & MBL has highest deviation & LBL has highest variability of this ratio. MBL has the least deviation in ratio & NIBL has least variability in this ratio.

) The NPA to Total Assets shows the proportion to non-performing assets and total assets of banks. It exhibits how much NPA is there in total assets. The NPA to Total Assets ratios are 1.414%, 3.52%, 0.95%, 10.44%, 0.65% & 0.39% respectively. It is found from this study that LBL has the lower ratio of NPA to Total Assets & it can be seen that it provides less amount of loan & advances whereas NCC bank has the highest amount of its resources as loan & advances. EBL has significantly lower ratio. NIBL & MBL has moderate ratio among them. The risks of banks are 0.152%, 0.994%, 0.29%, 4.43%, 0.39% & 0.43%

respectively. NIBL has least risk than other banks but NCC bank has the higher risk for the study period.

) The main objective of commercial bank is to make profit through mobilization of funds. The returns on loans & advances ratio revealed that NCC bank seems to be failure to earn return on loans & advances. NIBL & HBL provide the higher loan & advances. NCC bank shows negative returns because loan & advances are more profitable sectors but due to the larger non-performing assets they are in loss. The average return of NIBL, HBL, EBL, NCC bank, MBL & LBL are 2.352%, 2.404%, 2.165%, -1.008, 1.513% & 0.712% respectively. HBL with an average of 2.404% return on loans & advances has the highest ratio as it is a head in generating net average ratio with 1.53 % & 0.712% respectively.

) The correlation coefficient of NIBL, HBL, EBL, NCC, MBL & LBL are 0.23, -0.92, 0.98, 0.59, 0.63 & -0.89%. They all have lower correlation coefficient than their value of 6 times PE except EBL, they are insignificant and there is no evidence of correlation. Since, higher provision has to be provided for non-performing loan. The high negative correlation of HBL & LBL has the result of high non-performing loans in the total loan portfolio. NIBL have positive correlation between Loan Loss Provision and Loan & Advances but they are not significant. This is due to high proportion of Loan & Advances in total loan portfolio.

) The correlation coefficient between LLP & NPA denotes that there is positive correlation among all six banks. The correlation between these two variables is 0.21, 0.77, 0.12, 0.69, 0.95, 0.105% respectively. The correlation coefficient of EBL is insignificant but other three banks HBL, NCC & MBL have significant



ratios because their correlation coefficient is higher than 6 times probable error (PE). But in case of NIBL, EBL & LBL 6PE is greater than its correlation.

) While analyzing correlation between loan & advances and Total Deposits, it has been found that NIBL has high degree of positive correlation between two variables but MBL has lower correlation at the same time. The correlation of NIBL, HBL, EBL, NCC, MBL and LBL are as follows: 0.034, 0.64, 0.245, 0.93, 0.99, and 0.57%. The correlation of NCC bank, MBL are insignificant & unreliable. In recent years, NIBL & EBL is concentrating on loan recovery & there was no further investment of the banks in the form of loan & advances but deposits are increasing.

) The correlation between NPA and Loan & Advances shows the degree of relationship of NPA and Loan & Advances. The correlation coefficient are 1.40, -0.31, -0.044, 3.13, 2.7, 0.94 of NIBL, HBL, EBL, NCC, MBL & LBL respectively. HBL & EBL shows the negative relationship of them with -0.31%, -0.044% ratios which is insignificant. Other banks NIBL, NCC, MBL and LBL show positive relationship between NPA & Loan & Advances and they are significant and reliable.

) The correlation coefficient between NPA & Total Assets shows the degree of relationship of NPA and Total Assets of commercial banks. The correlation of NIBL, HBL, EBL, NCC, MBL & LBL are 0.96, -8.31, -0.031, 0.228, 0.54, 0.85% respectively. HBL & EBL have negative correlation coefficient, which means they have negative relation between the NPA & Total Assets. But, NIBL, NCC, MBL, & LBL have high degree of positive correlation which is insignificant & unreliable.

) Trend analysis is done based on the data of past five years. The trend of loans & advances shows the behavior of loan & advances that it is increasing or decreasing. From the study it can be found that NIBL & HBL are the higher loan provider and they are trying to maintain the loan amount. NCC bank is also higher loan provider and it is also trying to maintain its loan amount because their trend lines are decreasing except last two years. It may be because by change in management decision. The trend line of EBL, MBL & LBL shows the slowly increasing trend but it can be said that they are trying to constant their loan and advances during the study period.

) The trend line of non-performing assets of HBL was increased in the year 2004 but it started to decrease then after but it has higher NPA than other. NIBL has increasing trend of NPA, bank may control its NPA in future years. EBL has increasing decreasing trends of NPA. NCC bank has decreasing trend but slowly it started to increase from the year 2006 to 2007. MBL & LBL shows the lower NPA during the study period.

) The trend line of loan loss provision of HBL is decreasing except in the year 2007. NIBL, EBL, NCC and MBL have increasing trend. Trend LLP of LBL is increasing in the year 2004 and decreasing in 2005 and slowly increased from 2006. It is observed from the study that HBL is higher Loan Loss Provision maker. MBL is also trying to maintain its LLP in lower level. NIBL, EBL, NCC, MBL & LBL maintain its loan loss provision at minimum level because they have lower NPA. It means they have lower NPA and they make provision at lower level.

Finally, in this chapter, the whole study and findings are summarized with conclusions and suggested some recommendations based on the result of the analysis of data.

Financial sector have crucial role in the development of the country as it collect the national savings and lend it for further income generation. Banks plays an important role in the economic development of the country as the issues of development always rest upon the mobilization of resources. Banks deal in the process of canalizing the available resources to the needy sector causing overall economic development. This research is mainly aimed to study the non-performing loan & loan loss provisioning of commercial banks. To come in the conclusions, descriptive & analytical research design was adopted.

## **CHAPTER -V**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary**

The small financial institution plays vital role for the economic development of country. Banks are the financial regulator which collects funds and invest them in productive sectors. A commercial bank means the bank, which deals with exchanging currency, accepting deposit, giving loan & doing other commercial transactions. Therefore, one of the functions of commercial bank is to provide loan. There is not so long history of commercial bank in Nepal. Nepal Bank Ltd. is the first bank in Nepal, established on 30<sup>th</sup> Kartik, 1994 B.S. But, now there are altogether 25 commercial banks extending their services in different part of the country.

The assets of a commercial bank indicate the manner in which the fund entrusted to the bank depends on ability of the management to distribute the fund among the various kinds of investments known as loan and advances. Loan & advances are the most profitable assets of a bank. These assets constitute primary source of income to the bank. As being a business institution a bank aims at making huge profit since loan & advances are more profitable than any other assets of the bank, it is willing to lend as much as his fund as possible. But bank has to be careful about the safety of such loan & advances. It means the bank has to be careful about the repayment of loan & interest before giving loan.

This research is aimed at studying the NPA of commercial banks. For this purpose description & analytical research design was adopted. Out of total population of 25 commercial banks, six banks were taken as sample using judge mental sampling method; they are Nepal Investment Bank Limited, Himalayan Bank Limited, Everest Bank Limited, Nepal Credit & Commerce Bank, Macchapuchhre Bank Limited and Laxmi Bank Limited. In this study, secondary data are used. Beside this, newspaper, relevant thesis, journals, articles, related websites, etc. are also taken for this research. The data collected from various sources are recorded systematically & presented in appropriate form of tables and charts and appropriate mathematical, statistical financial and graphical tools have been applied to analyze the collected data in suitable manner. The data of 5 years of the six banks have been analyzed to meet the objective of the study.

MBL & LBL have the highest proportion of loan & advances to total assets of banks but HBL has relatively lower proportion of loan & advances during the study period. It indicates the risk adverse attitude of the management of HBL. NIBL EBL & NCC bank have moderate ratio. Same thing can be known on the basis of loan & advances to total deposit ratio. LBL has the highest proportion among them whereas HBL shows the lower ratio. From this ratio MBL, LBL, EBL, NIBL are the higher loan provision. They are rendering an average of 61.36, 49, 63.43, 62.66, 69.92, and 72.74% of their total deposit funds.

There is higher NPA in Total Loan & Advances of HBL which comes around 97.40% in average. It is very higher ratio than the acceptable standard of minimum 10%. The

second highest NPA is 84.47% of MBL, NCC, and EBL & NIBL have 81.89, 75.304 & 70.6% respectively. HBL has 56.33% ratio, HBL has lower NPA in comparison to others. HBL do not provide much loan & advances as other banks.

On the basis of NPA to Total Assets Ratio NCC shows the highest NPA and HBL also has relatively higher ratio whereas LBL shows the lower NPA. NIBL, EBL, & MBL shows the moderate NPAs. That means lower ratios indicate the greater profitability & the better performance to recover the loan and its interest.

From this study it can be observed that NIBL & EBL has made higher provision for loan loss & NCC has also relatively higher loan loss provision to NPA. HBL, MBL & LBL have moderate loan loss provision to NPA during the study period.

NCC bank invests in high income assets as loan but they have negative return for two years. It may be caused from the NPAs because they are investing most of the part of their resources in loan & advances. But at the same period, NIBL, HBL, EBL, MBL & LBL have positive returns because of their proper lending of resources. Among six banks HBL has highest mean return which shows the better performances of banks. It may be from the proper lending function, low deposit cost, high fee based income, high foreign currency deposit, exchange earning, etc.

There is positive correlation coefficient between loan loss provision and loan & advances in NIBL, NCC, and MBL & LBL. But these two variables show negative correlation between HBL & LBL. This is due to increment in loan & advances of

HBL & EBL. Amount to be provisioned depends upon the non-performing loan and its quality. However, even though loan & advances do not increase, if in the same loan portfolio LLP will increase. The correlation coefficient between the loan loss provision and NPA of six banks shows positive relation. NIBL, EBL, NCC, MBL shows insignificant result when the HBL & LBL shows the insignificant & reliable results. When NPA increases the banks make provision low. Similarly, the correlation between loan & advances and deposit shows the positive relationship. It means that when deposit amount increases the loan & advances and deposit amount increases the loan & advances also increases. The correlation coefficient of HBL & EBL shows negative correlation but NIBL, NCC, MBL & LBL shows positive correlation coefficient.

The trend line of NIBL, HBL, EBL, MBL, & LBL shows the increasing trend but in case of NCC it is different the trend has been increased upto five years but in last year of the study it has been decreased. It means NCC is trying to decrease the amount of loan & advances in recent years because it is suffering from the lot of NPA problem. If this trend continues forever then it will be beneficial for the bank. But at the same time other bank shows the lower amount of loan & advances and they are relatively increasing trend.

The non-performing assets trend of all banks shows fluctuating trend except Laxmi Bank it has decreasing trend. It means they are trying to decrease the amount of loan and advances in recent years because they are suffering from the lot of NPA problem. If this trend continues forever then it will be beneficial for the bank. But in the same

period the NCC shows increasing trend in 2007 which indicates lower amount of loan & advances.

The line of LLP of NIBL, HBL, EBL, NCC & MBL are in increasing trend and trend line of HBL & LBL is fluctuating. The trend line of HBL shows increasing trend in 1<sup>st</sup> three years and LBL shows increasing decreasing and increasing trend. LBL and MBL provide lower amount of provision. Hence, their LLP trend lines remain constant at low level.

## **5.2 Conclusions**

Finance is the blood of the any organization. Thus, its proper utilization may lead to the success of any business or organization. Today's banking industry is severely affected by the problem of Non-performing assets (NPA). It can be concluded that improper credit appraisal system, inefficient credit monitoring & supervision system, economic slowdown, borrower's misconduct and overvaluation of collateral, political pressures to lend for uncredit worthy parties etc. are the major factors leading to non-performing assets.

In order to streamline the financial sector, liberalization started in Nepal in 1980s which encourage financial institution to support the national development by gathering scattered small savings & disbursing them in various productive fields. After adopting this policy by the nation, foreign investment entered in Nepal by means of joint venture in financial sectors. There are 25 commercial banks and almost same numbers of development banks are in existence at present. Banks came into



existence mainly with the objectives of collecting idle funds, mobilizing them into productive sector for the economic development. These banks have responsibility of safeguarding the interest of depositors, stakeholders and society they are serving. Lending is the top most income generating function of the commercial banks but it is equally risky too. In order to cover the risk inherent in the lending portfolio, banks have to make loan loss provision by categories as per the NRB directives. Increasing non-performing loans adversely affect the income flow of the bank by claiming additional resources in the form of provisioning.

Nepalese banks have to remain focused in their efforts to recover their spiraling bad loans, or non-performing assets to sustain the positive trend of improving asset quality. Better risk management techniques, compliance with the core principles for effective banking supervision, skill building and training & transparency in transactions could be the solution. Removal of non-performing loans from the banking system even through government or quasi government funds at times, is essential. But official assistance should be so structured as to avoid moral hazard. To conclude with till recent past, corporate borrower even after defaulting continuously never had any real fear of bank taking any action to cover their dues deposit the fact that their entire assets were hypothecated to the banks. This is because there was no legal Act framed to safeguard the real interest of banks. While NPA can't be eliminated, but can only be contained, it has to be done not at a heavy cost of provisioning and increasing the portfolio of credit along with recovery fresh inflow of NPA should be brought down at a level much less than the quantum of its exist. If this

specific goal is reacted, there is an eventual solution for this problem. Good governance is essential for the success in NPA management.

It is found that HBL has very high position of NPA resulting higher provision but due to the change in HBL management the provision amount is drastically changed. The LLP of HBL after change in management is decreased from 203 million in year 2003 to 186 million in 2004 and slowly decreased thereafter. Likewise, NCC also shows higher ratio of NPA. It can be concluded that the bank has not made proper provision for loan loss. NCC invests most of their resources in income generating assets i.e. loan & advances but they are in loss. NIBL, HBL, EBL, MBL & LBL invest least amount of their resources in loan & advances and their profits show the positive during the study period. Their NPA are also acceptable. Where as HBL & NCC have high NPA at the same period. Among them NIBL is the best bank. And also it can be said that EBL has also quite satisfactory result and MBL & LBL have also satisfactory result rather than HBL & NCC based on the above findings. MBL & LBL are less interested in lending loan & advances. Thus it may be caused to get less NPA and loan loss provisioning & vice-versa to the public sectors banks.

In conclusion, improper credit policy, political pressure to lend, lack of supervision and monitoring, economic slowdown, overvaluation of collateral are the major causes of occurring NPAs. In recent year, not only the joint ventured banks like NIBL, HBL, and EBL & NCC but also non-joint ventured banks like MBL & LBL are trying to maintain their loan & advances to control over becoming the non-performing assets. To overcome the NPA from banks, they should try to recover their loan & interest amount on time and also make a suitable loan loss policy.

In addition, lending factors of accumulating NPAs are poor credit appraisal system, ineffective credit monitoring & supervision system, poor security and economic recession, willful defaulters, non-willful defaulters etc. Some common warning signals for NPA are large borrowing request without proper borrowing cause, unable to meet commitments made for debt, recurrence of problems, Changes in Management, changes in personal habits, slowdown in debtors recovery, excessive stocks, increase in trade creditors, increase in borrowing/ deteriorating debt-equity ratio, late/ incomplete statement submission, etc. Proper classification and close review of loans enable banks to monitor loan portfolio and take remedial step to safeguard deterioration of its credit quality. Further more, establishment of strong recovery cell, hiring Assets Management Company, implementation of proper rules & laws are also essential to solve the problem of NPL. Present NRB directives is more effective than previous as a result proper classification of loans & adequate provisioning for the future loss which reduces profit in short term but can be used as cushion for future distress situation.

### **5.3 Recommendations**

High level of non performing assets not only decreases the profitability of the banks but also affect the entire financial as well as operational health of the organization. If the NPA are not controlled immediately, it will be the main cause for shutdown of banks in future. Therefore, following are some of the recommendations, which will help to reduce the level of NPA of Nepalese commercial banks.

While disbursing loans to the client there should be the strong policy in C.B to float loans on the basis of the business position, scope of viability and business need. At

the same time the commercial banks are required to give proper attention on the personal integrity of the borrower too. It will prevent the possibility of lending to the purpose other than business required and as well as possibility of loan flotation to the willful defaulter. Future, the offered security should also be assessed properly as on the distress situation if the retained security is good then the loan can be recovered. It is recommend to HBL & NCC to take serious action for recovering the bad loans. And also they should make remedial actions for new loans. It is recommend to HBL & NCC to apply following modes of recovery of NPA: immediate cash recovery, short-term cash recovery arrangement, long-term cash recovery arrangement, invoke personal guarantee, restrain other properties, auction of collateral, assume of collateral in bank name, refer case for blacklisting, refer case to DRT for recovery, refer case for passport seizure, etc.

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## **APPENDIX**

### **Brief Profile of Sample Banks**

#### **Nepal Investment Bank Ltd. (NIBL)**

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one of the largest banking group in the world.

With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50% shareholding of credit Agricole Indosuez in Nepal Indosuez Bank Ltd.

The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank's Annual General Meeting, Nepal Rastra Bank and Company Register's office with the following shareholding structure.

- ) A group of companies holding 50% of the capital.
- ) Rastriya Banijya Bank holding 15% of the capital.
- ) Rastriya Beema Sansthan holding the same percentage.
- ) The remaining 20% being held by the General Public (which means that NIBL is a Company listed on the Nepal Stock Exchange).

NIBL, which is managed by a team of experienced bankers and professionals having proven track record, can offer its customer what they are looking for.

#### **Himalayan Bank Limited (HBL)**

Himalayan Bank was established in 1993 in joint venture with Habib Bank Limited of Pakistan. Despite the cut-throat competition in Nepalese Banking sector, Himalayan Bank has been able to maintain a lead in the primary banking activities-Loans and Deposits,

Legacy of Himalayan lives on in an institution that's known throughout Nepal for its innovative approaches to merchandising and customer service. Products such as Premium Saving Account, HBL Proprietary Card and Millionaire Deposit Scheme besides services such as ATMs and Tele-banking were first introduced by HBL. The bank stands for the innovations that they bring about in this country to help Customers besides modernizing the banking sector. With the highest deposit base and loan portfolio amongst private sector banks and extending guarantees to correspondent banks covering exposure of other local banks under its credit standing with foreign correspondent banks, bank believe that it lead the banking sector of Nepal. The most recent rating of HBL by Banker's Almanac as country's number 1 Bank easily confirms its claim.

All branches of HBL are integrated into Globus (developed by Temenos), the single Banking software where the bank has made substantial investments. This has helped the bank to provide services like 'Any Branch Banking Facility', Internet Banking and SMS Banking, Living up to the expectations and aspirations of the Customers and other stakeholders of being innovative. HBL very recently introduced several new products and services like Millionaire Deposit Scheme, Small Business Enterprises Loan, Pre-paid Visa Card, International Travel Quota Credit Card,

Consumer Finance through Credit Card and online TOEFL, SAT, IELTS, etc. fee payment facility are some of the products and services. HBL also has a dedicated offsite 'Disaster Recovery Management System'. Looking at the number of Nepalese workers abroad and their need for formal money transfer channel; HBL has developed exclusive and proprietary online money transfer software- Himal Remit TM. By deputing own staff with technical tie-ups with local exchange houses and banks, in the Middle East and Gulf region, HBL is the biggest inward remittance handling Bank in Nepal. All this only reflects that HBL has an outside-in rather than inside-out approach where Customers' needs and wants stand first.

### **HBL is not only a Bank, It is Committed Corporate Citizen**

Corporate Social Responsibility (CSR) holds one of the very important aspects of HBL. Being one of the corporate citizens of the country, HBL has always promoted social activities. Many activities that do a common good to the society have been undertaken by HBL in the past and this happens as HBL on an ongoing basis. Significant portion of the sponsorship budget of the Bank is committed towards activities that assist the society as large.

### **The Bank's Vision**

Himalayan Bank Limited holds of a vision to become a Leading Bank of the country by providing premium products and services to the customers, thus ensuring attractive and substantial returns to the stakeholders of the Bank.

### **The Bank's Mission**

The Bank's mission is to become preferred provider of quality financial services in the country. There are two components in the mission of the Bank; Preferred Provider and Quality Financial Services; therefore HBL believe that the mission will be accomplished only by satisfying these two important components with the Customer at focus. The Bank always strives positioning itself in the hearts and minds of the customers.

### **The Bank's Objective**

To become the Bank of first choice is the main objective of the Bank.

### **Everest Bank Limited (EBL)**

Everest Bank Limited (EBL) started its operation in 1994 with a view and objectives of extending professionalized and efficient banking services to various segments of the society. The bank is providing customer friendly services through a network of 22 branches.

Punjab National Bank (PNB), EBL's joint venture partner (holding 20% equity in the bank) is the largest nationalized bank in India having 112 years of banking history. PNB is a technology driven bank serving over 35 billion customers through a network of over 4500 branches spread all over the country with a total business of around INR 2178.74

The bank has been conferred with "*Bank of the Year 2006, Nepal*" by the banker, a publication of financial times, London. The bank was bestowed with the "NICCI Excellence award" by Nepal India chamber of commerce for its spectacular performance under finance sector.

### **Unique Selling Proposition**

- ) One of the Largest Network among private sector banks spread across Nepal and all connected with ABBS
- ) Strong Joint Venture Partner providing Technical Support
- ) Representative office in India to facilitate remittance from India
- ) Direct Drawing arrangement with PNB and HDFC bank India whereby instant payment is done on presentation of the instrument.
- ) Direct account credit in PNB branches connected with Central Banking System and RTGS member banks via speed remittance.
- ) More than 126 remittance payout location in Nepal

### **Pioneering Achievements**

Recognizing the value of offerings a complete range of services, EBL have pioneered in extending various customer friendly products such as Home Loan, Education Loan, EBL Flexi Loan, EBL Property Plus (Future Lease Rental), Home Equity Loan, Vehicle Loan, Loan Against Share, Loan Against Life Insurance Policy and Loan for Professionals.

EBL was one of the first banks to introduce Any Branch Banking System (ABBS) in Nepal.

EBL has introduced Mobile Vehicle Banking system to serve the segment deprived of proper banking facilities through its Birtamod Branch, which is the first of its kind.

## **Growth**

The bank's performance under all parameters has been outstanding during the fiscal year 2063-64 after providing for income tax and statutory provisions there was a disposal net profit of Rs. 30.06 crore compared to Rs. 23.73 crore last year- an increase of 26.68 %. The bank was able to increase its operating profit by 31.9%, deposit by more than 38% and advances by 39% during the year compared to the corresponding period last year. During the last financial year, the Bank opened three branches namely Balaju in Kathmandu Valley, Nepalgunj and Birtamod. The Bank has further opened a branch at Baglung during the month of Bhadra, 2064. At Present, EBL has Twenty-Two Branches that spread out the nation. Everest Bank is first private commercial bank having largest network.

## **Quality**

Assets quality has improved by reduction of Non Performing Asset (NPA) to 0.80% from 1.27% in the previous year. This is one of the lowest NPA among the commercial banks in Nepal.

Against the Paid-Up Capital by shareholders of Rs. 37.80 crore, the shareholders' funds now amount to Rs. 119.87 crore – with Core Capital base of Rs. 81.67 crore. Earnings per Share have surged to Rs 62.78 from Rs 54.22. The local Nepalese Promoters hold 50% stake in the Bank's equity, while 20% of equity is contributed by joint venture partner PNB whereas remaining 30% is held by the public.

The capital adequacy ratio of EBL is 11.38% which is above the requirement of 11% set by the central bank.

### **Debit Card/ATM (Debit Card and ATM machine)**

EBL in association with Smart Choice Technology (SCT) is providing ATM service to its customers through more than 74 ATMs and over 850 Point of Sales across the country. ATM sharing arrangement with Punjab National Bank has facilitated usage of EBL Debit Card at more than 1000 PNB ATM outlets across the India at a nominal rate. Similarly, Indian tourists and businessmen having PNB cards will be able to use EBL ATM, while in Nepal.

### **Remittance**

EBL is playing a pivotal role in facilitating remittance to and from across globe. Being the first Nepalese bank to open a representative office in Delhi, India, the Nepalese in India can open account in Nepal from the designated branches of Punjab National Bank and remit their saving economically through banking channel of Nepal. The Bank is also offering Cash Management System through HDFC Bank., India for managing the funds of corporate exporting to India by collecting their fund from about 183 locations in India.

The Bank's own Web based online remittance product "Everest Remit" facilitates remittance from Malaysia, Doha, UK, Baharain, UAE and Qatar to more than 126 payout location in Nepal.

With India Remit, the Bank has same day remittance facility with India with association of PNB's 2200 networked branches at 550 locations, besides draft drawing arrangement with 280 PNB branches across India.

All the branches of the bank are connected with Anywhere Branch Banking System (ABBS), which enables customers to do all their transactions from any branches other than where they have their account.

### **Nepal Credit & Commerce Bank Ltd. (NCC Bank)**

Nepal Credit & Commerce Bank Ltd. (NCC Bank) formally registered as Nepal - Bank of Ceylon Ltd. (NBOC), commenced its operation on 14th October, 1996 as a Joint Venture with Bank of Ceylon, Sri Lanka. It was the first private sector Bank with the largest authorized capital of NRS. 1,000 million. The Head Office of the Bank is located at Siddhartha Nagar, Rupandehi, the birthplace of Lord Buddha, while its Corporate Office is placed at Bagbazar, Kathmandu.

The name of the Bank was changed to Nepal Credit & Commerce Bank Ltd., (NCC Bank) on 10th September, 2002, due to transfer of shares and management of the Bank from Bank of Ceylon, an undertaking of Government of Sri Lanka to Nepalese Promoters.

At present, NCC Bank provides banking facilities and services to rural and urban areas of the Kingdom through its 17 branches. The Bank has developed corresponding agency relationship with more than 150 International Banks having worldwide network.

### **Capital Structure**

Authorized Capital- Rs 1000 million

Issued Capital- Rs 1000 million



Paid-up Capital-Rs 700 million

### **Technology**

The Bank is using Pumori Plus, the most commonly used software by Nepalese Banks. The Bank offers Any Branch Banking Service (ABBS) in branches operating in Kathmandu and Banepa. Telex and SWIFT are other modes of communication for efficient and effective transmission of information. In order to facilitate the customers with state of art technology, Bank is providing Debit Card facilities under the SCT (Smart Choice Technology) Network jointly in consortium with 12 other member Banks. This facility enables the customers to withdraw cash from any of the 26 ATM Terminals located at different parts of the country and to purchase goods from more than 250 shopping complexes and departmental stores under POS arrangement.

### **Global Connection**

NCC Bank has strategic alliance with ICICI Bank, which facilitates our customers to remit their money to more than 670 locations of India through ICICI Bank branches and their correspondent Banks in India.

NCC's customers can affect their money transfer to India either through Speed Transfer Arrangement or through Demand Draft Arrangement. Under Speed Transfer Arrangement, money can be credited on-line to the beneficiary's account at more than 400 branches of ICICI Bank, India. Under Demand Draft Arrangement, the Bank can issue draft payable at more than 670 locations in India.

NCC is globally connected through various prominent Banks in Asia, Europe and North America like American Express Bank, Standard Chartered Bank, UBAF etc.

Its services across the globe include remittance, draft arrangement, import and export business, guarantee etc.

### **Macchhapuchhre Bank Limited (MBL)**

Machhapuchhre Bank Limited was registered in 1998 as the first regional commercial bank to start banking from western region of Nepal with its head office in pokhara. Today, with a paid up capital of above 820 million rupees, it is one of the full fledged commercial bank operating in Nepal; and it ranks in the topmost among the private commercial banks.

This bank is striving to facilitate its customer needs by delivering the best of services in combination with the state of the art technologies and best international practices.

Machhapuchchhre Bank Limited is the pioneer in introducing the latest technology in the banking industry in the country. It is the first bank to introduce centralized banking software named GLOBUS BANKING SYSTEM developed by Temenos NV, Switzerland. Currently it is using the latest version of GLOBUS, referred as T-24 BANKING SYSTEM. The bank provides modern banking facilities such as Any Branch Banking, Internet Banking and Mobile Banking to its valued customers.

The bank in the last few years have really opened up with branches spread all around the country. At this stage, it has its Corporate Office in Kathmandu and branch offices in other parts of Kathmandu, Damauli, Bhairahawa, Birgunj, Banepa and different parts of Pokhara in addition to the Head Office in Naya Bazar, Pokhara. A full-fledged banking branch is in operation in Jomsom located high up in the mountains too. The bank aims to serve the people of both the urban and rural areas. The bank intends to open many more branches in the coming years and have already envisaged the opening of 8 branches during the year 2007/08.

#### **Laxmi Bank Limited (LBL)**

Laxmi Bank was incorporated in April 2002 as a commercial bank. The current shareholding constitutes of promoters holding 55.42 percent, Citizen Investment Trust holding 9.02 percent and the general public holding 35.56 percent. Promoters represent Nepal's leading business families with diversified business interests. The Bank's shares are listed and actively traded in the Nepalese Stock Exchange.

Laxmi Bank has grown with branches in Birgunj, Banepa, two in Pokhara, Biratnagar, Narayanghat, Pulchowk, Lalitpur, Teku, New Road, Janakpur and New Baneshwor and more recently in Damak. Following the merger with Hisef Finance Ltd., a decade old first generation finance company, its office in Hattisar, Kathmandu was converted to that of Laxmi Bank. This office was converted to a full branch and our corporate office in October 2005.

With a view to providing safe, seamless, quick and advance banking services, the bank has been heavily investing in contemporary banking technologies. The Bank uses Flex cube as its main banking platform. Flex cube incidentally has been ranked the number one selling core banking solution globally, and has been embraced by over 500 financial institutions across over 90 countries. The Bank provides its services through a host of delivery channels including cell phone, Internet, ATM, Point of Sales (PoS) etc., in addition to a network of physical branches. Our Internet banking facility comes with capabilities of online shopping in addition to regular Internet banking features. Similarly, through the bank's alliance with Smart Choice Technologies (SCT), the ATM/Debit cardholder of Laxmi Bank has access for a network of ATMs, and PoS terminals located in all major urban centers of the country. The bank is the first in South Asia to have implemented SWIFT Net, the advanced version of the SWIFT technology, which is used for speedy and secure payment and messaging services.

Under a professional management team, the bank has established itself as an emerging key player. Today the bank is recognized as an innovative and progressive bank geared to providing shareholders and customers with quality earnings and value-added services. Transparency, good governance, and sound business growth are our driving forces.

### **Passion for Excellence**

Bank's pursuit of excellence has led to take several bold steps, sometimes to the extent of pursuing strategies or introducing initiatives, which no Nepali Bank has

previously attempted. Its pioneering spirit has been received with tremendous encouragement, evident through awards like the Best Presented Accounts.

### **Mission**

Mission goes as follows:

Bank is committed to excellence in delivery of entire gamut of financial services in order to achieve sound business growth and maximize stakeholder values by embracing team spirit, progressive technology and good corporate governance. Its IT capabilities are arguably the best in Nepalese banking industry today, products and services Bank offer are comprehensive in context of the markets Bank operate in, it has been recognized for transparency and good governance, bank have built a solid foundation for sound business growth.

### **Aim for Total Stakeholder Satisfaction**

The main pillars of support for Laxmi Bank are its customers, shareholders and our employees. It is banks mission to deliver quality banking and stakeholder satisfaction in the true meaning of the word. Bank fully grasp the ultimate importance of engaging more closely in customer relations at every level, ensuring satisfactory, sufficient profits and ploughing back the fruits of business successes back to customers, the community, and shareholders.

### **Bank's values are built around high standards of corporate governance**

Transparency, professionalism and high ethical tone at the leadership are pillars on which Bank's actions are based. Laxmi Bank's Code of Conduct encapsulates international best practices applicable to Nepali context. The level of commitment of

people to take Laxmi Bank to greater heights has been a huge catalyst. The team spirit within the organization is main secret of success.

### **Building a Strong Corporate Identity**

Identity is formed by an organization's history, its beliefs and philosophy, the nature of its technology, its people, ethics, culture and strategies. Bank has made great efforts to build and protect the integrity and value of brand in the marketplace as it is the most proficient representative of financial community. Bank is gratified to note that its corporate reputation is fast becoming a key source of competitive advantage.

### **Vision**

Bank envisioned that it shall be/ have:

- ) Provider of most integrated financial services
- ) Key player in consumer banking
- ) The best asset book
- ) Best IT capability
- ) Preferred employer in the financial sector

Over a period of time, Laxmi Bank foresees itself to be one of the leading banks in Nepal and eventually a niche player in the South Asian region.

The bank expects to achieve its overall vision through the strength of its strong management pillars, which includes professionalism, team spirit, customer focus, technology support, driven and outward looking culture, good corporate governance, individual challenges and empowerment.

## **Strategy**

At the bank's management conference 2005, Bank adopted 'Growth Thru Efficiency' as its strategic theme for the current year. The strategy is evolutionary, not revolutionary. It builds on the bank's strengths and it addresses the areas where further improvement is considered both desirable and attainable.

To improve profitability in future, the bank shall continue to improve its customer services and product deliveries, thereby attracting long-term low cost deposits, and improve fee based revenue streams. The bank also intends to increase its business volume through steady growth in risk assets, while maintaining its quality.

The bank shall continue focusing on quality, and not be too volume driven, given the current business environment in Nepal, which is not conducive for an aggressive growth. Laxmi Bank's activities and results thereof over last couple of years clearly indicate that the bank is not prepared to compromise on quality for short-term growth.