A CASE STUDY ON NON PERFORMING ASSETS OF UNION FINANCE COMPANY LIMITED.

A THESIS

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CHAPTER- I
INTRODUCTION

1.1 Background of the Study

With the dawn of democracy in year 2046 B.S., Nepal started observing the inception and development of financial institutions. Further, the promulgations of various economic liberalization policies by the government time to time have added ghee to growth of these financial institutions. Economic liberalization policy of the Government has encouraged the establishment and growth of financial institutions in Nepal. There are so many financial institutions such as Commercial Banks, Development Banks, Financial Companies and Co-operatives in operation. Some other institutions in pipeline are supposed to come in to function very soon. The government-owned banks were notable to cater the need of the people and there were rapid growth of financial companies during a short span of time.

A country cannot achieve a better position without proper development of trade and industries. Thus, financialization and economic structure have a critical role in overall development of the nation. Financial companies are the backbone of a country's economy. Financial co. is to mobilize the resources by investing the same in a profitable manner. The resources may include capital funds consisting of shareholders' equity, money deposited by the people, borrowing and profit capitalization. The competency of any financial company is referred as to the utilization of the resources on most profitable manner. The profit should be adequate to meet its costs of funds as well as there should be some margin left over as the reward for risk-bearing. The financial institutions are supposed to have contribution for the overall economic reforms in the country. Though their activities are guided by some social obligations but some profits are always desirable for maintaining existence.

Now-a-days finance companies play a vital role for the development of the nation. Big chunks of resources are being utilized on loans and advances. As the return from loan floatation is higher than the return from any other activities. Financial companies are concentrating their financial activities for the management of loans and advances. By virtue of principal for higher return higher risk should be taken and vice versa. The mushrooming growth of the financial companies has led them towards cut-throat competition. One the one hand, the economic condition of the country is not grooming rather remained stagnant, no any new avenue is being explored. The competition among the financial co. is just to share from the small and same size of the cake.

The less opportunity for getting avenues for loan floatation has compelled the financial co. to finance without being choosy. Quality of the loans and advances could not be maintained to the desirable level if there is no choice whether to finance or not. Once the loans are given it is supposed that repayment of interest or principal shall have to be served without any hindrance. The resources could not be considered utilized properly when the loans provided to the clients could not be regular and if there is cumulative overdue outstanding. There may be various reasons behind the loans that turn irregular from regular one. The main reason may be economic situation of the country which has global and far reaching impact. The smooth operation of the financial co. is possible only when the economy of the country functions well. Satisfactory level of return on investment is the prerequisite for the financial sector to be groomed. The other contributing factors that turn the good loan into bad are the attitude of the borrower, types and quality of security taken and legal hurdles created by the borrower when the recovery action is started. Once the distributed loan is not returned timely by the clients and becomes overdue than it is known as non performing asset (NPA) for the financial co. Reduction of NPA has always been a significant problem for every financial company and proper attention for the management of the NPA now under top priority. Due to various hurdles on way of management of NPA, financial companies are now losing their profitability and struggling for their existence.

The operation of the financial institutions has been regulated by the international norms, relevant acts, regulations, Memorandum of Association (MOA), Articles of Association (AOA), instructions given at the time of getting intent and directives issued by central bank time to time. Like-wise, the execration of the stakeholders should also be taken in to consideration. All financial institutions are supposed to confine their activities within that periphery. The formulation of an effective monetary strategy and reformation program of the financial system in the county can make an important contribution in mobilization of more domestic resources as well as to finance the required funds needed for economic expansion.

Union Finance Company Limited is a proposed public limited company to be established in the Kingdom of Nepal, under Company Ordinance, 1994 and Bank and Financial Institution Ordinance, 2052. It shall have its operation throughout Nepal and be termed as national level financial institution under the umbrella of various rules and directives prescribed by Nepal Rastra Bank.

Proposed financial institution shall carry out its operation in Nepal with a primary objective of carrying of financial activities as prescribed under the ordinance and directives prescribed by NRB and make substantial contribution towards the development and boosting of the country's economy. The financial institution shall provide various financial activities to the target customer with innovative touch on the market and creation and development of financial products. For the promotion of the foreign employment and maintenance of the foreign currency reserve in the country at the time of recession, the financial institution is conceived with the objective of supporting and endorsing various activities pertaining to promotion of foreign employment. The following shall be the predominant business activities of the financial institution, which are in lines with the laws and directives governing the company:

- Mobilization of deposits, particularly from source of remittance received from employees of foreign employment
- Providing term loans, hire purchase loans and especially loan to promote foreign employment
- Providing short term – long term loans for commercial purpose
- Issue guarantees
- Participate in equity investments as well as investment in government bonds and bills
- Provide financial advisory, merchant banking and consultancy services
- Provide various training and development activities

The registered office of the proposed financial institution shall be in Kathmandu metropolitan city, Kathmandu, Nepal and shall compose with the capital structure of Rs. 32 crores having 60% from promoter and 40% from public offering.

Based on various analysis of economic situation of Nepal and comprehending past economic growth of the country, reforms in financial sector and its future prospect, the rationale of establishing one more finance company in Nepal at national level could be supported by following summarized prominent facets, that has been envisioned by the promoters:

- The overall economic indicators of Nepal show a very slow growth of the country. The rate of GDP growth rate is just 3.6%, which is very low against the South Asian growth rate and much more less if so compared with growth rate of immediate neighboring country India and china. The two neighbors of Nepal are growing at the rate of almost 7-9%. The analysis in the previous paragraph has been indicative of the fact that despite the need for industrialization of the economy and promulgation of policy decisions to that direction, we have not yet been able to build up requisite financial institutions to cater to the funding requirement of the industrial sector. To Support the national economy addition of another financial institution is a plus point factor in the economy.

- Apart from the traditional lending areas, foreign employment should be taken in a high profile of the economy. For this, a good vision of the financer is required. There is not any financial institution established for this vision. Therefore, entry of a financial institution in the financial market of Nepal would cater in boosting the growth of the country through channelizing the investment and credit mobilized towards the industry sectors. Not only that, the proposed institution shall identify new avenues and area where the lending could be concentrated like foreign employment sector etc., so that the ultimate results have overwhelming effect on the country's economy.

- Till date, the remittance of the foreign worker is coming through hundi with high commission, which is not accounted in the systematic manner in the national economy. The remittance through banking channel is in the growing trend, but this resource is in the initial stage comparing to the volume of remittance. One pertinent reason for establishment of proposed financial institution is to promote foreign employment, which at present is considered as major source of foreign exchange of the country and maintaining the foreign exchange reserves. Foreign employment remittance is also deposited in the economy, but the recipients' literacy is very low. If they get any place where the remitted is receive, then that would be a beneficial for the person so receiving. For these, the proposed financial institution will be the milestone for deposit and loans.

- More significantly, the promoters behind the establishment of the finance companies are old players in the remittance business. With 12 branch offices of the remittance, the people all over the country are able to receive the remitted money easily in Nepal. With such existing image and goodwill in the remittance business, the introduction of the finance company would facilitate the activities smoother, so that remittance received could be deposited with the same known and trusted group in the finance company enabling them to earning handsome interests. Ultimate establishment of the finance company having number of branches all over Nepal would provide the Nepali laborer to safely remit the money and deposit in the finance company so that interest could also be earned.

- The establishment of proposed financial institution would certainly increase the domestic resources and help in reducing the saving investment gap in the country. A need can be perceived where establishment of one more financial institution will contribute an additional vehicle to mobilize resources which are being untapped by existing institutions.
- The role of banking and financial sector is crucial in the process of the economic development in the country. In the last few years, it is revealed that the economy is shaping according to the market forces and this process seems to be continuing in the future too. The government policies of liberalization, privatization and involving private sectors in the process of economic development of the country, have enormously changed the economic scenario of the country. The establishment of new banks and financial institution as well as industrial expansion in the country could evidence this.
- The establishment of banks and financial institutions has also contributed in increasing resources available and income generation in the country. This sector has also provided employment opportunity to a large number of people directly and indirectly.

With the aforementioned rationale for establishment the prominent vision and mission of the promoters are:

To provide support for the promotion, development and enhancement of the foreign employment including loan to foreign work seekers.

To safely mobilize the resources of foreign remittance in the same sector and promote the foreign employment sector significantly

To become a pioneer financial institution to dedicate the resources into foreign employment and its promotion, so that human resources of the country would emerges as very imperative factor for the country’s growth and development.

To provide support for the promotion, development and enhancement of the business involved in various traditional sectors like agriculture, hire purchase, real estate, services, trading, leasing etc.

The main activities of the proposed financial Institution will be the activities described in the section 47(3) of the Bank and Financial Institution Ordinance, 2062 in line with the conditions in the license, which to be issued by NRB, to the proposed Financial Institution. Considering these points, the main activities of the financial institution will be:

- **Resource mobilization:** In this activity, the proposed company shall mobilize the resources from the public through collection of fixed, saving, cumulative, recurring deposits and other deposits arrangements and instruments as prescribed by NRB Resource mobilization through equity investments is also another part of in addition to the deposits. Concentration of resource mobilization will be concentrated more on the foreign remitted amount coming in the country.

  The most significant strategies of mobilization of resources are through capturing of foreign remittances. Of Rs.59 billion remitted to Nepal, almost 70-80% money is being remitted through the prominent promoter of the proposed financial institution. Since, these money are routed through the promoters remittance company, the strategies will be to transfer most of these money into the finance company, by making the remittance receiver as depositor of the proposed company. Only 2-6% of these remitted if deposited in the finance company, it would create a significant collection that aggregates to Rs. 10-47 crores.

- **Lending activities:** In this activity the proposed financial institution shall makes a strategy for lending foreign employment loan, term loan, business loans, loan against FDR and government securities, hire purchase loan, agriculture loan, leasing loan, real estate and housing loan and other lending instruments as per the market scenario and conditions of NRB etc.

The proposed financial institution will massively enter in the foreign employment lending. This shall be the one of the major area of the lending. Till now days, there is no such big scheme for the foreign employment, even the most part of the national income comes from the foreign employments. With the involvement of 480 manpower companies in Nepal and almost 450,000 Nepalese moved out of the country for foreign jobs. This lending includes the loan to the foreign employment promotional institutions, personal lending, lending for the trainings to the foreign employments etc. This lending will make us good deposit mobilizations. This is almost new part of market share and justifiable for lending and deposit mobilization. In this area, the proposed financial institution shall not curtail any market of the existing banks and other financial institutions but creates a new area with economic confidence for other financial institutions.

- **Non-funded activities:** This includes issue of bank guarantees and similar non-funded instruments.
- **Other activities:** Apart from above activities, the proposed financial institution shall do other activities like leasing, business counseling, marketing and business research, merchant banking, advisory services etc.
  - Deposit and Credit Department
  - Administrative and Finance Department

The management of proposed financial institution will be in the leadership of Chief Executive Officer (CEO). He/ She shall be an executive staff under the board of directors. The CEO will be experienced and competent banker, management and marketing experts in the field of banking sector and wholly and completely responsible and accountable for day-to-day operation and management of the company and will be directly responsible for reporting and presenting the activities of the company to the board of directors.

As per the Projected Profit and Loss Account of the proposed financial institution, the company shows a slight profit of Rs.1 million in the first year after the deduction of staff bonus and taxes, due to initial operation period. From second year onwards, the company will start making higher profit of Rs. 5.8 million. On the fifth year, the increase of Profit after tax will reach to Rs. 30 million. The proposed financial institution is planning to declare dividend on its 3rd year of operation, which is 10%. On fourth and fifth year, 15 and 20% is proposed to be declared from the accumulated reserves.

The CD ratio of the financial institution though considered very high in the initial years due to its aggressive investment strategies as well as low deposit collection, which is at 1.13, will be maintained at 1.09 till the 5th year. The current CD ratio of the development financial institute is 1.08. The return to net worth of the financial institution in the first year is 6.2%, however the return shall increased to 44.6% by end of fifth year. The average rate of return on net worth is 26.6%. Likewise, the Operating profit to Net worth in the first year is 6.9% and this will increase to 49.0% by fifth year. The earnings per share of the company are as follows:

Year	Year 1	Year 2	Year 3	Year 4	Year 5
Earnings per Share	4.46	14.59	27.38	36.73	59.92

In spite of considering all the possibilities in the sensitivity analysis, the proposed financial institution does show positive projection and profitability. With strong strength and opportunities and less weakness and threats, the operations of the proposed financial institution stand at low risk with high return. The comparative status of the financial indicators of the different items of the sensitivity analysis is listed as follows:

Table No 1.1

	Year 1	Year 2	Year 3	Year 4	Year 5
Profit after tax					
Original	1,338	7,295	13,692	18,367	29,959
Operating Exp inc. by 20%	1,061	6,877	13,107	17,606	28,972
NPA raise by 10%	1,317	7,188	13,426	17,821	29,474
Interest less by 1.5%	1,049	6,488	12,355	16,512	27,154
Deposit reduction 10%	1,038	6,454	12,009	15,883	26,054
Earnings per share (in Rs.)					
Original	4.46	14.59	27.38	36.73	59.92
Operating Exp inc. by 20%	3.54	13.75	26.21	35.21	57.94
NPA raise by 10%	4.39	4.39	4.39	4.39	4.39
Interest less by 1.5%	3.50	12.98	24.71	33.02	54.31
Deposit reduction 10%	3.46	3.46	3.46	3.46	3.46

*Rs in Millions

In addition, the objective, mission and goal of the institution are focused and driving, thus financial institution shows very conducive environment for its establishment in Nepal. Although, the proposed financial institution does not exhibit high profits and return, a very conservation path was adopted to portray the financial scenario, to be in line with the reality. Considering this reality situation, a new financial institution would definitely contribute an additional helping hand in the economic growth of the country and with highly motivated operational and management team, success of its own growth is unequivocal.

1.1.1 Finance Companies in Nepalese Financial System

Finance companies in Nepal are licensed under the Finance Company Act, 1985(2042) but recently they are incorporated under Nepal Company Act, 2053 and are the largest group of deposit taking financial institutions after commercial banks and development banks. These financial institutions are the creation of early 1990's. Finance companies are established as public limited mainly for providing loans to procure motor vehicles and other consumer durables on hire purchase terms, land acquisition and building constructions and leasing plant and machinery. Finance companies lending operation have tended to complement the operation of commercial banks mainly on urban areas. These companies are not allowed to accept demand and saving deposit from the public and have thus, concentrated in mobilizing funds through fixed deposit. Thus, finance companies are the institutions to perform non-banking activities arrangement and operation of different schemes whereby they collect the funds under different arrangement they have made and disburse the funds to demanders of funds and meet their objectives.

Economic liberalization policy of the government has encouraged the establishment and growth of finance companies in the country. In Eight Plan (1992-97), it has been clearly stated that “the vacuum in the present national financial system needs to be filled by institutionally developed capital market institutions like investment companies, **finance companies**, leasing and housing companies in order to create a healthy, competitive financial sector”. In tenth plan (2002/07) it has been describe that, “Encouragement will be made to establish **finance companies** in development regions where they are not yet established. At the same time their scope of service delivery will be expanded, wherever possible.” In a situation when the existing financial institution, specially commercial banks to meet consumer need for credit, it is time to encourage the growth and operation of finance companies to meet individual credit needs, undertake fee/based merchant banking function and to gradually curtail the Upahar and Dhukuti programs which were run unofficially.

In purpose to government’s economic liberalization policy, NRB took some policy majors for the healthy and completive development of commercial banks and finance companies dissuade them from contracting in Kathmandu. The approval and permission of NRB to encourage the establishment and growth to finance companies started in Nepal after the first amendment in Finance Company Act, 1985(2042). Within a period of four years 1991/95 as per available data, there had been 56 finance companies of various capital sizes registered in Office of the Company Registrar. But in the year 1994, the wave of establishing finance companies reached to the maximum number. Altogether 32 finance companies were registered as per official record in company register. Moreover, four additional finance companies were registered in 1995.

Out of the 56 finance companies, 23finance companies were started operation since 1995. In mid January 1999, the total resources of finance companies amounted to rs.9582 million. In mid January 2000, the total resources of finance companies reached to Rs. 12245 million. By the mid March 2003, the number finance companies licensed under the Finance Company Act, 2042 totaled 55. The number of finance companies reached 70 in mid April 2006 (Annual Report of NRB, 2006).

In view of the growing numbers of finance companies registered and applying for licensed with NRB, a high-level technical committee has been constituted for more serious and details study and analysis of feasibility report submitted by finance companies under the management and leadership of NRB's deputy competitive environment in financial sector. Based on the recommendation of a high-level committee, policy framework and guidelines will be published to help and direct the establishment and regulation of finance companies in the country. The recommendation of this committee will also help to determine basic eligibility criteria to apply why issuing licensed to new finance companies and also in monitoring to those already established and had started operation. There is tremendous growth in the number of financial institution in Nepal in the last two decades at the beginning of the 1980's. It is where financial sector was not licensed there were only two commercial banks performing banking activities in Nepal and there were no micro credit development, finance companies, cooperatives and NGO's. Financial market has made hallmark progress in terms of financial institution. By mid July 2007 NRB, license bank and non-banking financial institutions totaled 180 out of them 70 were finance companies. It can be concluded that finance companies covers the large portion of the financial markets that collects the idle savings from the nook and corner of the country and make use of that in productive sector for the benefit of themselves and the welfare of the nation as a whole.

Finance Companies came into operation under the Finance Companies Act, 1985.They are registered as limited companies with the office of the registrar of companies according to the provisions made in the companies act, 1965. They accept time deposits and advance loans to individuals, firms, companies, or institutions for agriculture as well as non-agriculture purposes in order to increase economic activities. They have become populous among low-income and medium class people as they make loans available for hire purchase and for the purchase of vehicle, machinery tools, equipment, durable household goods or other similar movable properties. Subsequent to the adoption of financial liberalization, many FCs came into operation especially in Kathmandu and other urban areas. In FY 2007, the no. of FCs reached 70 in which 47companies are inside the Kathmandu Valley. Annual report of NRB, 2007

1.1.2 Concepts of Non-Performing Assets

Non-performing asset (NPA) means the amount of loan that the individual financial company or bank has provided and the client has not paid it until the time is already matured. Once the distributed loan is not returned timely by clients and becomes overdue then, it is known as Non – Performing Asset for the bank or financial company. Reduction of NPA has always been a significant problem for every financial company and proper attention for the management of the NPA now has got the top priority. Due to various hurdles on the way of management of MPA, financial companies are now losing their profitability and struggling for the existence.

NPA may be defined broadly as the bad debt. However, it in terms of financial sector, NPA consists of those loans and advances which are not performing well and likely to be turn as bad debts. As per the current directives of Nepal Rastra Bank, (NRB), NPA has been categorized as classified loans and advances. NPA has several impacts on the financial institutions. On the one hand, the investment becomes worthless as expected return cannot be realized and on the other, due to the provision required for the risk mitigation, the profitability is directly affected. The existence of the financial company can be questioned in this situation. Thus, interest along with principal has to be recovered timely and without any obstacles.

Non-performing assets could wreck financial company’s profitability both through a loss of interest income and need to write off the principal loan amount. It tackles the stage pf their identification till the recovery of dues in such amount.

To start with performance in terms of profitability in a benchmark for any business enterprises including the financing industry, The non performing assets has a direct impact on financial profitability as legally financial companies are not allowed to book income on such accounts and at the same time, financial companies are forced to make provisions on such assets.

Loans and advances dominate the assets side of balance sheet of any financial company. Similarly, earnings from such loans and advances occupy major space in income statement of the financial companies. However it is very important to remind that most of the finance company failures in the world due to shrinkage in the valve of the loan and advances. Hence, loan is known as a risky asset, Risk of non- repayment of loan is known as credit risk or default risk. Performing loans have multiple benefits to the society while non-performing loans erode even existing capital.

Performing assets are those loans that repay principal and interest to the finance company from the cash flow it generates. Loans are risky assets, though a finance company interest most of its resources in granting loans and advances if an individual finance company has around 10% non-performing assets or loans, it sounds the death knell of that finance company other remaining the same. The objectives of bound loan policy are to maintain the financial health result in safety of depositor's money increases in the returns to the shareholders. Since the loan is a risky asset, there is internal risk in every loan. However, the finance company should not take risk above the certain degree irrespective of the returns prospects.

1.1.3 No of Finance Company Listed in Nepalese Finance Company

Table No: 1.2

Finance Companies in Nepal

S.N.	Finance company	Date of Licensed by NRB	Paid-up Capital (in Lakh)	Head office
1	Nepal Housing Development Finance Co. Ltd	2049/04/12	580.19	Kathmandu
2	Nepal Finance and Saving Co. Ltd.	2049/09/22	200.00	Kathmandu

3	NIDC Capital Market Ltd.	2049/10/13	600.00	Kathmandu
4	National Finance Co. Ltd.	2050/01/25	950.4	Kathmandu
5	Annapurna Finance Co. Ltd.	2050/06/14	800.00	Pokhara
6	Nepal Share Markets Ltd.	2050/07/03	1600.00	Kathmandu
7	People's Finance Ltd.	2051/01/02	500.00	Kathmandu
8	Mercantile Finance Co. Ltd.	2051/07/24	180.00	Birgunj
9	Katmandu Finance Ltd.	2051/07/24	329.00	Kathmandu
10	Himalaya Finance and Saving Co. Ltd.	2051/07/25	480.00	Kathmandu
11	Union Finance Co. Ltd.	2051/08/26	725.1	Kathmandu
12	Narayani Finance Ltd.	2051/11/24	421.7	Bharatpur
13	Gorkha Finance Co. Ltd.	2051/11/28	250.00	Kathmandu
14	Paschimanchal Finance Co. Ltd.	2051/12/26	506.00	Butwal
15	Nepal Housing & Merchant Finance Co. Ltd.	2051/12/28	544.50	Kathmandu
16	Universal Finance Ltd.	2052/01/04	375.00	Kathmandu
17	Samjhana Finance Co. Ltd.	2052/01/20	212.50	Banepa
18	Goodwill Finance Co. Ltd.	2052/02/01	500.00	Kathmandu
19	Siddhartha Finance Co. Ltd.	2052/02/01	520.00	Siddhartha Nagar
20	Shree Investment & Finance Co. Ltd.	2052/02/18	480.00	Kathmandu
21	Lumbini Finance & Leasing Co. Ltd	2052/03/12	600.00	Kathmandu
22	Investment Finance Ltd.	2052/04/01	240.00	Birgunj
23	Yeti Finance Co. Ltd.	2052/4/01	250.00	Hetauda
24	Standard Finance Ltd.	2052/04/01	600.00	Kathmandu
25	ACE Finance Co. Ltd.	2052/04/30	900.00	Kathmandu
26	International Leasing & Finance Co. Ltd.	2052/07/14	1200.00	Kathmandu
27	Mahalaxmi Finance Co. Ltd.	2052/08/15	600.00	Birgunj
28	Kathmandu Finance Co. Ltd.	2052/08/28	506.25	Kathmandu
29	Bhajuratna Finance & Saving Co. Ltd.	2052/09/25	350.00	Kathmandu
30	United Finance Co. Ltd.	2052/10/12	600.00	Kathmandu

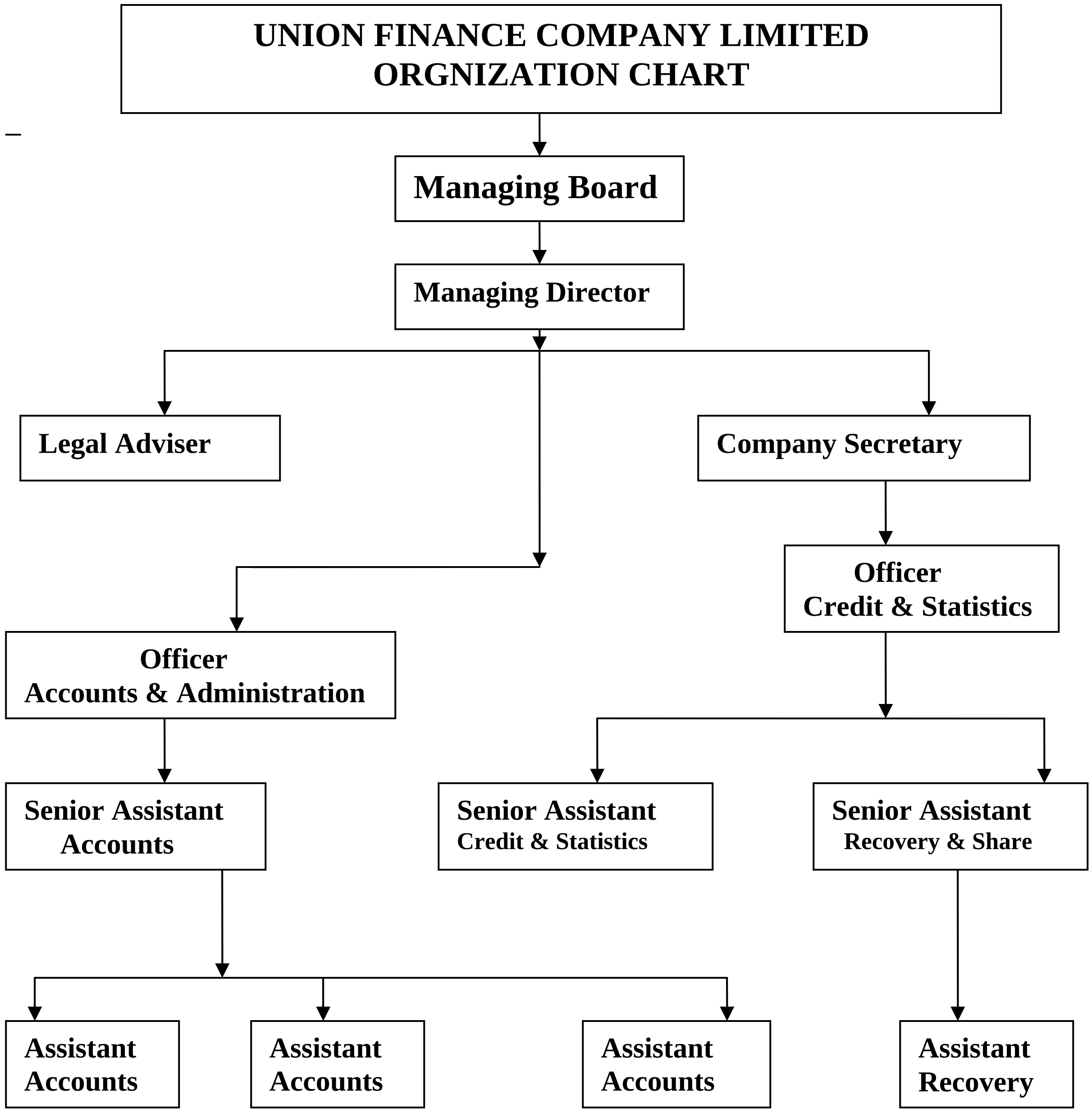
31	General Finance Ltd.	2052/10/18	200.00	Kathmandu
32	Nepal Shreelanka Merchant	2052/10/21	1300.00	Kathmandu
33	Merchant Finance Co. Ltd.	2052/12/14	180.00	Kathmandu
34	Aplic Everest Finance Ltd.	2053/04/02	500.00	Kathmandu
35	Nepal Merchant Banking & Finance Ltd.	2053/09/11	1300.00	Kathmandu
36	Nava Durga Finance Co. Ltd.	2053/09/22	220.00	Bhaktpur
37	Janaki Finance Co. Ltd.	2053/11/24	200.00	Janakpur
38	Pokhara Finance Ltd.	2053/12/13	520.00	Pokhara
39	Central Finance Co. Ltd.	2054/1/2	360.00	Kathmandu
40	Standard Finance Co. Ltd.	2054/2/26	240.00	Kathmandu
41	Arun Finance & Saving Co. Ltd.	2054/05/01	90.00	Dharan
42	Multipurpose Saving & Investment Co. Ltd.	2055/01/02	30.00	Rajbiraj
43	Butwal Finance Ltd.	2055/03/25	575.00	Butwal
44	Purijana Finance Ltd.	2056/08/09	104.00	Lahan
45	Nepal Bangladesh Finance & Leasing Co. Ltd.	2056/12/05	500.48	Biratnagar
46	Om Finance Ltd.	2057/06/12	500.00	Pokhara
47	Cosmic Merchant Banking & Finance Co. Ltd.	2057/08/05	750.00	Kathmandu
48	World Merchant Banking & Finance Co. Ltd.	2058/08/01	600.00	Hetauda
49	Capital Merchant Banking & Finance Ltd.	2058/10/29	700.00	Kathmandu
50	Crystal Finance Ltd.	2058/11/02	350.00	Kathmandu
51	Royal Merchant Banking & Finance Ltd.	2058/11/02	325.00	Kathmandu
52	Guheshwori Merchant Banking & Finance Ltd.	2059/09/29	500.00	Kathmandu
53	Patan Finance Ltd.	2059/03/04	300.00	Kathmandu
54	Kist Merchant Banking & Finance Ltd.	2059/10/23	889.9	Kathmandu

55	Fewa Finance Co. Ltd.	2060/01/09	500.00	Pokhara
56	Everest Finance Ltd.	2060/03/11	200.00	Siddhartha Nagar
57	Birgunj Finance Ltd.	2060/06/7	600.00	Birgunj
58	Prudential Finance Co. Ltd.	2061/02/25	500.00	Kathmandu
59	Investment Credit & Finance Co. Ltd.	2061/03/30	500.00	Kathmandu
60	I.M.E. Finance Ltd.	2062/03/14	300.00	Kathmandu
61	Sagrmatha Merchant Banking & Finance Co. Ltd.	2062/05/13	300.00	Kathmandu
62	Shikhar Finance Ltd.	2061/03/30	300.00	Kathmandu
63	Civil Merchant Finance Co. Ltd.	2062/06/02	300.00	Kathmandu
64	Union Finance Co. Ltd.	2062/11/14	300.00	Kathmandu
65	Imperial Finance Co. Ltd.	2062/11/24	305.00	Kathmandu
66	Kuber Finance Co. Ltd.	2062/12/11	275.00	Kathmandu
67	Valley Finance Co. Ltd.	2063/01/28	275.00	Kathmandu
68	Seti Finance Co. Ltd.	2063/02/24	51.00	Tikapur
69	Hama Finance Co. Ltd.	2063/03/02	315.00	Kathmandu
70	Reliable Investment Bitiya Sanstha Ltd.	2063/08/22	578.00	Kathmandu
71	Lord Buddha Financial Institutions Ltd.	2063/11/05	350.00	Kathmandu
72	Api Financial Institutions	2064/03/27	140.00	Kaski
73	Namste Bitiya Sanstha Ltd.	2063/11/05	51.00	Gorahi, Dang
74	Kaski Finance Ltd.	2064/04/14	300.00	Pokhra, Kaski
74	Suryodya Financial Institutions Ltd.	2064/04/14	300.00	Kathmandu
75	Zenith Financial Institutions Ltd.	2064/05/22	360.00	Kathmandu
76	Unique Financial Institutions Ltd.	2064/05/26	300.00	Kathmandu
77	Manjushree Financial Institutions Ltd.	2064/05/02	700.00	Kathmandu
78	Subhalaxmi Finance Ltd.	2064/07/25	700.00	Kathmandu

Source: - Annual Report of Nepal Rastra Bank, 2008.

1.1.4 Profile of Sample Finance Company

Union finance company limited (UFCL) is the first non-banking financial institution to introduce the leasing business in Nepal. It was established 1993 in technical collaboration with BAIL EQUIPMENT OF UECIC BANKS OF FRANCE whose leasing expertise is widely recognized throughout France. UFC was registered with company registrar's office on march 25^{th} 1993 with an authorized capital of Rs.120 million and issued and paid-up capital Rs. 60 million and Rs. 45 million respectively. Its operation came into effect on December 12^{th} 1994 after obtaining licensed on September 17^{th} 1994 from Nepal Rastra Bank. Its office is located at Kamaladi Kathmandu (Website of UFCL).



1.2 Focus of the Study

To be precise, NPA may be defined broadly as the bad debt. However, in terms on financial sector NPA consists of those loans and advances which are not performing well and likely to be turn as bad loans. As per current directives of Nepal Rastra Bank (NRB) NPA has been categorized as classified loans and advances NPA has several impacts on the financial institution. On the one hand, the investment becomes worthless as expected return cannot be realizable and on the other, due to the provision required for the risk mitigation the profitability is directed affected. The existence of the financial co. can be question on the situation. Thus, interest along with principal has to be recovered timely and without any obstacles.

NPA as categorized by NRB are classified loans and advances. For the probable loss on lending that cannot be recovered even after liquidation of security held with financial co. NRB has directed to maintain loan loss provisioning according to aging basis for risk 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 financial Co. This study has made effort to find out the relationship of NPA on profitability of the financial companies.

Management of NPA has led the financial co. towards the rigorous recovery action which ultimately may cause auctioning of the security held with financial custody. Due to advance economic situation of the country and perception build up among the people that the properties under auction are always over-valuated there is less participation of the bidders during auction. Such situation compels the financial co. to accept the security on its own name. Continuous acceptance of the ownership has now created another problem by pilling up the volume of non financing assets (NPA). As the major chunks of NPA are fixed in nature, the funds supposed to be rolled over are being tied up on fixed asset which is heating the liquidity of the financial companies. The present study is confined to evaluate the relationship of NPA and NFA.

It is confined to analyze the implication of NPA on the profitability pf the financial co. Further, it is an effort to assess the relationship of NPA and NFA. Credit concentration risk and its implication on NPA increment are also considered. Affecting internal and external factors for the conversion of NPA are other areas to be intended to focus under this study. For the analyzing of the cause and consequences the NPA level of Union Finance Co. Ltd., Kathmandu has been taken into consideration.

1.3 Statement of the Problems

While floating loans, the financial company expects that interest and principal are served on time. In principal loans and advances extended by financial company are repayable on demand. But in practice, all loans are not recovered as per the terms of the sanction or within the expiry of repayment period granted in normal curses. When the interest and principal cannot be recovered timely, the loan is said to be classified loan or NPA. Nepalese financial company are still under the developing condition. They have to follow all the rules and regulations or the directives issued by the Nepal Rastra Bank, the central bank of the country. Furthermore, the implementation of policy is not an effective. Lack of absence of strong commitment towards its proper implementation has caused many problems to the financing companies of Nepal. The core financing business is mobilizing the deposits an utilizing it for leading to industry leading business is generally encouraged because it has the effect of funds being transferred from the system to productive purposes which results into economic growth. However, lending also carries credit risk which arises from the failure of borrowers to fulfill its contractual obligation during the course of transaction. It is well known that the bank and financial institutions in Nepal face the problem of swelling non- performing assets and the issue is becoming more and more unmanageable. While floating the loans the financial co. expects that interest and principal will be served on time. In principle loans and advances extended by financial co. are repayable on demand. But in practice all loans are not recovered as per the terms of sanction or within the expiry of repayment period granted in normal courses. When the interest and principal cannot be recovered in time the loan is considered as classifieds loan or NPA. In the recent days not only government-owned banks but some of the banks under private sectors and financial companies are also suffering from NPA burden. It is a matter of debate among the financial sector regarding the real cause of NPA increment and on some occasion it is said the newly issued NRB directives are the causes of NPA increment. This study has identified the following research questions regarding to NPA with special reference to Union Finance Co. Ltd., Kathmandu.

(a) What is the overall impact of NPA on the profitability of the financial co.?

(b) What is the relationship of NFA with NPA?

(c) What are major external factors that have significant contribution on NPA increment?

(d) What are major internal factors that influence the NPA growth?

1.4 Objectives of the Study

The gradually increasing NPA has now become a major issue for every financial company. Every financial co. has now put the NPA management under top priority. Thus, in present context analyzing the cause and implication of NPA obviously shall be useful for financial sector. The basic objective of this study is to analyze and identify the impact, causes and consequences of NPA. The specific objectives of this study are as follows:

(a) To evaluate the impact of NPA on the profitability of the finance co.

(b) To assess the relationship of NFA & NPA.

(c) To analyze the external factors that has significant contribution on the conversion of performing loans in to NPA.

(d) To find out the internal factors that influence the proper management of NPA.

1.5 Significance of the Study

Problem due to increasing NPA is more or less being faced by every financial company in Nepal. The nature of problem is similar for every finance company. The proper mobilization and utilization of domestic resource become indispensable for suitable economic development and there is no doubt that financial companies have pivotal role for the collection of dispersed small savings of Nepalese people and transforming them into meaningful investment. The success and prosperity of the finance company rely heavily upon the successful important sectors of economy as well as to generate more profit by investing in the consumers darned. The main aim of the present study is to find out what sorts of tools and techniques have been used to overcome the problem of conversion of performing assets into the non-performing assets by the financial companies and to analyze what other kinds are being used in the present world that the corresponding financial company can adopt, if found, under the study.

Loans and advances are the most profitable of all the assets of a financial company. These assets constitute primary sources of income to the financial company. It means interest earned from such loans and advances occupies a major space in income statement of the finance company. As a business institute, a finance company aims at making huge profit. Since loans and advances are more profitable than any of other assets, the finance company is willing to lend as much as its fund as possible. But it has to be careful about the safety of such loans and advances. Hence, loan is known as a 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 loan/assets erode even existing capital. Therefore success of any finance company does not depend upon now much money a finance company is able to lead, but it depends upon the quality of the loan. So, success of a finance company depends upon the amount of performing assets/loans. Performing assets are those loans that repay principal and interests to the finance company from the cash flow it generates.

It is well known fact that bank and financial institutes in Nepal have been facing the problem of swelling non-performing assets and issues are becoming more and more unmanageable. Unfortunately, now-a-days, financial companies have been becoming the victims of high level of NPA, which has been the subject of headache to the financial sector and Nepalese banking or financing industry is not also exception from this truth.

Problem due to increasing NPA is more or less being faced by ever financial company in Nepal. The nature of problem is similar for every financial company. As this problem has already been recognized as a serious problem thus obviously this study has both academic as well as practical significance. The findings and conclusion of the study would add to the literature of non-performing assets in general and review the pervious findings. The study would be helpful for the financing industry to identify and to trace the contributing factors causing NPA and to reduce its level. This study will also be helpful for the regulating authoring to know exiting recovery problem so as to have some modification on directives, laws and other proceedings. The study would be helpful for the finance company to identify and to trace the contributing factors causing NPA and to reduce it level.

1.6 Limitations of the Study

The present study is a milestone in exploratory study in searching the NPA problems and its solutions in Nepalese financial sector. Findings of the study might be very much useful for academicians as well as for practitioners. However, this study has suffered from many limitations such as:

(a) Cross sectional data are the major limitation to find the casual linkage between NPA and profitability of the financial co. as well as NPA and its relationship with NPA.

(b) This study is confined on the NPA of Union Finance Co. Ltd.

(c) The analysis is based on the data available from financial statement of the Union Finance Co. Ltd. that are secondary in nature and it is assumed that figures depicted reflect their actual position.

(d) It is assumed that the findings and conclusions would relevant for all financial companies.

(e) Limited time and resources are other limitations of this study to reach into the specific aspects of the issues.

1.7 Organization of the Study

The study has been organized into five chapters. They are as follows:

Chapter I: Introduction

This is the introductory chapter, which has covered background of the study, focus of the study, statement of the problem, objectives of the study, significance of the study etc.

Chapter II: Review of Literature

This chapter has included conceptual framework i.e. theoretical analysis and review of related different studies. In this chapter has been also considered that how this present studies are different from previous studies.

Chapter III: Research Methodology

This chapter has dealt with the research design, population and sample, sources of data, data collection techniques and data analysis tools (financial tools and statistical tools) and methods of analysis and presentations.

Chapter IV: Presentation and Analysis of Data

This chapter describes the research methodology employed in the study. It will include secondary data and primary data presentation, data analysis, interpretation, testing of hypothesis and major finding.

Chapter V: Summary, Conclusion and Recommendations

The last chapter states the summaries, conclusions of the whole study and recommendations. It also offers several avenues for future research. The exhibits and bibliography are incorporated at the end of the study.

CHAPTER-II
REVIEW OF LITERATURE

2.1 Background

This chapter includes the brief presentation of the concept of financial companies, development of financial companies in Nepal with detail profile about the Union Finance Co. Ltd. under study. This also covers the review of the theoretical background being implemented for the management of NPA. Nepalese financial companies have now started to give proper attention on NPA. Some banks have recently introduced the NPA management policy for the recovery and regularization of the dues.

In India, The State Bank Staff College, distance learning Department, Hyderabad had prepared the paper for the management of NPA which was basically for the purpose of internal management of NPA. No previous research papers have been found in this sector. However, it is tried the best to give the introduction of NPA and categorization norms in India and Nepal through Reserve Bank of India (RBI)'s guidelines and Nepal Rastra Bank (NRB) directives on country specific. For some theoretical aspects, some financing related books have also been studied for the assessment of financing approach towards NPA.

2.2 Concept of Financial Companies

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

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

Nepal has been ruled over by many rulers like Kirati, Lichavi, Malla, Ranas 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 "Vansavail" in fourteenth century, the ruler of the then Kathmandu Jayasthiti Malla segregated the local domiciles into 64 different classes according to professions 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: 89).

After long time, during the rana regime only handful prime ministers thought about the economic development of the country. They established some offices in 1933 B.S. (1877 A.D.) 'Tejarath Adda' was established during the tenure or Prime Minister Ranodip Singh Rana as a first institutionalized credit house. Tejarath Adda provided loans 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 and financing institution and for a quit long time it tendered a good service to government employee as well as to the general public (Shrestha, 1995). The government also implemented the rules taken by money lenders. Thus, the government occupied an important role in the banking and financing history of Nepal.

In Nepal, before the birth of Finance Companies Act 2042, there was no development and extension of finance companies. But by the lack of sufficient knowledge, it was not utilized for 6/7 years after Finance Company Act was introduced.

Financial institution is an intermediary, it is not a bank. It takes loans from the certain institutions; it accepts deposits and invests in hire purchase. Hire purchase company, insurance company, industrial development corporation, provident fund, finance companies, pension fund, saving & loan association and trust fund etc are financial mediators. These institutions utilize the savings of the nation; make important contribution to economic development of nation. It is difficult to imagine the development of any countries without the development of financial institution provident fund, insurance company and unit trust.

Finance is the most important perquisite for establishing and operation any business organization. Finance helps bringing together all the factors of production in an industrial unit. Therefore, finance is a critical factor for establishing, operating and success of business. In the absence of adequate finance, even the business having high potentiality may fail.

Finance company is a type of financial institution. A finance company is also called a loan company. The hire purchase business of finance company is very important. The collected fund from the different small savers, giving the high interest rate in the deposit. It also provides loans to the investor. Finance companies provide the loan to buy land, to buy and build the house etc by taking movable and immovable properties as securities. Similarly, under the hire purchases, they provide the capital wise goods in installment loan like motorcar, motorcycles, television, bus, truck, taxi and machine devices. The finance companies take the loans from big financial institutions, mix own capital, and take deposits from common people. Generally, the finance companies give the high interest rates in the deposits; provide different types of attraction to collect a great quantity of deposit. The small savers are much attracted towards finance companies.

A finance company is not established with the objective as the commercial banks established. It is established with the objective of collecting the capital scattered in the country with the medium of non-banking activities. Private sector was encouraged to open the finance company to bring the speed in the economic development liberal and free market economy.

2.3 Functions of Finance Companies

Finance company is established primarily for the purpose of earning a profit. To achieve this, it performs various activities. Major functions of a finance company include.

1. Brokerage for the loan
2. Assisting to the monetization

3. Functioning as a mediator
4. Reduce the risk
5. Providing advices and the high quality financial services
6. Building the liability and property
7. Others

1. Brokerage for the loan

The finance institutions are the brokers of the loan-able funds. Their main business is to work for such broking. The financial institutions can convert a loan a credit and takes the risk.

2. Assisting to the monetization

The institution sell indirect securities like close substitute for money not only for all savers but they also encourage the savers who want to take the money, to buy the close substitutes for money. These are used as the alternatives of money. They monetary the gaining future income power of the consumers with the medium of hire purchase.

3. Functioning as a mediator

The function of the financial institution is to do business of intermediary between the savers and investors. The financial institutions sell the secondary securities to the savers and buy primary securities from investments.

4. Reduce the risk

They reduce the risk of the particular investor, the risk which appears in doing the function of intermediary between creditor and borrower. By setting off compensation from the properties that have more income to the properties that have less income. Financial institution does the function of maintaining the balance of their own income.

5. Providing advices and high quality financial services.

The financial institution collects the fund from the capital market by utilizing the saving. They give financial suggestions and advices both to the debtor and creditor because they are persons with knowledge of special law and experience. They can maintain their image and influence by doing different types of transactions and work in the financial market of nation. The financial institutions grow their attraction by providing quality financial services to the savers.

6. Building the liability and property

The financial institution creates different types of properties and liabilities. The presence of the financial institution creates the financial claim and liability. These claim liability are called closed money which are the alternatives of money. The financial institutions do the function of building much more capital in economy helping to transfer the amount between the borrowers and investors with the objectives of providing and producing safe and liquid assets.

7. Others

Actually, financial institution does many other works such as,

(1) It used collected fund in hire purchase

i) Vehicle

ii) Machinery

iii) Equipment

iv) Land & Building

v) Leasing finance

(2) It works as merchant banking functions

a) Advertising

b) Venture Capital

c) Underwriting

d) Acquisition

Financial institutions are the vehicles through which public deposits are mobilized in various development activities i.e. agriculture, industry, trade, commerce etc. along with the financial lubrication, number of financial institution grew rapidly, but most of them are centralized either in the capitalism or within urban areas of the country. Financial institution flows the midterm and long term loan also. It is an institution to loan broker.

2.4 Development of Finance Companies in Nepal

The development of financial institution in Nepal is the consequence of different reasons. In fact behind the development of such institution there are many argumentative reasons among which growth of people's consciousness can be taken as a main reason. Another important reason that can be considered important is the influence of internationalization & liberalization in the financial sector. The people living in rural areas of Nepal who cannot keep their own money safely, give it individually to another person to keep safely for the owner, and this custom is in use more or less till now. About 18 to 20 years ago in town areas the private firms or individuals used to collect the amount from general people through the much debated “Bumper Programmers” treasure and present programmers. Later they used to return goods and cash for those programmers. Such firms and individuals after collecting amount in installment from be common people, later they failed to give any goods and escaped being dishonest they had given low quality of goods after a long waiting.

Financial Company Act 2042 (1985) was introduced in Nepal. This act has kept the provision that a finance company may be opened that can do banking business in private sector. The Act remained merely as act after the introduction of Co-operative Act 2048. The Co-operative institutions were permitted to collect the deposits and could provide the loans among the members and slowly the financial institution came to be established.

A finance company is not established with the objective as the objective of the commercial bank is opened. It is established with the objective of collecting the capital scattered in the country with the medium of non-banking activities. The private sector was encouraged to open the finance company to bring the speed in the economic development, liberal and free market economy.

In Nepal, before the birth of Finance Company Act 2042, there was no development and extension of finance companies. But by the lack of sufficient knowledge, it was not utilized for 6/7 years after the Finance Company Act was introduced.

Finance company is a type of financial institution. The condition of business, trade and industries can be visualized though the analysis of activities of finance companies. Finance companies provide various services such as lending, deposit and merchant banking. Finance companies take loans from big financial institutions, mix own capital and take deposits from common people. According to Annual Report of Nepal Rastra Bank, there are 78 finance companies established in country. Table No. 1 exhibits the names of finance companies, approval date from NRB, paid up capital and head offices.

2.5 Definition of Loans and Advances

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

Likewise, the term loan is defined as a lending. Delivery by one party to and receipt by another party of sum money upon agreement expressed or implied by to re-pay it with or without interest Boerner vs. Colwell Co.21 cal. 3d. 37. 145 cal rptr.380, 384, 577 P. 2d. 2001. Anything furnished for temporary use to a person at his request. On condition that it shall be returned, or its equivalent in kind, with or without compensation for its use (Liberty mat bank & Trust Co. v travelers idem. Co. 58 Misc. 2d. 443, 295N. Y. S. 2d. 983, 986) loan includes

(i) The creation of debt by the lenders money to the debtor or to a third party for the account of the debtor.

(ii) The creation of debt by a credit to an account with the lend or upon which the debtor is entitled to draw immediately.

(iii) The forbearance of debt arising from a loan: uniform consumer credit code: 3-106.

Further, debt means “principal and interest provided to debtor by banks or financial institutions, with the pledge of immovable or movable property or other securities or guaranties or without guarantee, and the word also means over dues of the transaction beyond balance or fees, commission and interest incurred in that relation (Debt Recovery Act for bank and financial institution, 2058)

The supreme court of India has defined the debt during the decision of the case United Bank of India vs. DRT (1999 ISS, Banking) Shudhir Gupta states that “In the case in hand, there cannot be any dispute that the expression ‘debt’ has to be given the widest amplitude to mean liability which is alleged as dues from any person by a bank during the course of any business activities undertaken by the bank either in cash or otherwise whether secured or secured, whether payable under a decree or order of any court or otherwise and legally recoverable on the date of the application (Gupta,2002).

2.6 Definition of Non-Performing Assets (NPA)

To define NPA, first of all meaning of assets should be understood an asset means the property of a person or a company. This indicates that assets are the properties of a company accumulated with the help of sources.

Non-performing loan means an outstanding loan that is not repaid, i.e. neither payments on interest nor principal is made. In case of the financial companies & banks, the loans and advances are the assets as the financial companies flow loans from the funds generated through share-holders. Hence, the term NPA means the loans and advances that are not performing well. Thus, all the irregular loans and advances can be termed as NPA.

2.7 Classification of NPA

As per the NRB directives, NPA are said as classified loans. And this includes substandard, doubtful and loss categories as defined by new NRB directives (NRB Circular, 2057).

As per the Circular No. BP.BC.79/21-043-92 dated April 27, 1992 and dated December 17, 1992, the RBI had identified the NPA as an account of loan where on the balance sheet date in respect of (Tannin, 1997:201)

- Term loan interest remains "Past due" for more than 180 days Overdraft and cash credit account remain out of order.
- Bills purchased or discounted remind overdue or unpaid for more than 180 days.
- Other accounts receivable remind past due for 180 days.

The circular further says a NPA is a credit facility in respect of which interest has remained unpaid for two quarters. According to the circulars, the loans are classified based on weakness and dependence on collateral securities into four categories and prescribed the provisioning rate as follows (Tannin, 1997:201).

Categories of loan	Criteria of classification	Provisioning required
Standard	Not disclosed any problem and not carry risk (actually a performing asset)	1% of outstanding loans
Sub-Standard	Overdue for not exceeding 2 years	10% of the total outstanding
Doubtful	Overdue for exceeding 2 years	(a) 100% provision on unrealizable value of the security (b) 20% if the asset has to remained doubtful up to 1 years (c) 30% if the asset has remained doubtful up to 3 years (d) 50% if the asset has remained doubtful for more than 3 Years
Loss	ecoverable loans, continuance asset are	Entire amount should be written off. If assets are permitted to remain in the books for any reason, 100% outstanding should be provided for.

In our country, the previous circular of NRB had classified the loans into six categories. However, as per new circular issued and effective from F/Y 2059/60, commercial banks are required to make provisions against loans and advances as follows.

Classification of loans and advances	Criteria for provisions	Provision rate
Pass	Not past due for a period up to 3 months. (performing loans)	1%
Sub-standard	Past due for a period of 3 months to 6 months	25%
Doubtful	Past due for a period of 6 months to 1 year	50%
Loss	Past due for a period of more than 1 year or advances which have least possibility of recovery	100%

However, for F/Y 2062/63, 2063/64 and 2064/65 there are certain relaxation on ageing of due loan. The above criteria are supposed to be effective fully onwards F/Y 2064/65.
(NRB Circular, 2057)

2.8 Effect of NPA on Profitability of the Financial Company

Under the circumstances assets that do not earn any income to the financial company affect the profits in a way (Athmanathan and Venkatakrishnan, 2001)

(a) Profitability impact:

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

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

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

- NPAs have a direct impact on return on assets and return on equity the two main parameters for measuring profitability of the financial company.
- Return on assets will be affected because while the total assets include the NPA, they do not contribute to profits which are the numerator in the ratio.

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

- NPAs bring down the profits, affect the shareholder value and thus, adversely affect the investor’s confidence.

As a whole, the impact of NPA can be assessed with the following (Athmanathan and Venkatakrishnan, 2001: 67)

- Lower ROE and ROA

- Lower image and acting of financial company.

- Disclosure reduces invertors confidence
- Increases cost / difficulties in raising Capital.
- NPAs do not generate income.
- They require provisioning
- Borrowing cast of resources locked in
- Opportunity loss due to none recycling of funds.
- 100% risk weight on net NPA for car
- Capital gets blocked in NPA
- Utilizes capital but does not generate income to sustain the capital that is blocked.
- Recapitalization by government comes with string
- Administration and recovery cost of NPA
- Effect on employee morale and decision making.

<u>China</u>

Causes

i. Moral *Hazard:* The SOE's believe that there the government will bail them out in case of trouble and so they continue to take high risks and have not really strived to achieve profitability and to improve operational efficiency.

ii. Bankruptcy laws favor borrowers and law courts are not reliable enforcement vehicles.

iii. Political and social implications of restructuring big SOE's force the government to keep them afloat.

iv. Banks are reluctant to lend to the private enterprises due to
a. Non-standard accounting practices
b. While an NPA of an SOE is financially undesirable, an NPA of a privet enterprise is both financially and politically undesirable.

Measures

i.Reducing risk by strengthening and spearheading reforms of the SOE's by reducing their level of debt.

ii Laws were passed allowing the creation of assets management companies, foreign equity participation in securitization and asset-backed securitization.

iii.The government, which bore the financial loss of debt 'discounting'. Debt/equity swaps were allowed in case a growth opportunity existed.

iv.Incentives like tax breaks, exemption from administration fees and clear-cut asset evaluation norms were implemented.

<u>Thailand</u>

Causes

i. Liberalized capital and current account and external borrowing with inaccurate assessment of exchange rate risk and risk of capital flight in a crisis.

ii. A legal system that made credit recovery time consuming and difficult.

iii. Real estate speculation looks massive loans projecting high growth in demand and prices of properties. When this did not materialize all the loans went bad.

iv. Steep interest rate rise turned a list of loans into NPAs

v. Inability to correctly assess credit risk.

Measures

i. Amendments were made to the bankruptcy Act.

ii. Corporate debt restructuring plan (1998) focused on capital support facilities for bank recapitalization and setting up of AMC's

iii. New rules governing NPA exit procedures based on international standards were introduced.

iv. Privatization of government entities was mooted, but faced strong political opposition for fear of social backlash.

v. Adoption of international standards for loan classification and provisioning.

vi. Caps on foreign equity ownership in financial institutions were removed.

<u>Korea</u>

Causes

i. Directed credit: Protracted periods of interest rate control and selective credit allocations gave rise to an inefficient distribution of funds. The chaebols' focus on increasing market share and pursuing diversification with little attention to profitability caused tremendous stress on the economy.

ii. The "compressed growth" policy via aggressive, leveraged expansion worked well as long as the economy was growing and the ROI exceeded the cost of capital. This strategy backfired when slowing demand and rising input costs placed severe stress on their profitability.

iii. Lack of monitoring-banks relied on collaterals and guaranteed in the allocation of credit, and little attention was paid to earnings performance and cash flows.

iv. Contagion effect from South East Asia coincides with a period of structural adjustments as well as a cyclical downtime in Korea.

Measures

i. *Speed of action*- the speedy containment of systemic risk and the domestic credit crunch problem with the injection of large public funds for bank recapitalization were critical steps towards normalizing the financial system.

ii. Corporate restructuring vehicles (CRVs) and Debt/equity swaps were used to facilitate the resolution of bad loans.

iii. Creation of the Korea asset management corporation (KAMCO) and a NPA fund to fund to finance the purchase of NPA's.

iv. Securitization of provision norms and loan classification standards based on forward-looking criteria (like future cash flows) were implemented.

vi. The objective of the central bank was solely defined as maintaining price stability. The financial supervisory commission (FSC) was created (1998) to ensure an effective supervisory system in line with universal banking practices.

<u>Japan</u>

Causes

i. Investments were made on real estate at high prices during the boom. The recession caused prices to crash and turned a lot of these loans bad.

ii. Legal mechanisms to dispose bad loans were time consuming and expensive and NPAs remained on the balance sheet.

iii. Expansionary fiscal policy measures administered to stimulate the economy supported industrial sectors like construction and real estate which may have further exacerbated the problem.

iv. Crony capitalism to the Keiretsus

v. Weak corporate government coupled with a no-bankruptcy doctrine was a moral hazard in Japanese economy.

vi. Inadequate accounting systems and information flow make assessment of loan performance outside a bank in Japan difficult.

Measure

i. Amendment of foreign exchange control law (1997) and the threat of suspension of banking business in case of failure to satisfy the capital adequacy ratio prescribed. Legislation to improve information flow has been passed.

ii. Accounting standards- Major business groups established a private standard setting vehicle for Japanese Accounting Standards (2001) in line with international standards.

iii. Government support: The Government committed public funds to deal with banking sector weakness.

2.9 Review of Previous Studies

On way to conduct this research some books, journals and publications have been studied to formulate ideas about the subject matter. Although, the specific books regarding the NPA could not be found, however, some banking and financing related book have been consulted such as Tannin's Banking Law and Practice in India (1997). Assessing the gravity of the problem, Tannin (1997) found saying that banks and financial institutions at present face considerable difficulties in recovery of dues from the clients and a significant portion of the funds of banks and financial institutions is thus blocked in unproductive assets.

In India for addressing the question of speeding up the process of recovery was examined in great detail by a committee set-up by the government under the chairmanship of the hate Tiwari.

Likewise, for taking reference book on management of bank credit written by Suneja, (1992) has also been consulted. Suneja (1992) pointing out the cause of NPA says that the risk connected with lending to business depends on an enormous number of factors. For any particular type of business the risk failure is affected by.

The state of economy treads in demand for the product or service provides competition from any other suppliers financial resources are too limited and management skills are lacking. Reiterating and difficulties, Suneja (1992) says probably the most difficult decision facing a banker is to determine when it becomes necessary to recall a loan and to begin the process of liquidating the security. Further, she suggests that if a customer fails to make repayment on the due date the financial/bank has to consider what stress need be taken to recover the debt.

Ghimire (2056) in her article "Disbursing efficiency indicators of commercial bank or financial company". A comparative analysis, found saying that efficiency indicator of the financial institution and the bank may allocate for loan loss provisioning against loan and investment.

Pradhan (2058) in his article "NPA: some suggestions to tackle them, found saying that unless the growth in NPA is kept in control, it has the potential to cause systematic crisis. He has mentioned that a dream of globalization led to huge investment which unfortunately could not be utilized properly due to hesitant liberalization polices. Large corporate misused the credits and delayed payments and contributed indirectly for enhancing NPA ratio. He further argues that lack of vision in appraisal of proposal while loan sanctioning, reviewing or enhancing credit limits, absence of risk management policy of financing, concentration of credit in few group of parties and sectors, lack of coordination among various financiers. Lack of initiatives to take timely action against willful defaulters. Indecision on existing out of bad loans for fear of investigating agencies like Special Police, CIAA and Public Accounts Committee of the Parliament have also contributed in what's ever measures to the worsening situation of NPA front. He further pointed out that most crucial reason for the increase in the NPA is the shabby and defaulter friendly legal system. Suggesting the remedy of NPA, he adds that administrative system should strengthen, legal reforms should be made and assets Reconstruction Company should be formed. Henderson (2003).CEO of RBB during his interview to new business age, agreed that the challenging target of RBB turnaround was restructuring and collection of NPA Mr. Dinesh Kumar Khadka, (2004), in his thesis entitled "Non-performing assets of Nepalese Commercial Banks," has explained about the topic in which he had objectives to study and examine the level of NPA's in total assets, total deposits and total lending of commercial banks of the banking industry of Nepal. He also had studied whether the Nepalese commercial banks have been following the directives of NRB regarding loan loss provision for non-performing loans/assets or not. He had taken sample banks as Nepal SBI Bank Limited, Nepal Investment Bank Limited, Nepal Bangladesh Bank Limited, Bank of Kathmandu Limited, Nabil Bank Limited. From his studies, it was found that the limited seemed greater than all of the other banks under his study, Similarly, Nepal SBI Bank and Bank of Katmandu stood at second and third position respectively. The position of Nabil Bank Limited seemed, to be quite satisfactory because, the Bank had been reducing its NPA every year. NPA of Nepal Investment Bank stood at minimum than that of all the other banks. From the study it was also found that none of the banks had been following the directives of NRB regarding the loan loss provision. Despite of high level of NPA the loan loss provision made by Nepal Bangladesh Bank seemed to be quite satisfactory than any of the other banks. Despite of the outstanding success in managing the NPA, the loan loss provision made by Nepal Investment Bank was not considerable. It meant the loan loss provision of Nepal Investment bank is very less than the requirement.

Mr. Govinda Ghimire (2005) did a research work entitled Non-performing assets of commercial banks: Causes and effects, 2005, in which he had the objectives to evaluate the impact of NPA on the profitability of the commercial banks. He also studied about the internal and external factors that affect the non performing assets to increase from the loan and advances. The internal factors that influence the effective management of the NPA and its increment. The objective of his studies was also to find out very much important results from the survey. The study was able to find out the internal responsible factors that contributes turning good loan into bad loans, bad intention, weak monitoring and mismanagement were the most responsible factors. Similarly, weak legal provision and credit concentration were also found as the least preferred factors in turning good loans into bad loans. Some factors such as lack of portfolio analysis, not having effective credit policy and shortfall on security were identified as having average effect on NPA growth. In connection to the external factors, it had been found that recession, political and legal issues were more relevant factors in turning good loans into bad loan. Likewise, legal provisions for recovery as reasons for increment in NPA in Nepalese banks have been found as the factors having less impact. Supervision and monitoring system have been identified as average factors. It is therefore, can be generalized that economic and industrial recession and not having strong legal provision for loan recovery are the major external factors that have major contribution for the increment of NPA.

It has also been concluded in the study that Nepalese banks or financial companies gave much priority to trade sector for lending its resource. At the same time it was found that service sectors were not being given that much emphasis. Though these studies are found to be quite useful in their own side but the question of NPA and its cause as well as effect on various aspects in financial institutions is yet to be reviewed. This study has been based on the various contributing factors that increase NPA level in financial companies in Nepalese perspective and its effect on profitability position of the financial company.

CHAPTER – III

RESEARCH METHODOLOGY

Research Methodology describes the method and process applied in the entire aspect of the study. Research methodology refers to the various sequential steps to be adopted by the researcher in studying a problem with certain objectives in view. Its focus is made on the application of technique and procedure to analyze the relevant variables in order to see the basic relationship between relevant topics. To achieve the basic objectives of the study, the following methodology has been adopted which includes research design, population and sample, types, nature and sources of data, data gathering procedure, data processing procedure, tools and techniques of analysis and so on.

Research methodology is the way to solve systematically about the research problem. It is compose of two words, "research and methodology" which mean the process of investigating in values a series of well thought and activities in gathering, recording, analyzing and interpreting the data with the purpose of finding answers to the problem. The entire process by which we attempt to solve the problem is called research while methodology is the method used to list the hypothesis.

"Research design is the plan, structure and strategy of investigation conceived so as to obtain answer to research questions and to control variances. The plan is the overall scheme or program of the research." (Kelinger: 1994:46).

For this study, both field work and desk research have been adopted. The field work has been conducted to collect necessary information and published documents from the experts and officials concerned, while desk-work has been conducted to analyze and interpret the information so collected. In order to make the report meaningful and purposeful the following procedural methodology was adopted.

3.1 Research Design

Research design in the plan, structure and strategy of investigation conceived to obtain answers to research questions and to control variances. In detail, the research question or rest the relationship; the second purpose of a research design is to control variance.

His study seeks to analyze the impact of NPA on profitability, NPA and its relationship with NPA and influencing external and internal factors. The research design of the study is, therefore, combination of two major research designs i.e. descriptive design for secondary data and survey research design for primary data.

3.2 Population and Sample of the Study

Population is the universe about which the study has aimed to enquire and sample is the representative of the population.

Total register number of finance company are the population of the study, currently there are seventy eight finance company in Nepal among them I have selected union finance as a sample by using random sampling method.

The respondents of the questionnaire design for the assessment of internal and external factors having significant contribution for turning good loan into bad loans are the personnel from the Union Finance Co. Ltd. in different level and have experience on credit operation of the financial companies.

Since this study has aimed to assess the impact of NPA on the profitability of the financial companies as well as the influencing variables of NPA, the nature and types of data are both primary and secondary in nature.

3.2.1 Gender of Respondents

The following table shows the actual status of male-female ratio of the respondents.

Table 3.1

Gender of the Respondents' Category Frequency

Category	Frequency
Male	12
Female	4
Total	16
System	8
Total	24

Source: Annual report of Union Finance Company Ltd.

The above table shows that there are 75% of respondents are male and 25% of respondents are female out of total respondents and respondents of system are also male identified in their gender.

3.2.2 Age of Respondents

The present survey design has attempted to gather the information from diverse groups of respondents. Age is also a factor in this campaign. The following table depicts the age group of respondents.

Table 3.2

Age of Respondents

Category	Frequency
Age Below 30	3
31-40	12
41 Above	1
Total	16
System	8
Total	24

Source: Information from staff of Union Finance Company Ltd.

The above table shows that majority of the respondents were from the age group of below 40. The all respondents were under the age group of 50. It is clearly evident that the respondents were young personnel.

3.2.3 Posts of Respondents

Data were collected from Union Finance Co. Ltd. The following table presents the designation of staff of Union Finance Co. Ltd.

Table: 3.3

Posts of Respondents

Post	**Name**
G.M	Amir Dhoj Pradhan
C.E.O.	Surendra B.N. Pradhan
Legal Adviser	Sitaram Shrestha
Officer	Binita Sijapati
Officer	Pratyush Amatya
S. Assistant	Rojy Joshi
S. Assistant	Sunita Kharel
S. Assistant	Navin Ghimre
Assistant	Amrit Paudel
Assistant	Eklal Lama
Assistant	Umesh Bhattarai
Assistant	Bimla Khatri
Driver	Mangal Magar
Driver	Ram Sharan Siwal
Peon	Karma Maharjan
Peon	Bhab Nath Badal

Source: Annual Report of Union Finance Company Ltd.

The above figure shows that most of the respondents were junior level employees.

3.3 Nature and Types of Data

Since the study is concerned with case study of Non-performing assets of financial companies in Nepalese perspective Union Finance Company Ltd. is the sample of the study. The census of the population is neither feasible nor desirable for the study of this nature. That is why, a sample from the population has therefore been selected. For the purpose of this study the selection of the sample from the population, purposive random sampling method has been applied and accordingly Union Finance Company Limited, Kathmandu has been chosen as for the sample.

3.3.1 Sources of Data

Data and information have been collected from both primary and secondary sources. For the analysis of impact of NPA, secondary data have been collected from the annual reports of the Union Finance Company Limited. Likewise, for the study of cause of NPA, primary data in from of questionnaire have been collected from the respondents of Union Finance Co. Ltd.

3.4 Data Gathering Procedure

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

(I) First of all natures and types of data have been identified.

(ii.) For the collection of secondary data, annual reports of the Union Finance Co. Ltd. have been taken for the period of fiscal year 2059/60 to fiscal year 2064/65.

(iii.) For the collection of primary data the official of Union Finance Co. Ltd. have been identified as the respondent and questionnaires have been distributed and required information and data have been collected.

3.5 Necessary Tools and Techniques

Few statistical packages such as excel and SPSS were used to process and analyze information. Secondary information collected from annual reports of the Union Finance Co. Limited were first tabulated in excel spreadsheet and then analyzed using formula and charts of the same software. Statistical tools such as mean, standard deviation, variance, co-variance correlation have also been applied. Likewise, primary data were collected from careful designed questionnaire. These data were first tabulated in SPSS program and variables are defined properly. Some data were parametric and some data were non-parametric data. Suitable tools such as descriptive statistics, mean and standard deviation, were done wherever necessary, ranking was also used to analyze the non-parametric test.

Statistical tools -

a) Correlation

b) Co-efficient of multiple determinations

c) T-Test

a) Graphical Approach

No financial tools are applied.

Correlation

Correlation analysis is the statistical tool that we can use to describe the degree to which one variable is linearly related to other variables. Two or more variables are said to be correlated if change in the value of one variable appears to be related or linked with the change in the other variables. Correlation is an analysis of the covariance between two or more variable. The measure of correlation, called correlation coefficient summarizes, in one figure, the degree and direction of correlation. The correlation analysis refers the closeness of the relationship between the variables *(Sharma & Chaudhary, 2000:420)*. Correlation may be positive or negative and ranges from -1 to +1. Simple correlation between inflation and interest rate and between liquidity and interest rate is determined in this study. Similarly multiple correlation coefficients between above mentioned variables also has been determined assuming interest rate is dependent and other two variables are independent.

$$\text{Simple Correlation coefficient (r)} = \frac{n\sum X_1 X_2 - (\sum X_1)(\sum X_2)}{\sqrt{n\sum X_1^2 - (\sum X_1)^2}\ \sqrt{n\sum X_2^2 - (\sum X_2)^2}}$$

$$\text{or,} \quad (r) = \frac{\text{Cov}(X_1, X_2)}{\sqrt{\text{Var } X_1} \cdot \sqrt{\text{Var } X_2}}$$

Where, $\text{Co variance}(X_1, X_2) = \frac{1}{n} \sum X_1 - \overline{X}_1)(X_2 - \overline{X_2})$

n = total number of observations

X_1 and X_2 = two variables, correlation between which is calculated

$$\text{Multiple Correlation Coefficient (R1.23)} = \sqrt{\frac{r_{12}^2 + r_{13}^2 - 2\, r_{12}\, r_{13}\, r_{23}}{1 - r_{23}^2}}$$

Where, r_{12} = correlation coefficient between variable one and two

r_{13} = correlation coefficient between variable one and three

r_{23} = correlation coefficient between variable two and three

Co-efficient of multiple determinations

The square of multiple correlation coefficients is called coefficient of multiple determination and it is very useful in interpreting the value of multiple correlation coefficient. The main significance of the multiple determinations is to represent the proportion of total variations in the dependent variable which is explained by the variations in the two independent variables.

Co-efficient of multiple determinations $R_{1.23}^2$

T-test for Significance of Correlation coefficient (When number of samples $\leq$ 30)

If 'r' is the observed sample correlation coefficient of 'n' pairs of observations from bi-variate normal population, the test statistics for significance of correlation under null hypothesis is given by:

$$t = \frac{r}{\sqrt{1-r^2}} \times \sqrt{n-2}$$

i..e.'t' follows t-distribution with n-2 degree of freedom (d.f.).

Confidence limit for estimating population correlation coefficient (ρ)

1-α % confidence limits for estimating population correlation coefficient (ρ) are given by;

$r + t_\alpha (n-2) \times S.E.(r)$ $\qquad$ t_α = Level of significance

$$= r + t_\alpha (n-2) \times \frac{1-r^2}{\sqrt{n}}$$

Graphical approach:

All the necessary information and data can be shown in figures. We can use Trend Line and Bar Diagrams where necessary.

CHAPTER-IV

DATA OF PRESENTATION AND ANALYSIS

4.1 Background

This chapter presents the presentation and analysis of secondary data and primary data that are collected from the annual reports and directly collected from the Union Finance Company Limited. The published annual reports and directly from Union Finance Company Limited have been collected and necessary data has been tabulated, for the purpose of the study Nine years data from fiscal year 2059/60 to 2064/65 of Union Finance Company Limited have been taken into consideration. In this chapter two, types of analysis have been carried out i.e. descriptive analysis and inferential section of analysis.

4.2 Descriptive Analysis

Descriptive analysis was carried out to assess the NPA level and its relationship with other key factors in the firms under study. Data of Nine years relating to NPA, operating profit, net profit, loan loss provisioning position and NFA ratio of Union Finance were been obtained. For the analysis of trend of NPA with other related variables the analysis was subdivided into three parts.

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

In second part, the trend of loan portfolio and NPA increment level on the basis of previous year positions have been computed. The purpose of assessing the trend was finding the relationship of loan expansion and growth of NPA. If there is positive growth of NPA. If there is positive growth of loan and advances in case of financial companies under study, we can say that the enhancement of credit portfolio may cause accumulation of risky assets resulting NPA growth.

The third part of the analysis is for assessing trend of NPA and NFA. NFA is created when the security either current or fixed kept in financial companies custody auctioned after the borrower defaults. Situation arises when financial company has to accept the ownership of the security in its own name than NFA or NBA has significant relationship with NPA.

General assumption of this study is that with the growth of NPA level there is also growth of NPA level. Through the analysis of this chapter, the impact of NPA for creation of NPA or NBA can be assessed. If the trend of NFA is not similar to that of NPA, we can say that either the auctioned security has been sold through auction or financial companies have disposed off the NFA by way of selling.

4.3 Trend Analysis of NPA & Profitability of Finance Companies

Net profit ratio shows the relationship between net profit and operating income. The purpose of net profit is to show the overall profitability i.e., efficiency of the bank. Higher the net profit ratio, the better it is considered. This ratio is also useful in making inter-firm comparison of the profitability. Net profit ratio is computed as under:

$$\text{Net Profit Ratio} = \frac{\text{Net Profit}}{\text{Operating Income}}$$

Where,

Operating Income = Interest Income+ Commission and Discount + Exchange Gain

Table 4.1

Analysis of NPA and Profitability of Union Finance Company Limited, Kathmandu.

Years	NPA (Rs.)	Increment	Operating Profit (Rs.)	Increment	Net Profit(Rs.)	Increment	Loan loss Provision(Rs)	Increment
2060/61	1922780	0	5115415.86	-	3105022.43	-	2715.24	-
2061/62	6052669	214.79 %	469345.78	-90.82%	422411.20	-86.40%	4338490.53	1596.83
2061/62	3670594	-39.36%	6578500.00	1301.63%	3380743.97	700.34%	-	-
2062/63	6664408	81.56%	10005843.93	52.10%	3381286.56	0.02%	2953282.23	100%
2063/64	3477520	-47.82%	10144529.01	1.39%	7343626.82	117.18%	661079.10	-77.62 %
2064/65	5543214	59.40%	7611003.00	-24.97%	4688368.00	-36.16%	3947065.00	497.06 %

Sources: Annual Report of Union Finance Company Ltd.

Figure 4.1

Analysis of NPA and Profitability of Union Finance Company Limited, Kathmandu

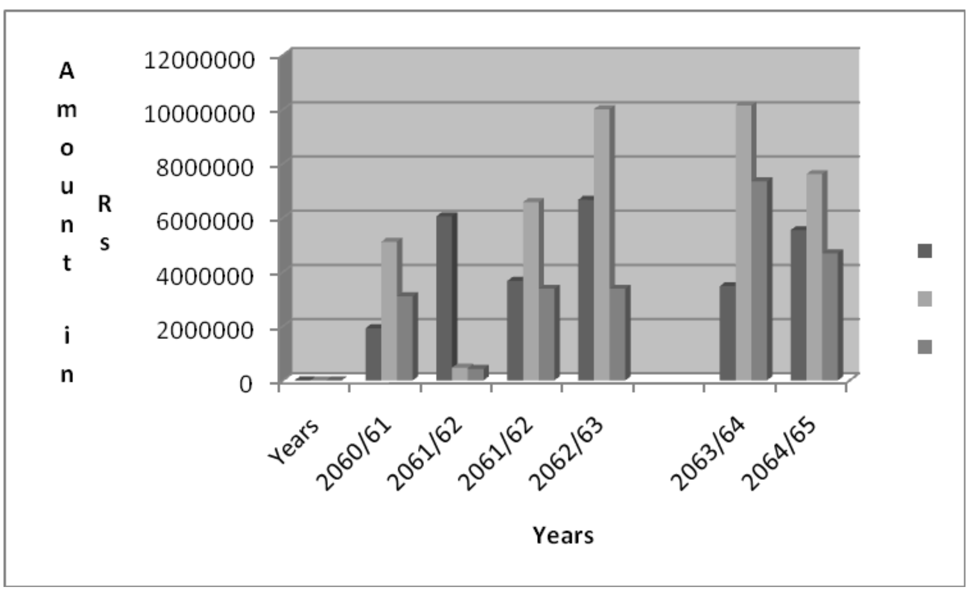
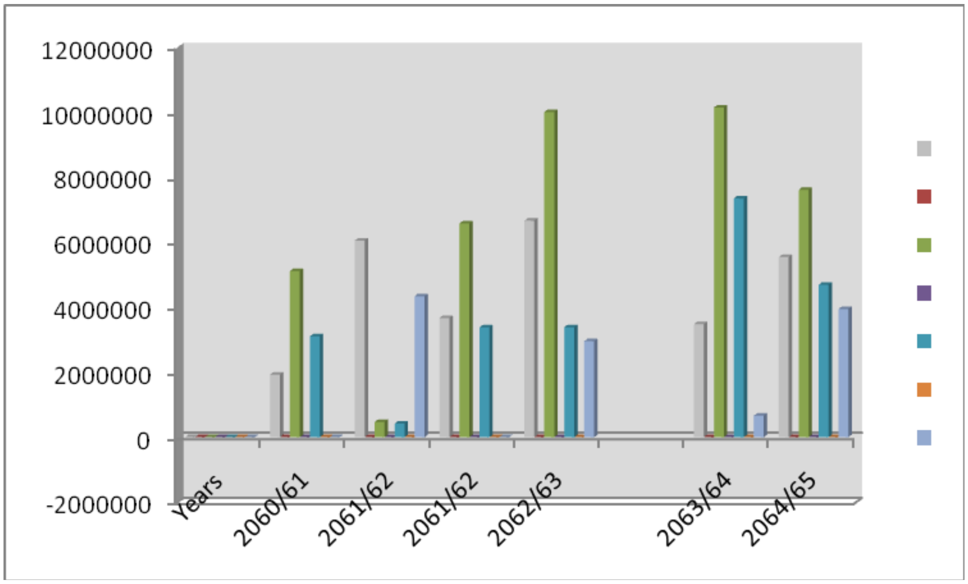


Figure 4.2

Analysis of NPA and Profitability of Union Finance Company Limited, Kathmandu



The above analysis reveals that the NPA growth in case of Union Finance Company Limited, Kathmandu is significant and found steady. In the Fiscal Year 2059/60, the NPA, operating profit, net profit and loan loss provision were positive. Likewise, the operating profit and net profit as well as loan loss provisioning growth were also steady. But in the fiscal year 2059 to 2060, growth of NPA and loan loss provision was positive but the growth of operating profit and net profit was the negative. Growth of NPA in the fiscal year 2060 to 2061 was negative, but operating profit and net profit are positive. In the fiscal year 2061 to 2062 NPA growth was positive as well as operating profit and net profit growth was also positive. In the fiscal year 2063/64 growth of NPA was negative but the operating profit and net profits were positive. However loan loss provision was negative. Likewise, the growth of NPA, loan loss provision is positive but the growths of operating profit and net profit are negative. In fiscal year 2060/61 and 2064/65, the growth of operating profit and net profit was negative. However, NPA and loan loss provision growth was positive. This indicates that due to increase in NPA, the finance company had to make significant provisioning from operating profit had negative growth in that period and due to this net profit is reduced by 86.40%, 36.16% in year 2060/61 and 2064/65 respectively comparing to fiscal year 2059/60. Now, therefore we can say that one of the causes of losing profitability in case of Union Finance Company Limited in fiscal year 2060/61, 2062/63 and 2064/65 were due to increasing volume of NPA.

After reviewing the overall position of Union Finance Company Limited, it reveals that though there was positive growth of non-performing assets (NPA) but the growth of operating profit and net profit was negative due to increase in loan loss provisioning. The basic reason was the requirement to allocate some portion of operating profit for loan loss provisioning as per NRB guideline. Hence, in summary we may conclude that whenever there growth of NPA it affects the net profit of the financial companies.

4.4 Trend Analysis of NPA & Loan Outstanding of the Finance Companies

Analyzing the result of Union Finance Co. Ltd., we can say that NPA growth was to the related with credit expansion. We may say that there is some relationship between credit expansion and increment on NPA. The expansion of loan level can be regarded as one of the causes of NPA increment.

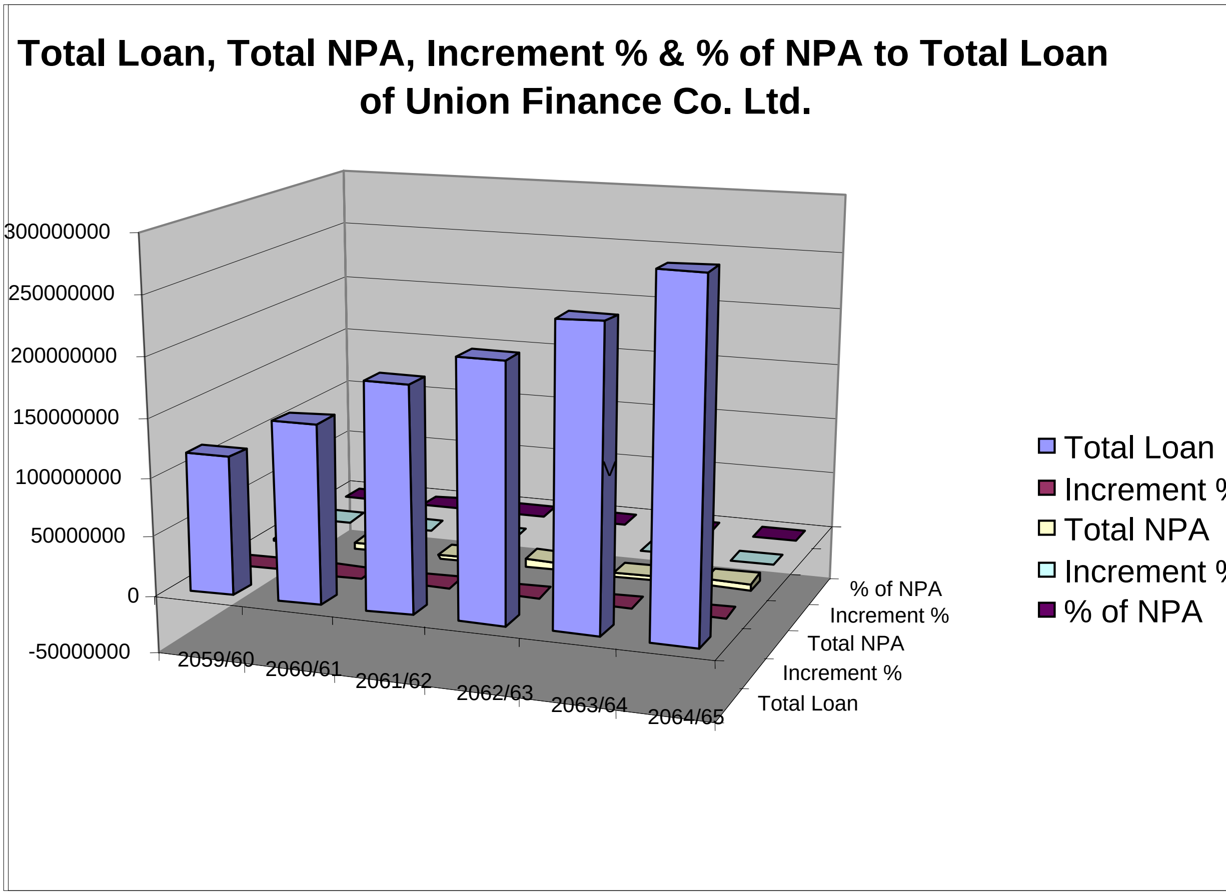
Table 4.2

Analysis of NPA and loan of Union Finance Company Limited. Kathmandu.

Union Finance Company Ltd.					
Total Loan, Total NPA, Increment & % of NPA to total loan					
year	**Total Loan**	**Increment %**	**Total NPA**	**Increment %**	**% of NPA**
2059/60	117242711	0%	1922780	0%	1.64%
2060/61	151316718	29.06%	6052668	214.79%	4.00%
2061/62	189205887	25.04%	3670594	-39.36%	1.94%
2062/63	214289633	13.26%	6664408	81.56%	3.11%
2063/64	250181273	16.75%	3477520	-47.82%	1.39%
2064/65	291758644	16.62%	5543514	59.41%	1.90%

Source: Annual Report of Union Finance Co.

Figure: 4.3



While observing the above table, it was found that there is inconsistency between the growth of loan and NPA. In the fiscal year 2060/61 though the loan was increased by only 29.06% but NPA growth was increased by 214.79%. Likewise, in the fiscal year 2061/62 loan was increased by only 25.04% but NPA was decreased by 39.36%, resulting only 1.94% of NPA on total loan. This indicates that the Union Finance Company had become successful to manage and reduce the level of NPA in those years. This indicates that in the fiscal year 2061/62, financial company had faced earlier fluctuate effect. In the fiscal year 2062/63, loan grew by only 13.26% but NPA increased by 81.56%. It also indicates that in the fiscal year 2062/63, Union Finance Company had faced problem related to NPA management. In the fiscal year 2063/64, the growth of loan was 16.75% but NPA had decreased by 47.82%. This indicates the weak management of Union Finance Co. However in the fiscal year 2064/65, the loan was increased by 16.62% only, but NPA was increased by 59.41%, resulting 1.90% of NPA. The growth trend of loan and NPA in the fiscal year 2063/64 was nearly similar. It can be drawn general conclusion that expansion of aggressive loan portfolio might be the case of creating NPA growth. So, we can say that in case of Union Finance company ltd, that expansion on loan portfolio had some impact on growth of NPA sometimes.

Analyzing the result of Union Finance Co. Ltd., we can say that NPA growth was to the related with credit expansion. We may say that there is some relationship between credit expansion and increment on NPA. The expansion of loan level can be regarded as one of the causes of NPA increment.

4.5 Trend Analysis with Respect to NPA Ratio & NBA/NFA Ratio

In consolidation after assessing the NPA and NBA of Union Finance Company Limited we may conclude that rigid relationship between NPA and NBA was difficult. Simply, we can say that NBA was created due to having NPA that is why NBA growth is result of NPA growth. But we cannot say that whenever there is NPA it creates NBA.

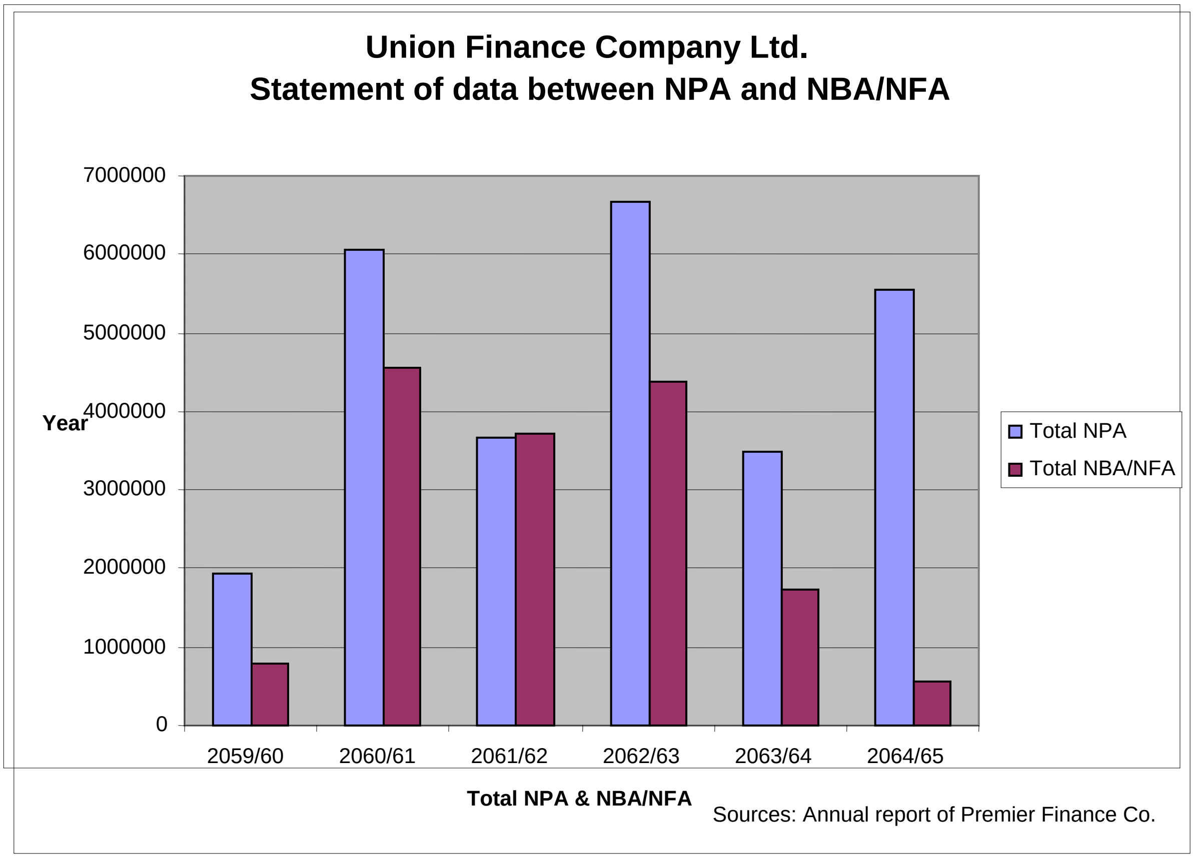
Table 4.3

Analysis of NPA and NBA/NFA of Union Finance Co. Ltd. Kathmandu

Union Finance Company Ltd.		
Statement of data between NPA and total Assets		
Year	**Total NPA**	**Total NBA/NFA**
2059/60	1922780	784671
2060/61	6052668	4557593
2061/62	3670594	3706575
2062/63	6664408	4386440
2063/64	3477520	1724527
2064/65	5543514	569795

Source: Annual Report of Union Finance Co.

Figure: 4.4



In consolidation after assessing the NPA and NBA of Union Finance Company Limited we may conclude that rigid relationship between NPA and NBA was difficult. Simply, we can say that NBA was created due to having NPA that is why NBA growth is result of NPA growth. But we cannot say that whenever there is NPA it creates NBA.

Table 4.4

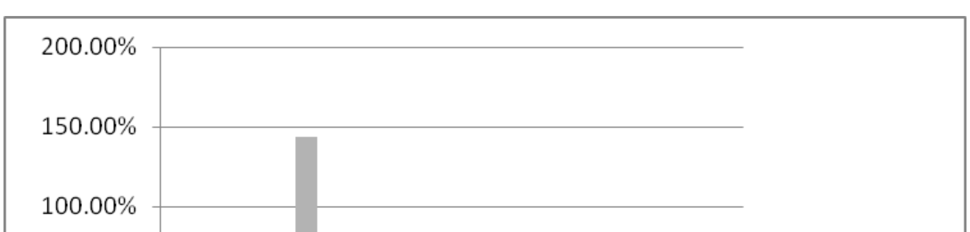
Analysis of NPA and NBA/NFA Ratio of Union Finance Co. Ltd., Kathmandu.

Union Finance Company Ltd.				
Statement of data between NPA and NBA/NFA				
Year	**NPA Ratio**	**Increment%**	**NBA Ratio**	**Increment%**
2059/60	1.64%	0	0.67%	0
2060/61	4%	143.90%	3.01%	349.25%
2061/62	1.94%	-51.50%	1.95%	-35.22%
2062/63	3.11%	60.31%	20.41%	946.67%
2063/64	1.39%	-55.31%	0.69%	-96.62%
2064/65	1.90%	36.69%	0.20%	-71.01%

Source: Annual Report of Union Finance Co.

Figure: 4.5

Analysis of NPA and NBA/NFA ratio of Union Finance Co. Ltd., Kathmandu.



The above table shows that there was positive growth of NPA in fiscal years 2060/61, 2062/63 and 2064/65.But there was negative growth of NPA in fiscal years 2061/62 and 2063/64. However, NBA ratio in fiscal year 2061/62, growth of NPA was negative but in the fiscal year 2062/63, there was huge growth of NPA, after than up to fiscal year 2063/64, growth of NPA was negative. It reveals that there was inconsistency that the growth of NPA. The NBA ratio was nigh. This indicates it cannot be said that whenever there is NPA growth increase. The reason behind this is though there is NPA financial company may delay initiating legal action or the property auctioned had been sold or financial company has not accepted the ownership in its own name or sold all of NBA expect fiscal year 2062/63 some of NBA. That is why it is difficult to draw direct relationship between NPA and NBA. Hence, we can say that direct relationship between both of them was difficult to establish.

In consolidation after assessing the NPA and NBA of Union Finance Company Limited we may conclude that rigid relationship between NPA and NBA was difficult. Simply, we can say that NBA was created due to having NPA that is why NBA growth is result of NPA growth. But we cannot say that whenever there is NPA it creates NBA.

4.6 Inferential Analysis

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

4.6.1 Analysis of correlation coefficient between Loan & NPA.

Table No 4.5

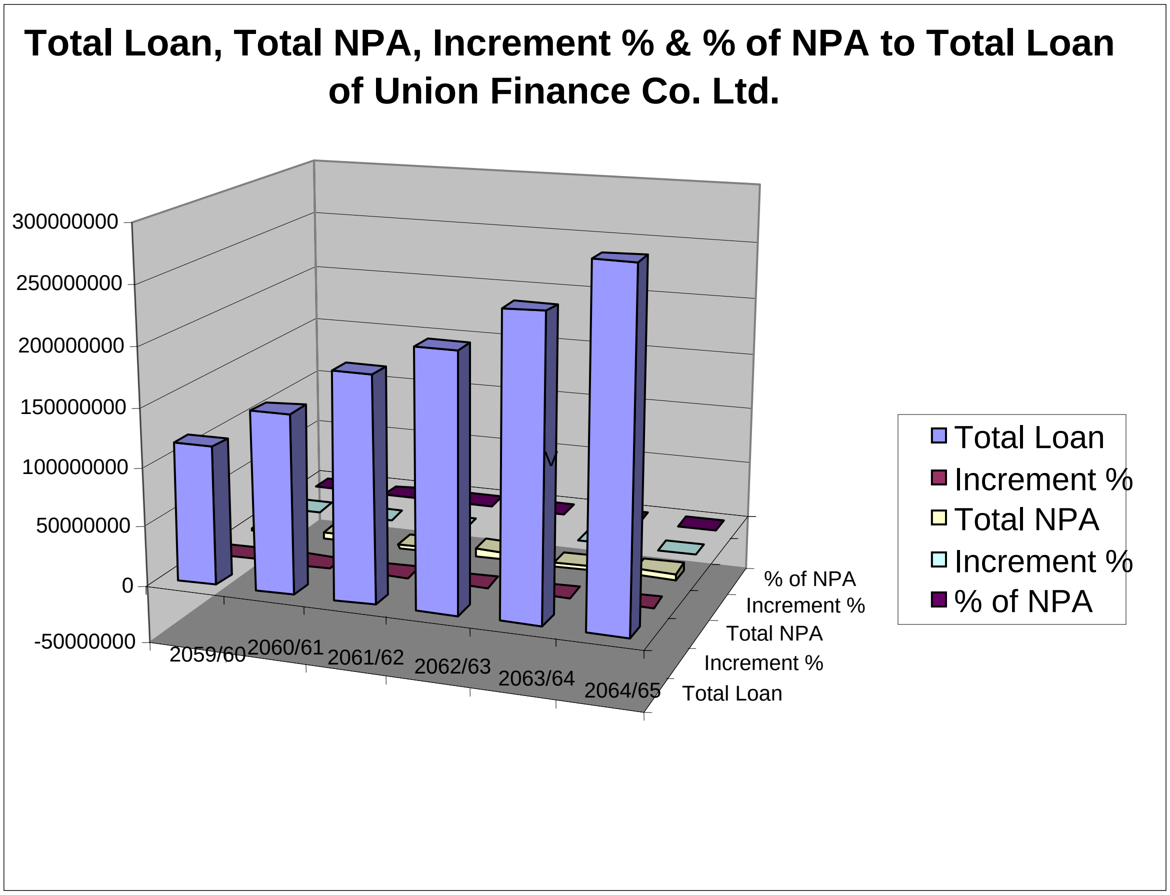
Analysis of Correlation Coefficient between Loan & NPA. Of Union Finance Co. Ltd.

Union Finance Company Ltd.					
Total Loan, Total NPA, Increment & % of NPA to total loan					
Year	Total Loan	Increment %	Total NPA	Increment %	% of NPA
2059/60	117242711	0	1922780	0	1.64
2060/61	151316718	29.06	6052668	214.79	4.00
2061/62	189205887	25.04	3670594	-39.36	1.94
2062/63	214289633	13.26	6664408	81.56	3.11
2063/64	250181273	16.75	3477520	-47.82	1.39
2064/65	291758644	16.62	5543514	59.41	1.90

Source: Annual Report of Union Finance Co.

: - Coefficient of correlation (r) = 0.502

Figure: 4.6



Since risk positive, so we can say that low degree of positive correlation between credit expansion and NPA level of Union Finance Company limited relationship between loan and NPA is poor. In case of Union Finance company since it reveals that with the increment on credit level NPA level is also increased and vice versa. We can say that expansion of credit level led to the finance company towards NPA growth.

4.6.2 Analysis of correlation coefficient between NPA &NBA

we can say that when there was NPA increment, the financial company took action and auction property held in its custody. Sometimes, situation occurs where the financial company had to accept the property in its own name due to this there was increments of NBA. IN case of Union Finance Company Limited reveals that either finance company had not auctioned the property in its own name upto fiscal year 2064/65. Sometimes, finance company might have sold all NBA.

Table 4.6

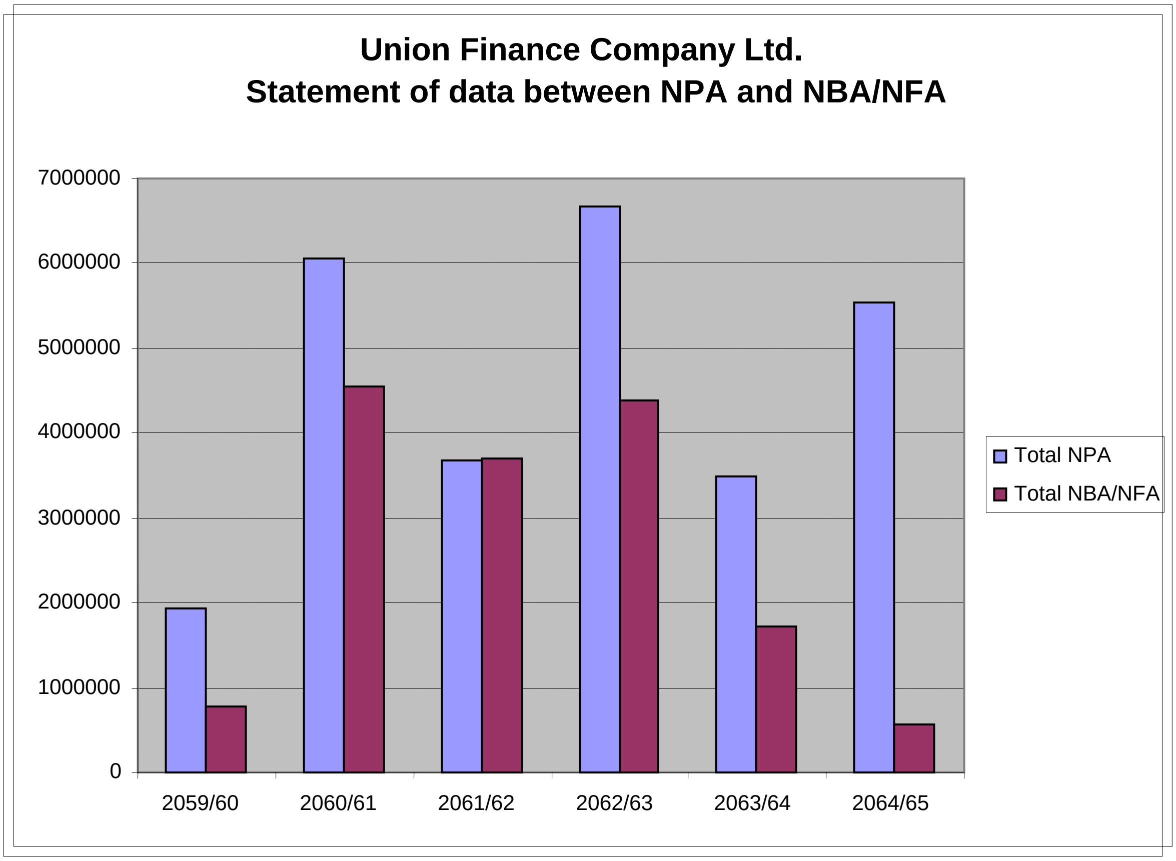
Analysis of Correlation Coefficient between NPA & NBA. of Union Finance Co. Ltd.

Union Finance Company Ltd.		
Statement of data between NPA and total Assets		
year	**Total NPA**	**Total NBA/NFA**
2059/60	1922780	784671
2060/61	6052668	4557593
2061/62	3670594	3706575
2062/63	6664408	4386440
2063/64	3477520	1724527
2064/65	5543514	569795

Source: Annual Report of Union Finance Co.

: - Coefficient of correlation (r) = 0.904

Figure: 4.7



Since coefficient of correlation found to be 0.904, so we can say that the relationship between NPA & NBA was positive. It means that whenever NPA was increased NBA was also increased if coefficient of correlation between NPA and NBA were negative it means that NPA level was increased NBA level was decreased and vice versa. It seems that though level of NPA was increased but NBA remained constant or decreased due to non acceptance of the property and assets in the name of the financial company lord financial company dispose it by sale or other way and the level of NBA decreased. In this case it is found that there is not direct relationship between NPA & NBA.

From the above analysis, we can say that when there was NPA increment, the financial company took action and auction property held in its custody. Sometimes, situation occurs where the financial company had to accept the property in its own name due to this there was increments of NBA. IN case of Union Finance Company Limited reveals that either finance company had not auctioned the property in its own name upto fiscal year 2064/65. Sometimes, finance company might have sold all NBA.

4.7 Loan Loss Provision

This chapter investigates loan loss provision of Union Finance Company. In this chapter we also investigate cause and impacts of NPA in Union Finance Company Ltd. Primary data were collected through questionnaire from the respondents' of the Union Finance

Company. The researcher has conveniently selected Union Finance Company Ltd. External and internal contributing factors on NPA were raised as issues to ask the respondents research has attempted to collect opinion of official working at different level and in credit departments. Questionnaire was designed including the major issues of NPA in structured question various measurement scales were used to collect information. Main were liker type scale, ranking or ordinal scale and nominal scales. Questionnaires were administered t respondents and all of them returned the valid questionnaire for the study. For the processing of the data the software SPSS has been used and data have been tabulated and processed. To find out the significance of the variables with respect to NPA, some statistical tools have been computed.

4.8 Basis of floating loans by Nepalese Financial Companies

One of the potential factors may be the lending policy of the financial companies in increasing non-performing assets. To find out the existing lending practice in Nepalese financial companies, the researcher has designed a questionnaire to test the attitude of employees. People build attitude based on their experience therefore the view of the respondents may be useful method to identify how effective the lending policy in Nepalese financial companies. A set of questions was designed to identify the basis of floating loan to the customers. Six statements relating to reasons behind flaring loan to the borrower were provided to the respondents to rate their agreement on them. These statements agreement on them. These statements were related to financial strength of borrower, security offered by the customer personal integrity of the borrower relationship with top management. Portfolio management and monitoring and control system. The opinion of the respondents has been tabulated then processed through ANOVA test first of all descriptive statistics are presented so that the actual basis of floatation in Nepalese financial companies could be analysis. The following are the responses collected from the respondents.

Basis of floating loan in Nepalese financial companies:

(a) Financial strength of the borrower is a basis for floating loan.

(b) While floating loan your financial companies' basis security offered.

(c) Personal integrity of the borrower is always taken into consideration in your financial companies.

(d) Relationship of the borrower with top authority in your financial companies some time may influence to float the loan.

(e) While floating loan, portfolio management is given priority in your financial companies.

(f) Monitoring and control system is effectively adopted in your financial companies.

The respondents identified relationship of borrower with top management as a major factor in floating loan in Nepalese financial companies secondly respondent identified portfolio management as a major reason floating loan in the certain sectors. Mean value of monitoring & control security offered, and financial strength were found within average. Most of the respondents denied including personal integrity of the borrower as a reason in floating loan to borrowers.

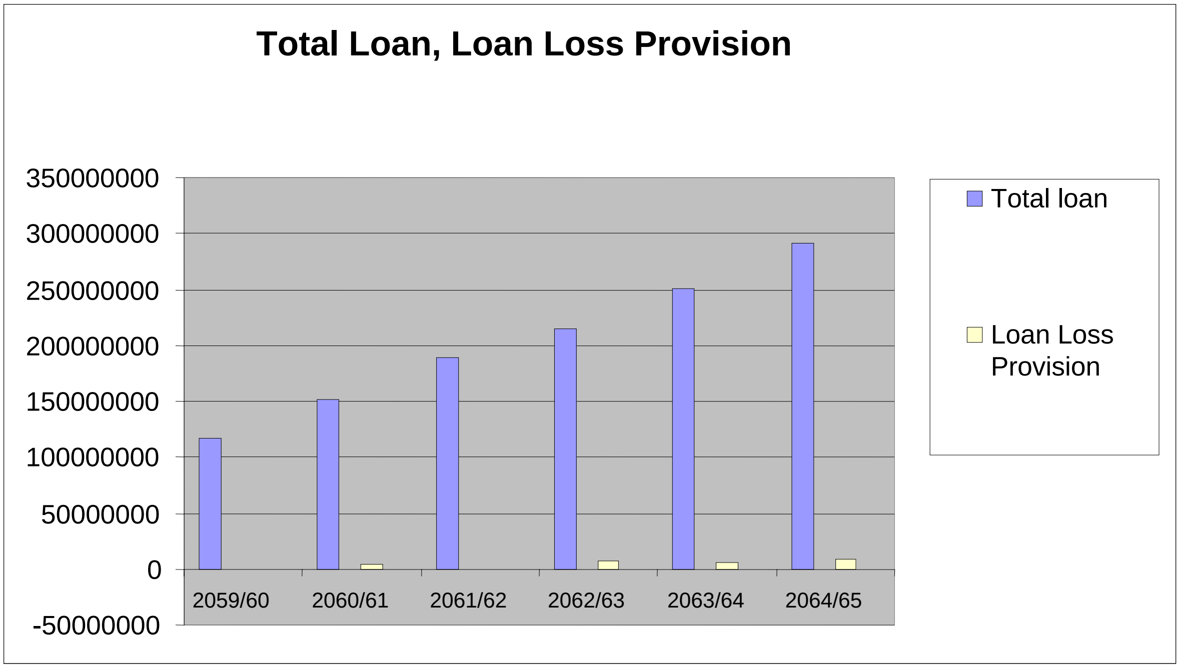
Table 4.7

Trend Analysis of Loan and Loan Loss Provision of Union Finance Co. Ltd., Kathmandu

Years	Total loan	Increment%	Loan Loss Provision	Increment%
2059/60	117242711	0.00%	2715	0.00%
2060/61	151316718	29.06%	4338490	1596.97%
2061/62	189205887	25.04%	0	-100.00%
2062/63	214289633	13.26%	6722814	100.00%
2063/64	250181273	16.75%	6236526	-7.23%
2064/65	291758644	16.62%	9028859	44.77%

Source: Annual Report of Union Finance Co. Ltd.

Figure 4.8



In case of Union Finance Company Ltd. it reveals that there is inconsistency between the growth of loan and loan loss provision in fiscal year 2059/60 and 2060/61. In fiscal year 2060/61 though the loan was increased by 29.06% and loan loss provision was increased by 1596.97%. In fiscal year 2061/62 loan was increased by 25.04% but loan loss provision was remain constant. In fiscal year 2062/63 loan was increased by 13.26% but loan loss provision was increased by high level. In fiscal year 2063/64 loan was increased by 16.75%, but loan loss provision was decreased by 7.23%. In fiscal year 2064/65 it had came to notice that the increment ratio of loan is 16.62% but loan loss provision was increased by 44.77%.

4.9 Internal Reasons Turning Good loan into Bad loan

The respondents were requested to rank eight factors: mismanagement, bad intension of the borrower, weak monitoring, lacking on portfolio analysis and shortfall on security, lacking on portfolio analysis, and shortfall on security weak legal provision, credit concentration and not having effective credit policy. The ranks of the internal reasons turning good loan into bad loan are shown below.

SN.	**Variable**
1.	Bad Intention

2.	Weak monitoring
3.	Mismanagement
4.	Shortfall on Security
5.	Not having effective credit policy
6.	Lack of portfolio analysis
7.	Credit Concentration
8.	Weak legal Provision

The ranks showed that respondents ranked more important to bad intension, weak monitoring, and mismanagement at the top level. They ranked weak legal provision and credit concentration as the least preferred factor in turning good loan into bad. Some factors such as lack of portfolio analysis, not having effective credit policy, and short fall on security were identified in an average level. The analysis of all factors to find out whether factors are significantly different among each other. Thus it can be concluded that bad intention, weak monitoring and mismanagement are the major reasons turning good loan in to bad in Nepalese financial companies.

4.10 External Reasons Turning Good Loan into Bad Loan

Five relevant factors were supplied to the respondents to rank them. These factors were industrial and economic recession, high and conservative provisioning requirement, not having strong legal provisions for the recovery of the due, inconstancy on government policy, and lacking on monitoring and supervision from NRB. The ranks of the external reasons turning good loan into bad loan are mentioned below.

S.N.	**Variable**
1.	Economic and industrial Recession
2.	Not having strong legal provisions for the recovery of the dues
3.	In consistency on government policy
4.	Backing on monitoring and supervision from NRB.
5.	High and conservation provisioning requirement
6.	Political, Bureaucratic and external pressure to float loan.

The respondents identified recession, political and legal issues more relevant factors in turning good loan into bad. They ranked at the least preferred to legal provisions for recovery as a reason for increment in non-performing assets in Nepalese financial companies. Supervision and monitoring were ranked in an average level by the respondents. It is identified that there is significant differences among the five alternative factors.

The earlier finding showed three factors: economic and industrial recession, political, and legal factors in the most important category. The respondent did not give much emphasis on three factors mainly outsider pressure, conservative provisions and lacking on monitoring and control as the reasons for increasing non-performing assets in Nepalese financial companies. Hence conclusion can be made that most important factors were economic and political and legal factor in increment of nonperforming assets in Nepalese financial companies. Present analysis could not show the significant differences in these six factors. It is, therefore, can be generalized that economic and industrial recession and not having strong legal provision for loan recovery relationship are the major external factors that have major contribution for the increasing level of NPA.

4.11 Lending Priority by Nepalese Financial Companies

The respondents were asked to weight the industrial trade service and other sector for floating loan. The alternatives were the major field of economy where financial companies can float loan and advances. They were asked to give weight from 0% to 100%

Table No 4.8

Lending priority given by Union Finance company ltd.

SN	Economic Field	Weight
A	Industrial	0.55
B	Service sector- foreign employment	0.32
C	Trading sector	0.41
D	Housing sector	0.39
E	Educational sector	0.28
F	Hire Purchase	0.65
G	Fixed Deposit	0.24
H	Other sector of economy	0.27

The result showed that more than fifty percent weight was given in industrial sector and hire purchase for lending in Nepalese financial companies by the respondents. However, thirty five percent or less than thirty five percent weights were given to service sector in foreign employment housing sector, educational sector fixed deposit and other sector of economy by them. It is identified that there is no any significant differences among other financial companies and Union Finance Company. Thus, the conclusion can be draw that Nepalese financial companies give priority to trade and industry sector for lending its resources.

4.12 Major Findings of the Study

The findings of the present analysis are very important for the academicians and researchers. The researchers can design future research to investigate research issues in this regard and financers can play more effective role management of NPA in financial companies.

The present study based on the analysis has become able to find out very much important result from survey. Nepalese financial sectors in recent days are facing several problems with increasing number of problems. With the level of increasing NPA profitability of the financial companies has been badly affected. To find out the causes of NPA increment with financial companies basis of loan floatation procedure, follow us practice carried out by the financial company for the recovery of overdue loan outstanding, internal responsible factor causing NPA growth as well as external factor that has significant impact for NPA growth have been tried to sort out survey design was based on respondents.

The analysis shows that relationship of borrowers with top management as the most adopted basis for floating loan in Nepalese financial companies. Similarly, yhe respondent identified portfolio management consideration the second basis for floating loan in the certain sectors. Monitoring & control, security offered and financial strength were given average emphasis. It is found that financial companies are giving least weight on personal integrity of the borrower while giving loan.

There is a lapse on prompt follow up system for overdue loan in financial companies. It has been tried to find the practice assigning four alternatives to the respondents about the period of follow up after the maturity of loan. They were seven days, fifteen days one month and one month onward. The number of respondents agreed that follow up starts one month later after the maturity of the loan it can be said that there is not effective and timely recovery practice in financial companies.

In regard to the internal responsible factor that contributes turning good loan into bad loan it was found that bad intension weak monitoring and mismanagement is 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. Likewise, legal provision for recovery as reason for increment I non-performing assets in Nepalese financial companies has been found the factor having least impact. Supervision and monitoring system have been identified as average factor. It is, therefore, can be generalized that economic and industrial recession and not having strong legal provision for loan recovery are the major external factors that have major contribution for the increasing level of NPA.

It was tried to find out the economy whether the financial companies are giving emphasis for lending. After analysis it is found that more emphasis industry and commerce sectors for lending in Nepalese financial companies. However, twenty or less forty percent weights are given to service, housing, education and other sector. It could not identify any significant differences among other financial companies and Union Finance Company Ltd. Thus, the conclusion can be drawn that Nepalese financial companies give most priority to industrial trading, Hire purchase sector for lending its resources. Same time it is found that service sector are not being given that much emphasis.

The result of analysis showed important findings based on secondary data analysis. For the analysis of the impact of NPA on overall profitability of the financial company trend of NPA is compared to assess whether the increment ratio of NPA has any impact on profitability. After the analysis it has been found that though there is positive growth of operating profit in case of Union Finance Company but the growth of net profit is negative due to increase in loan loss provisioning. The reason of this is the need to maintain loan loss provisioning as per NRB guideline. Thus, it can be said that the profitability is affected with the growth of NPA because if the increment ratio of NPA is higher than that of operating profit, significant portion of operating profit is used for maintaining required loan loss provisioning and there is reduction on net profit. Sometimes, even if net profit level is constant we may conclude that net profit level is maintained because financial companies have been able to generate the higher operating profit level and therefore, profitability is not affected.

In regard to the relationship with NPA growth and expansion of credit, we may say that there is some relationship between credit expansion and increment on NPA. In general we can say that expansion of loan level to some extent can be regarded as one reason of NPA increment. It may be significant in case of aggressive credit expansion. The finding showed that NBA/NFA is created due to having NPA. But we cannot say that whenever there is NPA it always creates NAB as on some occasion financial company may not auction the property or the auctioned property after acceptance of the name of the financial company is disposed off. The case of Union Finance Company Ltd. that either a financial company has not auctioned the property or situation prevails so where financial a company has not accepted the property in its own name. Sometimes, financial companies might have been sold some portion of NBA.

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

A financial company means the institution, which deals with giving loans; investing money and doing other various commercial transactions. Therefore, the major function of financial company is to accept deposits and provide loans.

The assets of a financial company indicate the manner in which the funds entrusted to the finance company are employed. The successful working of the finance company depends on ability of the management to distribute the fund among the various kind of investments know as assets outstanding loan and advances of the finance company. These assets constitute primary source of income to the finance company. As being a business unit, a bank aims at making huge profit since loan and advances are more profitable than any other assets of the finance company, it is willing to lend as much its fund as possible. But the finance company has to be careful about the safety of such loans and advances. It means the finance company has to be careful about the repayment of loan and interest giving loan. If a finance company is too limited, it may fail to obtain the adequate return on the fund, which is confined to it for use. Similarly, if the finance company is too liberal, it may easily impair its profits by bad debts. Therefore, finance company should not forget the reality that most of the finance company failures in the world are due to shrinkage in the world is due to shrinkage in the value of the loan and advances.

Despite of being loan and advances more profitable than other assets, it creates risk of non-repayment for the finance company. Such risk is known as credit risk or default risk. Therefore, like other assets, the loan and advances are classified in to performing and non-performing on the basis of overdue aging schedule. If the dues in the form of principal and the interest are not paid, by the borrower within a maturity period, that amount of principal and interest is called non-performing loan or assets. It means NPAs could wreck financial companies' profitability both through loss of interest income and need to write off the principal loan amount. Performing assets have multiple benefits to the company as well as to the society while non performing assets erode even existing capital of the finance company.

Escalating level of NPAs has been becoming great problem in financing or banking business in the world. In this con text, Nepal cannot be run off from this situation. The level of NPA in Nepalese banking or financing business is very alarming. It is well known fact that the banks and financial institution in Nepal have been facing the problem of swelling non-performing assets and the issue is becoming more and more unmanageable day by day. We are well know from different financial reports, newspaper and news that the total NPA in Nepalese banking system is about 30 billion, while it is relationship explains that increase in NPA of the Union Finance Company Limited leads to the decrease in NPA of the population, which is controversial with the practice.

Present chapter attempt to summarize the major finding of the earlier analysis and results. Researcher also attempted to draw some conclusion based on those findings. It is expected that those findings shall be very much useful for academicians and practitioners as well as financers working in financial companies, on the basis of summary and conclusion of the study, researcher also attempted to identify some strategies of management for NPA level in financial companies. It may have very good contribution for the study the cause of NPA and its impact on the financial position on financing or banking sector.

There is positive growth of operating profit maintained by Union Finance Company but the growth of net profit is negative due to increase in loan loss provisioning required as per NRB circular is very much risk, major chunk of operating profit has been allocated for maintaining loan loss provisioning. In the case where if net profit level is constant it is observed that net profit level is maintained because finance company had been able to generate higher operating profit level and therefore profitability is not affected even though the NPA level was for the analysis of relationship with NPA growth and expansion of credit it has been found that there is some relationship between credit expansion and increment on NPA. NBA is created due to having NPA. But it is not certain that NPA always creates NBA as on some accession finance company may not auction the property after acceptance of the same in the name of the finance company is disposed off. Same time financial company might have been sold some portion of NBA too.

In regard to the creation of high level of NPA, it has been found that relationship of borrowers with top management is the major determining factor in leading. Since loan floatation was made without being choosy and it results the high level of NPA in financial companies. It is found financial companies starts one month later after the maturity of the loan. It proves the poor loan recovery system in financial companies.

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. 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 mismanagement are the most responsible factor for NPA growth. Likewise, legal provision for recovery as a reason for increment in non-performing assets in Nepalese financial companies has been found the factor having least impact. Supervision and monitoring system have been identified as average factor. At the same time it has been identified that financial companies give highest priority to trade sector and hire purchase for lending its resources. Thus, it is found that the service sector is not given much priority.

5.2 Conclusion

The present research is very much important to analyze cause and effect of NPA. Primary and secondary information analysis found that profitability of the financial companies has been affected due to increasing level of NPA. Bad intension, weak monitoring, and mismanagement were found the major responsible factors for NPA growth.

Present study was found very much successful to assess the cause and impact on NPA. It can be concluded that the study is pertinent to academicians and practitioners and as well as for financers. Present research might be useful to address the problem of increasing level of NPA.

5.3 Recommendations

High level of non-performing assets not only decreases the profitability of the financial companies but also affect the entire financial as well as operational health of the country. If the NPA were not controlled immediately, it would be proved as a curse for the financial companies in near future. Therefore, following are some of the recommendations, which will help to reduce the level of NPA of the Nepalese financial companies:

- Financial companies plays key role in the effective loan management. Being loan a risky asset, efforts should be made to have proper control in every steps of loan management. The financial companies should establish separate department for credit appraisal documentation, disbursement, rapport building, inspection and recovery of loan which have possibility of finding mistakes of one department by the others, So that the effectiveness can be achieved.

- Loan must be only if the banker is satisfied that the borrower can repay money from the case flow generated from operating activities. However, the finance company wants to ensure that their loan is repaid even in case of failure of business. To protect financial companies from such happenings, the financial companies take collateral from the borrower so that in the event of default this collateral is disposed for the recovery of loan. Therefore, financial companies should take enough collateral so that the finance company at least will be able to recovery its principal and interest amount in case of failure of the borrower to repay the loan.

- Lack of proper financial analysis of the borrower by the finance company, is one of the major cause behind increasing NPA of Nepalese financial companies. Therefore, proper financial analysis should be performed before giving loan to the borrower.

- Those financial companies, which have high level of NPA, should take necessary action towards recovering their bad loans as soon as possible. In case of default to repay the loan by the borrowers, the financial companies should dispose of the collateral taken from them and recover the principal and the interest amount thereof.

- Diversification of the loan should be managed by the individual finance company. In the context of Nepal it is provided to the borrowers who often go to the finance company not in the new sector. Default by the older borrower can be found, which should be avoided.

- Control mechanism of the finance company should be managed properly. Black listed customers should not be given the new loan, as it could lead to the same situation to the finance company.

- Political influences in the loan disbursement should be avoided as it may lead to worse condition to the finance company as it may increase the non – Performing loan of the finance company.

- There should be strong follow up system in financial companies for the recovery of due loans. Strict monitoring and control system should be there for the timely recovery of loans. It is required to have general practice to follow up before the loans turn into bad loans. Financial companies should have proper attention towards the business position of the borrower while floating loan.

- NRB is the bankers' bank and representative of government to monitor smooth functioning of the financial sector. As the operational activates are fully guided by the NRB and by virtue of the legal provision it has full right to monitor the activities of the financial companies. It was told that since the NRB was not vigilante on the happenings to the bad credit flotation in financial companies the consequences faced by the financial companies could not be prevented. Now it is high time that NRB should effectively monitor and formulate the directives to safe guard the interest of financial companies.

- Financial companies should be capable to resist the undue pressures created for floating of loan from politicians and bureaucrats. In most of the finance company it is experienced that there is regular pressure from these parties for granting loan without being choosy and selective thus, financial companies should not be influenced under such pressure for availing loans.

- Project base lending is very essential and regular observation of the invested project has to be maintained.

- Vision of the finance co. management has to be cleared for the project base lending. Coercion to lend the loan has not to make from the program and policy maker.

- Unnecessary purchase of fixed assets helps to increment the NPA. Further purchase of fixed assets has not to make by the result, NPA will stopped to increment.