CHAPTER - 1

INTRODUCTION

1.1 Background of the study:

The development of country can not be assumed without economic development. People in underdeveloped countries now very conscious of their poverty and its contrasts with rich countries. They insist on doing something about it. have grown increasingly determined to do something about it. The sharp contrast in the standards of living between the economically advanced people and their own has not escaped their attention. it has led to a constantly growing demand for rapid development at no matter what be the cost. More and more people in undeveloped countries have come to realize that their poverty is neither necessary nor inevitable and this realization has acted as a stimulus to the desire for improvement i.e. economic development.

There are many bases for economic development. Among them, development of banking system is also major one. In other words, without development of banking business there is no possibility of economic development. The main reason for saying developed countries to America, France and Britain etc is the sound banking or financial system in them.

Nepal like all under developing countries has been facing the problem of accelerating the economic development. It is obvious that the economic development is impossible without the development of different sector like agriculture sector, industrial sector, service sector and tourism sector etc., so the development of the sectors need a regular supply of financial resources.

Currently, the Nepalese financial system consists of 26 commercial banks, 58 development banks, 12 micro finance development, 17 financial co-operatives, 47 financial NGOs, 26 insurance companies, 1 stock exchange, 1 employee's provident fund (EPF) and 1 citizen investment trust. The Nepal Rastra Bank (NRB) regulates and supervises the first six. The insurance board regulates insurance companies. Nepal security board regulates the securities market including Nepal stock exchange (NEPSE) limited and financial auxiliaries related to this. The ministry of finance (MOF) regulates and supervises EPF and CIT.[1]

Beside this, a number of financial sector reforms including flexible of instead rates, the removed of credit ceiling and the fixation of margin rates for various types of loans and the gradual phase out of directed credit programs provided financial

1 Figure taken from souvenir 2064 Magh 10 Page 51 institutions freedom to operate and decide the portfolio of assets and liabilities of their choice. The basis idea behind this is that market when left alone produces better outcome than with intervention. This encouraged the private sector to take up the banking business.

However, this doesn't mean that the Nepalese financial sector especially the banking, industry is devoid of problems. The long running burning problem is the negative net worth of commercial banks, which stands at Rs.4.2 billion. This is basically on account of the mounting level of non-performing loans (NPL). The high level of NPL is basically associated with three state owned commercial banks. The NPL of NBC, RBB and ABB/N taken together amounted to Rs.14.4 billion which is 64.8% of total NPL Rs.22.2 billion of commercial banks.

Non-performing Asset in literally meaning asset those are useless for the certain time frame or say asset that cannot be used in the productive sector and such condition the asset does not show any performance or positive results. In the banking term, when the borrower takes loan, he should pay interest along with principle in the certain time that's means the borrower is the asset for banks. But if that borrower does not show initiation in payment of interest and principle for long time, it turns to non-performing Assets. Nepal Rastra Bank has segregated the loans according to the ageing of the lending. These are

Pass Loan : It is the type of loan that has not crossed the boundary of three months of non-payment of interest and principles.

Sub Standard : When non-payment of interest and principles of the loan cross three months and lie within the six months time frame, this type of loan is called sub standard.

Doubtful : It is the types of loan when non-payment of interest and principles of the loan cross six months and lie within the one year time frame. It is the worst condition for the banks.

Loss : It is the worst condition for the banks. When the non-payment of interest and principle cross the one-year time frame, it is the Loss loan. There is a minimum chance of repayment of the loan.

As per the NRB provision or definition, NPL is the loan that lies in the three category of loan these are Sub standard, Doubtful and loss. That means when the non payment of interest and principal of any types of loan cross three months time frame, it is Non-performing Loan or NPL. In Nepal, deteriorating corporate sector, nepotism, non scientific or traditional technique of lending, window dressing in the collateral documents, lack of internal control system, lack of timely presentation of auditing report, all have created conducive environment to inflating NPL problem. Nepal's two large PSU banks viz. Nepal Banks limited and Rastriya Banijya Bank are in forefront in this problem. In comparison to PSU bank, private banks have less affected from NPL because of professionalism, risk management in banking, internal controlling system and technological aspect.

Globalization, liberalization, deregulation in the financial sector and rapid financial reform progress, the greater use of financial engineering techniques and models, sea changes in the information technology and changing and challenging consumer demands have all resulted in greater competition and opportunity among the banks. As consequences of these, banks started identifying these as new opportunities and begun to flow more and more money by the way of innovative product to cater the changing demand of the consumer and make bold presence in the financial market. But non-scientific or traditional technique of lending, deteriorating corporate sector, nepotism, highly bargaining power and negligence style of corporate sector, create the major problem by turning their asset to Non-performing loan (NPL). Most of the nations all over the world are suffering from this financial disease. China, despite having the communist dominated economy and tough rules and regulation, has failed to mitigate and reduce its high NPL of more than 34 percent.

NPL initially become the bank's burden but gradually the burden of the financial system and then the burden of the whole economy. Implications of NPLs are redacted in the shrinking bottom line and eroding balance sheets of banks. The problems characterized by erosion of assets and liquidity also affect owners, depositors, employees, good borrowers, general customers, general public and the economy. The borrowers who fail to repay the bank's due virtually turn out to be very wise in the whole game of banking. It, if unchecked, may lead to loss of public confidence and systematic risk. That's why every stakeholders of the economy should show initiation to mitigate the problem of NPL by the way of rules and regulation, asset management companies, securitization, social and mental pressure, incentives etc.

1.2 Statement of the problem

There are many problem of this statement. Nepal's majority population, almost 90%, live in rural areas and almost 80% of total population depends upon agriculture. There is a vast demand for rural financial services among them. But financial institutions including RBB have met a small portion of the demand for rural finances services. Most commercial banks have a wrong notion that the poor are not bankable.

They cannot repay their loans and they cannot pay commercial market rates of interest. They also think that financing to small borrowers is not cost-effective. They also feel that access to soft or subsidized credit is essential for the poor and ultra-poor in rural areas. Even governments and donor agencies have the same feeling. But it has been proved wrong in many developing countries in Asia, Africa and Latin America where these rural people have repaid their loans with commercial interest rates. More, the strength of rural persons is represented by the high depositing motive of their incomes in banks in recent years in Nepal.

Most commercial bankers regard rural finance as unprofitable business. They perceive rural finance and especially micro finance as bad credit risks. They have a perception that rural customers do not have stable and profitable enterprises. If they borrow for these enterprises, they will not be able to generate income to repay their loans. These banks ask for traditional collateral to guarantee their loans.

They also lack appropriate lending methodologies to extend rural credits. They are also scared of the costly banking operations in rural areas in providing small and short-term loans. Though RBB have been lending to rural enterprises since 1974. RBB has been implementers the intensive Banking program since 1981. He has opened branches even in the remote rural areas of the nation. But most of these branches are making losses.

Government owned major banks are in critical condition and they are unable to utilize their savings. While floating the loans the banks expects that interest and principal will be served on time. In principal loans and advances extended by banks are repayable on demand. But all loans are not recovered as the expectation of the bank. When the interest and principal cannot be recovered in time the loan is considered as classified loan or NPL. NPL burden is the major problems of the commercial banks because of the poor loan categorization, diversification, risk analysis, the overall performance of the government banks are poor. So the amount of NPA is increasing. This study has the following questions regarding to NPL with special reference to RBB.

i) What is the condition of government owned major banks?

ii) What is the overall impact of NPL on the profitability of the banks?

iii) What is the relationship of NBA with NPL?

iv) What are the major internal and external factors that influence the NPL growth?

1.3 Objectives of the Study

Commercial banks have a major common problem of increment of NPL. Every bank has now put the NPL management under top priority. This study shall be useful for banking sector. The basic objectives of this study are to analyze and identify the impact, cause and consequences of NPL in commercial banks especially in RBB. The basic objectives of this study are as follows.

i) To assess the level of NPL and other indicators that exists within RBB.

ii) To evaluate the impact of NPL on the profitability of the bank.

iii) To assess the relationship of NBA and NPL.

iv) To analyze the internal and external factors those influence the proper management of NPL.

1.4 Importance of the Study:

The increase of NPL has become a major problem of all commercial banks of Nepal. This is a serious problem of all commercial banks so this study will contribute by investigating the issues more systematically. The conclusion and findings of this study will be very useful for the literature of NPL in general and review the previous findings. The study will be helpful for the banking industry to identify and to trace out the contributing factors causing NPL and to reduce its level. This study will be helpful for the finding out the cause and effect of NPL in commercial banks and to give some suggestions for the modification on directives, laws and other proceedings for the better performance of the banks.

1.5 Limitation of the Study:

(i) Accuracy of Data:

The statistics, which is used for the purpose of the study, is secondary, which consist of banks publications, audited reports and other secondary sources. Bank publications may not be always reliable because they may publish the reports according to their profit policy and market situation. And the personal interviews and interactions may not be factual. But the audited data, which are used, are more reliable.

(ii) Time Limitation:

The basic purpose of the study is to fulfill the requirement for the Masters in Business Study, the study lacks sufficient time to collect information and analyze them.

CHAPTER - 2
REVIEW OF LITERATURE

2.1 Conceptual Framework

To explore the relevant and true facts for the research purpose, this chapter highlights the literature available related to the study. An attempt has been made to look into bank publications, periodicals and central bank's rules and regulations. In addition, informal interviews with bank personnel and a few customer/ borrowers have been aimed to receive. Further, interaction programs related with the financial issues transmitted by the various television channels will be taken as a supportive concept.

2.1.1 Conceptual Review

A commercial Bank is business organization that receives and holds deposits of fund from others makes loans or extends credits and transfers funds by written order of deposits.[2]

Commercial Bank is a corporation, which accepts demand deposits subject to check and makes shorts-term loans to business enterprises, regardless of the scope of its other services.[3]

A commercial banker is a dealer in money and substitute for money such as cheques or bill of exchange. He also provides a variety of financial services.[4]

Commercial bank Act-2031 B.S. of Nepal has defined that "A commercial bank is one which exchanges money, deposits money, accepts deposits, grants loans and performs commercial banking functions and which is not a bank mean for cooperative, agriculture, industries for such specific purpose."[5]

But, recently, The Bank and Financial Development Institutions Ordinance, 2060 has accumulated the five banking acts including Commercial Bank Act 2031, which defines the bank with respect to their transactions. This Act is trying to categories the banking institutions in two ways that is based on their transactions.

According to this Act, "Bank is the institution which performs its transaction under the provisions mentioned on section 47 of this Act."[6]

This Act has laid emphasis on the functions of commercial bank while defining it. Commercial banks provide short-term debts necessary for trade and commerce. They

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2. *Groloer Incorporated. (1984) The Encyclopedia Americana*
3. *Principle of Bank Operation, (1972), American Institute of Banking, USA*
4. *The New encyclopedia Britannia, (1985)*
5. *Article 2 (A), Commercial bank Act (2031)*

6 Article 2 (B), Bank and Financial Institutions Ordinance, (2060)

take deposits from the public and grant loans in different forms. They purchase and discount bills for exchange, promissory notes and exchange foreign currency. They discharge various functions on the behalf of their customers provided that they are paid for their services.

Financial activities are necessary for the economic development of the country and commercial banking in this context is the heart of financial system. Optimal investment decision plays a vital role in each and every organization. But especially for the commercial banks and other financial institutions the sound knowledge of investment is the must because this subject is relevant for all surrounding that mobilize funds in different sectors in different sectors in view of return.

As it is concerned to the commercial banks and other financial institution, they must mobilize (i.e., investment in different sectors) their collections (deposits) and other funds towards the profitable, secured and marketable sectors so that they will be in profit. For this purpose these banks and financial institutions should gather the sufficient information about the firm (client) to which supposed to be invested, these information include as financial background, nature of business as well as its ability to pay the loan back. These all information should be gathered from the viewpoint of security.

The income and profit of the bank depend upon the lending procedure applied by the bank. And, lending policy and investment in different securities also affect the income and profit. In the investment procedures and policies it is always taken in mind that "the greater the credit created by the bank, the higher will be the profitability".

A sound lending and investment policy is not only prerequisite for bank's profitability but also crucially significant for the promotion of commercial savings of a developing country like Nepal.

The sound policies help commercial banks maximize quality and quantity of investment and there by, achieve the own objective of profit maximization and social welfare. Formulation of sound investment policies and coordinated and planned efforts pushes forward the forces of economic growth.

Commercial banks as financial institutions perform a number of internal functions. Among them, providing credit is considered as most important one. "Commercial banks bring into being the most important ingredient of the money supply, demand deposit through the creation of credit in the form of loan and investment."[7]

7. Course, H.D. (1963), "Management Policies for Commercial Banks", Prentice Hall Inc, Englewood Cliffs.

2.1.2 History of Bank

Commercial banks are not the pioneers of the money transaction. Before the initiation of the commercial banking, goldsmiths and moneylenders used to provide money on the basis of gold, which were used as collateral. The Bank of Venice, set up in 1157 in Venice, Italy, is regarded as the first modern bank. Subsequently, bank of Barcelona (1401) and Bank of Genoa (1407) were established. The Lombard's migrated to England and other parts of Europe from Italy are regarded for their role in the development and expansion of the modern banking. Bank of Amsterdam set up in 1609 was very popular. The bank of Hindustan established in 1770 is regarded as the first bank in India. These banking activities gradually replaced goldsmiths and moneylenders. Though Bank of England was established in 1694, the growth of banks accelerated only after the introduction of Banking Act-1833 in United Kingdom as it allowed opening joint stock company Banks.

2.1.3 Origin of Bank in Nepal

The history of banking in Nepal starts right from the establishment of Nepal Bank Ltd. in 1937. Before the inception of this bank, the traditional ways of banking seemed to be prevalent. Even today, we find dominance of so called "sahu" and "Mahajans" in lending money, which is also known as unorganized monetary sector. Despite the operation of many commercial banks, role of non-banking unorganized sector is equally significant particularly in the rural area.

Realizing the importance of banking sector for economic development, Nepal Bank Ltd was set up as a commercial bank in 1937. Being a commercial bank NBL paid more attention to profit generating businesses.

Having felt a need of a central bank to control and direct the commercial banks and help the government formulate monetary policies, Nepal Rastra Bank was set up in 1956, since then it has been functioning as government bank and contributing to the growth of financial sector. Speedy development of the country is possible only when competitive banking service reaches in hidden places and corners of the country. Being a central bank, NRB had its own limitation to go to the profitable sector and engage in a commercial banking. To hope with these difficulties, Rastriya Banijya Bank was established in 1966, as a fully government-owned commercial bank.

Since the introduction of Rastriya Banijya Bank, the commercial banks are to be carried out commercial transaction as well as the function of development bank. However the need of a bank, particularly focusing on the agricultural sector was still missing despite of having agro-based economy in the country. To develop agricultural sector and to make necessary fund available for the farmers. Agricultural Development Bank was established in 1968.

2.2 Review of Related Studies

Sound, vibrant and competitive financial sector is a key to the economic development. As the countries are becoming more and more interdependent through globalization and liberalization, most of the poor and developing nations are finding themselves way behind the developed countries in terms of trade and development. To become a successful trade partner and to achieve economic development, development of a financial sector is a must and this is impossible without proper management of NPL. So the RBB is trying to manage the position of NPL through financial sector reform program. For this purpose, the books journals, articles, thesis and reports related to the NPL, financial sector reform program and other relating factors are reviewed for this study.

Non-performing loan is an outstanding loan that is not repaid i.e. neither payments or principal are made. In case of the banks the loans and advances are the assets as the banks flow loans from the fund generated through shareholder's equity money deposited by the people and fund having through borrowings. Hence the term NPL means the loans and advances that are not performing well. Thus all the irregular loans and advances can be treated as NPL.

Basyal (2057) discussing the financial performance of government owned banks in his article, *"Placing RBB and NBL under management Contracts Rational and Opposition"*[8] agreed that the disappointing performance of these two banks has become serious concern to all the stakeholders. Further he mentions that they are having with huge level of NPL, which could be termed as the darkest sides of their operational inefficiency and undisciplined financial behavior.

Pradhan (2058) in his article "NPL: *some suggestions to tackle them*"[9] found saying that unless the growth in NPL is kept in control, it has the potential to cause systematic crisis. He has mentioned that a dream of globalization led to huge investment, which unfortunately could not be utilized properly due to hesitant liberalization policies.

Large corporate misused the credits and delayed payments and contributed indirectly

8 Basyal, T.L. (2057), "Placing RBB and NBL under Management Contracts: Rational and Opposition", Economy Survey, First publication.

9 Pradhan, S.M. (2058), "NPL : Some suggestion to tackle them, Mirmire, Volume-1 (Baisakh) Kathmandu

for enhancing NPL ratio. He further argues that lack of vision in appraisal of proposal while loan sanctioning, reviewing or enhancing credit limits, absence of risk management policy of financing, concentration of credit in few group of parties and sector, lack of coordination among various financier, lack of initiatives to take timely action against will full defaulters, indecision on existing out of bad loans for fear of investigating agencies like special policy,

CIAA, Public Accounts committee of the parliament have also contributed in whatever measures to the worsening situation of NPL. He further pointed out that most crucial reason for the increase in the NPL is the shabby and defaulter friendly legal system. Suggesting the remedy of NPL he adds that Administrative system should be strengthened. Legal reforms should be made and Assets Reconstruction Company should be formed. Henderson (2003), CEO, CEO of RBB during his interview to New Business age agrees that the challenging target of RBB turnaround is restructuring and collection of NPL.

Through these studies are found to be quiet useful in their own side but the question of NPL and it's cause as well as effect on various aspects in commercial bank is yet to be reviewed. In view of these, this study has been based on the various contributing factors that increase NPL level in commercial banks in Nepalese perspective and it's effect on profitability positions of the banks.

In an article "Nepal's Financial Reform: A Tardy Pace of Deliberate Race" Bill Pendleton is trying to explore the need and relevancy of financial reform program in Nepal. In this article he suggest that "HMGN has way to go for complete financial reform, restore financial soundness to deserving public, much work is left to do; however, the Government had set to "Road Map" to complete this phase and continues to improve the reform process, a process vision to sustain the economy for generations to come. The upcoming World Bank sponsored Phase II of the Financial Sector Reform Program (FSRP) will support this vision. It is important that the citizens of Nepal, particularly the media services, support this effort as well.[10]

Tul Raj Basyal in the article "Financial sector reform: need and strategy" mentions that "the overcharging goal of the F.S.R. is to create a well regulated sound, market oriented and stable financial system, which will help from the basis for fiscal consolidation, macroeconomic stability, private sector-led economic growth momentum and significant reduction in poverty on a sustainable basis,"

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10 Pendleton, B. (2061), "Nepal's Financial Reform: A Tardy Pace of Deliberate Race", Nepal Rastra Bank Smachar- Vol 49, NRB, P1

Again the same author presenting the challenges of the Nepalese financial sector opines that "the host of challenges and complexities that confront this sector could be categorized as the weak financial position of most of the government owned financial institutions, negative net worth and huge accumulated losses of the government owned commercial banks, higher proportions of non-performing Loan (NPL), predominance of the informal financial system, higher interest rate differentials between the formal and informal sector of the economy, large interest rate spread lending and borrowing rates in the formal financial sector etc."[11]

In his article, "Need for macro prudential appraisal of the financial system soundness "Gunakar Bhatta has presented the interest of multilateral donor agencies in the financial system along with its development has become a common word in the recent years. There have been several efforts in the local, regional and global fronts to mitigate the risk and uncertainties in the financial system. Episodes of turmoil in the international financial markets particularly after mid nineties have underscored the need for better tools to monitor financial risks and vulnerability. Realizing this emerging need, the International Monetary Fund (IMF) initiated to strengthen its assessment of financial system soundness as part of its surveillance work"[12]

In the article "Financial sector stability and monetary policy" Nara Bahadur Thapa mentions "the primary instrument that is generally used for achieving the financial sector stability is the regulation and supervision of banks and financial institutions."[13]

In his article "Contract of Rastriya Banijy Bank: opportunities and challenges" Mahesh Gimire opines that "although the management contract of Rastriya Banijya Bank was quite expensive in cost, when it started, it is now starting to produce good results. Although there has not been good progress in loan recovery other aspects of management is starting to show progress."[14]

Ajaya Kumar Nepal in his thesis "Financial sector reform in Nepal: after economic liberalization" recommends "there is a critical need to reform, revitalize and modernize the financial sector. The government is endeavoring to achieve a privately owned and manged banking system, which provides economic and efficient financial intermediation in the economy. The inefficiency of the banking sector stems mainly

11 Basyal, Tul Raj, (2059), "Financial sector reform: need and strategy" Aroonodaya, p292, p303

12 Bhatta, Gunakar (2061), "Need for macroprudential appraisal of the financial system soundness" Nepal Rastra Bank Samachar '58

13 Thapa, Nara Bahadur (2061) "Financial sector stability and monetary policy" Nepal Rastra Bank Samachar, p31

14 Ghimire, Mahesh (2062), "Management contract of Rastriya Banijya Bank: opportunities and challenges" Nepal Rastra Bank Samachar, p88

because of the problems in the state owned banks viz. Nepal Bank Limited and Rastriya Banijya Bank. Meanwhile the Agricultural Development Bank and Nepal Industrial Development Bank are also facing similar type of problem."[15]

Same author also concludes, "As the biggest commercial bank, Rastriya Banijya Bank has important role to play in the economy. However, political interference, weak management, poor financial information system and ever growing bad loans have extremely impacted on RBB financial health. Current auditing work has also exposed a high negative net worth, weak internal control and information system and poor internal financial management."[16]

Peter S. Rose in his book "Money and capital markets" mentions that "powerful forces are reshaping financial institutions and financial services today and reshaping as well the public demand for new financial services. These forces for change include powerful new trends within the financial sector itself, major changes in the structure and functioning of the economy that surrounds the financial system, and new financial services."[17]

He again writes that "we must recognize that much of what is happening in the financial system of markets and institutions today is response to broad social, economic and demographic trends that span generations.[18]

Khan and Jain view in the book "Financial Management", "The type of relationship to be investigated depends upon the objective and purpose of evaluation. The purpose of evaluation of financial statements differs among various groups (creditors, shareholders, potential investors, management, government, labor leaders and so on) interested in the results and relationships reported in the financial statements. For example, short-term creditors are primarily interested in judging the firm's ability to pay its currently- maturing obligation".[19]

Again, the same author opine that "While it is true that general economic conditions and industry practices have a strong impact on the level of receivables, a firm's investments in these type of current assets is also greatly its internal policy."[20]

15 Nepal, Ajay Kumar (2002), "Financial sector reform in Nepal; after economic liberlisation" T.U., Krtipur

16 ibid

17 Rose, Peter S, "Money and capital markets" p 86

18 bid p88

19 Khan, M Y & Jain, P K (1988), Financial Management, Tata McGraw- Hill Publishing Company imited, New Delhi, p669

20 Khan, M Y & Jain, P K (1988), Financial Managemet, Tata McGraw-Hill Publising Company Limited, New Delhi, p 669

Dr. Shyam Joshi and Dr. Hari Prasad Shrestha in the book "Principle of Bank and Insurance", mentions the principle of sound investment policy of commercial bank. In this topic the authors identify the investment policy as profitability, liquidity, shift ability, safety, diversification of risks, capital adequacy, solvency, social welfare etc.[21]

In the book, "Accounting for Financial Aanalysis and Planning" the writers Ratna Man Dangol and Keshab Prasad Prajapati mention the use of Ratio Analysis as follows:

- For expressing trend
- For showing changes in financial statement
- For explaining plan for future
- For setting standard
- For effective control
- For comparing effeciency
- For maintain uniformity [22]

In an article, Mahesh Bhattarai, is trying to indicate the problem of banks' bad debt and non-performing loan. According to him "if a bank cannot recover its loan lending, bank's cash flow will be badly affected. "Similarly it can affect the close relationship between depositors.[23]

In an article, "Challenges of non-performing loan management in Nepal", Uma Karki has mentions the causes of increasing trend of non-performing loan. Author identifies the major causes such as "poor loan analysis, guarantee oriented loan system, depreciation on valued assets, misuse of loan, lack of regular supervision of laon.[24]

In an article, "WTO and Challenges of Financial Services Liberalization in Nepal" Gautam Biji, has put his opinion in the context of financial service liberalization and financial reform in Nepal. According to him "the process of financial services liberalization in Nepal is very recent phenomenon. It has been gathering pace gradually, the process of liberalization was started with the financial sector reform in mid eighties. It was surged up after the initiation of Structural Adjustment Program

21 Joshi, Shyam & Shrestha, H.P (2058), Principles of Banking and Insurance Taleju Publication, Kathmandu, p152

22 Dongol, R.M. & Prajapati, K.P.(2058), Accounting for financial Analysis Planning, Taleju Publication, Kathmandu, p369

23 Bhattarai, M.(2059), "Restructuring Process of Commercial Bank & Responsibility of Restructuring Team", Nepal Rastra Bank Samachar-vol 47, NRB, p62

24 Karki, Uma (2059), "Challenges of Non-performing Loan Management in Nepal", Nepal Rastra Bank Samachar - vol 47, NRB, p87

and Enhanced Structural Adjustment Program with respective loan and assistance of the World Bank and International Monetary Fund. Financial sector reform was implemented on a phase wise basis. It was designed to address the institutional deficiencies and closed and controlled financial system. Various macroeconomic policies were modified and adjusted during the period to facilitate the liberalization process. The procedural relaxation on the entry of joint venture banks (with collaboration), determination of interest rate (first, in 1986 with certain limit and then in 1989 without any limit) and operation of various financial transactions are mainly attributable for the reform. [25]

The audit report of Rastriya Banijya Bank for the fiscal year 2003/04 has presented some of the important accomplishments the management achieved in the fiscal year 2003/04 after it took control or the bank. The accomplishments, according to the report are as follows:[26]

1. Balance in the accounts reduced substantially over F.Y.03-04 (sundry debtors by Rs.155m, sundry creditors by Rs.129m and transit accounts by Rs.1952) due to write off of prior period expenses, passing of rectification entries and redesigning of chart of accounts. A list of all pending items in excess of 10000 items has been compiled and settlement is ongoing.
2. Receivables from government not recovered, Rs.36 millions relating to entries as old as 5 years, recovered in fiscal year 2003/04. Government transaction accounts fully updated and old outstanding reduced to nil.
3. In the fiscal year 2003/04 out of 51 accounting centers still to be updated in the previous fiscal year 32 deposit accounts of account centers have been updated. Actuarial valuation done and compliance with IAS-19 Employee Benefit ensured in F.Y.2003/04. Approved Retirement Fund has been formed to administer all staff related liabilities and Rs.1618 million transferred in the fiscal year 2003/04.
4. All the overdrawn deposits have been identified which aggregates to Rs.18 million as at end of F.Y.2003/04. a provision for an equivalent amount has been created. Recovery of the overdrawn amount is being done gradually.

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25 Gautam, B (2061), "Some Aspects of Economic Development", Nepal Rastra Bank Samachar - Vol 49, NRB, p73

26 Audit report (2003/04), Rastriya Banijya Bank

5. Loan loss provision has been strictly done as per Nepal Rastra Bank directives. Additional provision of Rs.1490 million has been made against specific non- performing Loan.
6. Provision of impairment assets reviewed/ revised at Rs.943 Million in the fiscal year 2003/04.
7. Interest suspense and interest mismatch by Rs.67 million has been reduced to 2 million.
8. Staff loan records are fully updated and reconciliation entries are being passed.
9. To check abuse of authority in letter of credit and other credit approvals department actions, new credit manual, strict monitoring system and internal check introduced.
10. Full compliance ensured in the F.Y.2003/04 as for the interest accruals not appropriate. As compared to accruals of 48 branches in the previous fiscal year, for interest income received in the first month from end of financial year in F.Y.2003/04 interest income of all branches in Shrawan 2061 accounted.
11. Maximum compliance with Nepal Rastra Bank formats ensured with impressive improvements. Financial statements quality improved substantially. Accounting system completely redesigned as per best accounting practices and documented in an accounting manual.
12. Strong internal audit department, systems manual designed and implemented for all the functions etc.
13. Financial reporting improved with quarterly publication of financial results, monthly branch returns and compliance with Nepal Rastra Bank directives. Overstaffing reduced number of branches optimized, competitive credit products launched, staff efficiency enhanced, deposit maintained at stable level, cost of fund reduced, interest spread reversed strong budgetary control system in place, automation of transaction ongoing. Continuous restructuring is ongoing.

CHAPTER - 3
RESEARCH METHODOLOGY

The topic of the problem has been selected as the position of NPL in RBB. The main objectives of this study are to assess the level of NPL in government owned banks especially in RBB, to fund out the causes and effects of NPL in RBB and to give some suggestions for the proper management of NPL.

3.1 Background

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 objects in view. Its focus is made on the basic relationship between relevant topics. To achieve the basic objectives to the study, the following methodology has been adopted which includes research design, nature and types of data, sources of data, data collection processing and tabulation procedure and methodology.

3.2 Rational of the Selection of the study

Thus, commercial banks, and specially government owned, and their lending transaction obviously affect the national economy. Moreover, lending and borrowing transaction that takes place through the commercial banks influence the daily livings of each national. And at the same time from the government side, a great concern should be taken as the mishandling of the banking transaction by the commercial banks can mislead the economy.

As we have already mentioned that government owned banks could play significant role in the economic development of the country especially when the bank covers almost 25 percent of the banking deposit. But due to the poor performance of the govt. owned banks whole financial system is suffering at the time when it should be more competitive to provide extra edge in the free market economy and globalization. Due to this a huge amount have been seized up as NPL not only in the RBB but also in all commercial banks.

As this problem has already been recognized as a serious problem in all commercial banks. So this study obviously will have both academic as well as practical significance. The findings and conclusions of the study will add to the literature of NPL in general and review the previous findings. The study will be helpful for the banking industry to identify and to trace the contributing factors causing NPL and to reduce its level. This study will also be helpful for the regulating authority to know existing recovery problem so as to have some modification on directives, laws and the proceedings.

3.3 Research Design

Research design is the plan structure and strategy of investigation conceived to obtain answer to research question and to control variance. The first purpose is to answer the research question or test the relationship the second purpose of a research design is to control variance. The purposed study will be carried out successfully by collecting information regarding the behavior/ attitude of the bank personnel, borrowers, and the policies of the banks through personal interviews and written sources as well. More over, the study will be conducted in the light of central bank's rules and regulations that abide the commercial banks. This study seeks to analyze the impact of NPL on profitability, NPL and its relationship with NBA 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.

3.4 Nature and Type of Data

The main purpose of this study is to assets the impact of NPL on the profitability of banks as well as the influencing variables of NPL. The nature of data used in the study is secondary in nature.

3.5 Sources of Data

Specially, the nature of the data is about to be secondary, as the basic purpose of the study is to fulfill the requirement for the degree of M.B.S., T.U. Taking consideration into the sources of data, the secondary sources of data are about to be bank publications, central bank's rules and regulations, audited financial statement etc.

3.6 Population and Sampling

Several commercial banks and development banks are operating in Nepal, out of these the following commercial banks have been taken as the populations of the study.

1. Rastriya Banijya Bank
2. Nepal Bank Limited
3. Agricultural Development Bank
4. Nepal Industrial Development Corporation

RBB is a state controlled bank so by studying the position of NPL in RBB, we can generalize the cause and effects of NPL of commercial banks in Nepalese perceptive. For the purpose of the study, RBB is chosen as a sample. In this way, it is believed that the sample can represent the requirement to the objectives of the study. An attempt will be made to look in to the seven-year's transactions.

3.7 Data Collection Method

After the identification of sample bank, the sources of data required for the study are also identified and collected through following procedures.

1. First of all nature of data have been identified.
2. For the collection of secondary data yearly annual report of the sampled bank has been taken for the period of seven years i.e. during the fiscal year 2057/58 to 2063/64.

3.8 Data Processing Method

According to the requirement of the study, the computer prints outs of financial key figure and the information collected through questionnaire. data is processed through different techniques and tools as per the requirement of the study.

3.9 Reliability of Data

There exists a kind of skepticism regarding the bank personnel's interviews as the study does not make them compelled to provide any sort of authentic data. However, data received thorough central banks' statistics and research departments, bank publications can be considered valid, as they have already been audited.

Similarly analytical data and texts from the freelance sector can also be considered as valid and reliable because their analysis is independent and free of business purpose.

3.10 Data Analysis Tools

Presentation and analysis of the collected data is the core part of the research work. The collected raw data are first presented in systematic manner in tabular form and are then analyzed by applying different financial and statistical tools to achieve the research objectives. Besides, some graph charts and tables have been presented to analyze and interpret the finding of the study.

The tools applied are:

3.10.1 Financial Tools

Financial tools basically help analyze the financial strength and weakness of a firm. Ratio analysis is a part of the whole process of analysis of financial statement of any business or industrial concerned especially to analyze its efficiency. Ratio analysis is used to compare firm's financial performance and status that of the other firms or to it overtime. Even though there are many ratios to analyze and interpret the financial statement, those ratios that are related to the efficiency of the bank are have been covered in this study. The following four types of ratios have been used in this study.

3.10.1.1 Asset management Ratio

Asset management ratio measures the proportion of various assets and liabilities in balance sheet. The proper management of assets and liability ensure its effective utilization. The banking business converts the liability into assets by way of its lending and investing functions. Asset and liability management ratio measures its efficiency by multiplying various liabilities and performing assets. The following are the various ratios relating to asset and liability management, which are used to determine the efficiency of the bank concerned in managing its assets and efficiency in portfolio management.

1. Performing Assets to Non-performing Assets Ratio

This ratio measures the ratio between the performing loans to non-performing loans. The more the ratio the more profit bank earns. This ratio is calculated by the following formula:-

$$\frac{\textit{Performing Assets}}{\textit{Non-performing Assets}}$$

2. Non-performing Assets to Total Assets Ratio

The ratio measures the ratio between the Non-performing Assets to Total Assets. The more the ratio the less profit bank earns. The ratio is calculated by following formula:-

$$\frac{\textit{Non-performing Loans}}{\textit{Total Assets}}$$

3. Loan and Advances to Total Deposit Ratio

This ratio measures the ratio between total loan and advances and total deposit. The more the ratio the more efficient banks performance is. The ratio is calculated by the following formula:-

$$\frac{\textit{Loan and Advances}}{\textit{Total Deposit Ratio}}$$

4. Total Credit and Investments to Total Deposit Ratio

This ratio measures the total credit and investment to total deposit. The more the ratio is the more efficient banks performance is. The ratio is calculated by the following formula:-

$$\frac{\textit{Total Credit and Investments}}{\textit{Total Deposit}}$$

3.10.1.2 Investment Management and Solvency Ratio

Investment management and solvency measures the performance efficiency of an organization from various angles of its operations. These indicated the efficiency of activity of an enterprise to utilize available funds, particularly short-term funds. These ratio are used to determine the efficiency, quality and the contribution of loans and advances in the total profitability. The following activity ratios measure the performance efficiency of the bank to utilize its funds.

1. Loan Loss Provision to Total Loans and Advances Ratio

The ratio measures the total loan and its provision. The more the provision the less profit the bank earns the profit. The ratio is calculated by following formula:-

$$\frac{\textit{Loan Loss Provision}}{\textit{Total Loan and Advances}}$$

2. Provision for Pass Loan to Total Pass Loan Ratio

Pass loan falls under the category of performing loans. The less the ratio the less waste of capital occurs. According to the N.R.B.S. directives the commercial banks should maintain 1% of provision for pass loan of total pass loan. The ratio is calculated by following formula:-

$$\frac{\textit{Provision for Pass Loan}}{\textit{Total Pass Loan}}$$

3. Provision for Sub Standard Loan to Total Sub Standard Loan Ratio

Substandard loan falls under the category of non-performing loans. The more the ratio the less the banks profit is. According to the N.R.B.S. directives the commercial banks should maintain 25% of provision for substandard loan to total substandard loan. The ratio is calculated by the following formula:-

$$\frac{\textit{Provision for Substandard Loan}}{\textit{Total Substandard Loan}}$$

4. Provision for Doubtful Debt to Total Doubtful Debt Ratio

Doubtful debt falls under the category of non-performing assets. The more the ratio the less the banks profit is. According to the N.R.BS. directives the commercial banks should maintain 50% of provision for substandard loan to total substandard loan. The ratio is calculated by the following formula:-

$$\frac{\textit{Provision for Doubtful Loan}}{\textit{Total Doubtful Loan}}$$

5. Provision for Bad Debt to Total Bad Debt Ratio

Bad debt falls under the category of non-performing loans. The more the ratio the less the banks profit is. According to the N.R.BS directives the commercial banks should maintain 100% of provision for bad loan to total bad loan. The ratio is calculated by the following formula:-

$$\frac{\textit{Provision for Bad Loan}}{\textit{Total Bad Loan}}$$

6. Debt Equity Ratio

Debt equity ratio is a part of solvency ratio. The standard debt equity ratio is 2:1. The high the ratio the more interest the bank pays. The ratio is calculated by the following formula:-

$$\frac{\textit{Total Debt}}{\textit{Total Shareholders Equity}}$$

7. Debt Ratio

Debt ratio is solvency ratio. The ratio between total debt and total assets is calculated by this ratio. The ratio is calculated by the following formula:-

$$\frac{\textit{Total Debt}}{\textit{Total Assets}}$$

3.10.1.3 Profitability Ratio

Profitability ratios are used to indicate and measure the overall efficiency of a firm in terms of profit and financial performance. For better performance, profitability ratios of firms should be higher.

1. Interest Expenses to Total Expenses Ratio

The relationship between the total interest and total expenses is calculated by the ratio. Higher ratio between the interest expenses and total expenses indicates that the bank has high interest bearing deposits. The ratio should be low for the profitability of the bank. The ratio is calculated by the following formula:-

$$\frac{\textit{Total Interest Expenses}}{\textit{Total Expenses}}$$

2. Interest Income to Credit and Investment ratio

This ratio calculates the relationship between the interest earned through the mobilization of credit and investment. The higher the ratio better is the banks profitability position. The ratio is calculated by the following formula:-

$$\frac{\textit{Total Interest Income}}{\textit{Total Credit and Investment}}$$

3. Return on Total Assets ratio

The ratio calculates the relationship between the net profit after tax and total assets. The higher the ratio the better is the banks position in terms of profitability. The ratio is calculated by the following formula:-

$$\frac{\textit{Net Profit after Tax}}{\textit{Total Assets}}$$

4. Return on Net Loan and Advances Ratio

Net profit tax on loan and advances is calculated by the ratio. Higher the ratios clear the indication that loan and advances are generating profit. The ratio is calculated by the following formula:-

$$\frac{\textit{Net Profit after Tax}}{\textit{Net Loan and Advances}}$$

5. Net Profit on Total Revenue

The ratio calculates the relationship between net profit after tax and revenues from the different sectors. Higher the ratio better is the banks position in term of profitability. The ratio is calculated by the following formula:-

$$\frac{\textit{Net Profit after Tax}}{\textit{Total Revenue}}$$

6. Earning Per Share

The ratio calculates the ratio of net profit after tax to shareholders equity. The ratio calculates how much a share earns in price. The higher the ratio the better a share earns. The ratio is calculated by the following formula:-

$$\frac{\textit{Net Profit after Tax}}{\textit{No. of Equity Shareholders}}$$

7. Total Interest Income to Total Revenue Ratio

This ratio measures the relationship between the total interest and total revenue. The higher the ratio the higher the contribution interest income on total revenue. The ratio is calculated by the following formula:-

$$\frac{\textit{Total Interest Income}}{\textit{Total Revenue}}$$

3.10.1.4 Liquidity Ratios

This ratio measures the liquidity position of a firm. It measures the firm's ability to meet its short-term obligations or its current liabilities. It measures the speed with which a bank's assets can be converted into cash to meet deposit withdrawal and other current obligations. As a financial analytical tool, following two liquidity ratios has been used to come into the acts and findings of the study.

1. Current Ratio

Current ratio measures the ratio between current assets and current liabilities. The more the current ratio bank has the more liquidity the bank possesses. The current ratio is calculated by following formula:-

$$\frac{\textit{Current Assets}}{\textit{Current Liabilities}}$$

2. Cash and Bank Balance to Total Deposit Ratio

This ratio measures the cash and bank balance to total deposit. This can also be called quick ratio. This ratio measures the real liquidity of the bank. The more the ratio the more liquidity the bank possesses. This ratio can be calculated by the following formula:-

$$\frac{\textit{Cash and Bank Balance}}{\textit{Total Deposit Ratio}}$$

3.10.2 Statistical Tools

Some important tools are used to achieve the objective of this study. In this study statistical tools such as mean, standard deviation, coefficient of variance, and coefficient of correlation have been used

3.10.2.1 Arithmetic Mean

Arithmetic mean of a given set of observation is their sum divided by number of observation. In general x_1, x_2 .... x_3 are the given number of observation, their arithmetic mean can be derived in this way.

$$\frac{\sum x = x_1 + x_2 + x_3 + \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots + x_n}{N}$$

Where,

X = variables

$\sum x$ = Arithmetic mean

N = number of observation

The arithmetic mean is a single value of selection, which represents them in average. Out of the various central tendencies a mean is one of the useful tools to find out the average value of the given data. Furthermore it is very much useful with respect of financial analysis and it is also easy to calculate.

3.10.2.2 Standard Deviation

Standard deviation is also one of the tools to analyze the data. This tool helps to find out the fluctuation and consistency of the specified variables. Actually it measures the level of variation from the mean of variables. If this variation is above the level of 5%, it will be interpreted as high level of variation. It is measured by following formula:-

$$\sigma_j = \sqrt{\frac{\Sigma\left(R_j - \overline{R}_j\right)^2}{n}}$$

Where,

σ_j = Standard deviation of return on stock 'j' during the time period n.

R_j = Standard Deviation

$\overline{R_j}$ = Mean of Return

3.10.2.3 Coefficient of Variation

Coefficient of variation checks the consistency of given data. The less the C.V. the more consistence the value is and vice versa. The C.V. is calculated by the following formula:-

$$\frac{\sigma}{\overline{X}} \times 100\%$$

Where,

σ = Standard Deviation

X = Mean

3.10.2.4 Karl Pearson's Coefficient Correlation

Out of several mathematical method of measuring correlation the Karl Pearson popularity known as Pearson's coefficient of correlation widely used in practice to measure the degree of relationship between two variables. Two variables are said to have correlation when the value of one variable is accompanied by the change in the value of the other. So, it is measured by following formula using two variables.[27]

$$r = \frac{\sum XY}{\sqrt{\sum X^2}\,\sqrt{\sum Y^2}}$$

Where,

- r = coefficient of correlation
- $\sum XY$ = Sum of product of deviation in two series.
- $\sum X^2$ = Sum of squared deviation in X series.
- $\sum Y^2$ = Sum of squared deviation in Y series.

The value of this coefficient can never be more than +1 or less than -1. Thus +1 and -1 are the limit of this coefficient. The r = +1 implies that correlation between variables is positive and vive versa. And zero denoted no correlation.

27 Bajracharya, B.C. (2056), Business Statistics & Mathematics, M K Publishers and Distributors, Kathmandu, p250

CHAPTER - 4
DATA PRESENTATION AND ANALYSIS

The topic of the problem is selected as the position of NPL in RBB. The study includes not only the NPL but also other factors that affect the profitability of the bank. So the study revolves around the program and the procedures initiated for the management of NPL and other factors. The financial sector reform program is the most important program initiated for the management of NPL and other factors.

Each and every nation has some expectations from its financial system. It is because, financial system can contribute a lot for accelerating the pace of economic growth through mobilization of resources. However, the magnitude of expectations from the financial system may vary within the various stages of economic development, the financial system is expected to be a good facilitator and a partner to achieve a sustained economic growth all the time.

Financial system should be able to discharge its responsibility through efficient financial intermediary functions. A financial intermediary should be efficient in mobilizing resources specially within low interest spreads from surplus units to deficit units, managing risk exposure within prudent limits, overall management based on best practices, quick and prompt delivery of services to general public and stakeholders, providing adequate qualitative services, maintaining healthy competition within market, maintaining a in-built system of good governance and initiating a continuous effort to build up and develop sophisticated financial markets in global context. Therefore, financial system should grow, develop and expand according to the needs of the economy and in global prospective as well. In this context, the improvements of the weak areas demand reform programs. Therefore, a reform program is a continuous and inevitable phenomenon to keep the system up-to-date and also to achieve a sustained economic growth. Within normal circumstances, the reform programs are aimed at solving a particular issue on case by case basis. Where as in extreme cases, the reform programs come with a wide coverage depending upon the severity of problems that needs to be tackled and their inter-linkage along with their sensitiveness to the system as a whole.

Nepalese banking system as well as the financial system have achieved some developments during last two decades. The financial system of Nepal has reasonably well diversified during this period. This can be evidenced by the number and variety of institutions. As of July 2002, Nepalese the financial system includes 16 commercial banks, 16 development banks, 5 rural development banks, 1 postal saving bank, 54 financial companies, 34 saving and credit co-operative societies involved in limited banking activity, 25 non-government micro-credit institutions, one stock exchange with several brokers and securities dealers, 13 insurance companies, one employees' provident fund, one credit guarantee and deposit insurance corporation, one Citizen Investment Trust. Some of these are under the regulatory framework of NRB and some of these are under other government authorities. All of these have to play an active roles in the system.

At present, the financial system of Nepal has been suffering of so many problems. It has been observed that solving a particular area will not be enough to boost up the system to achieve sustainable economic growth, generate adequate employment opportunities and maintain efficient and sound system as needed by the economy. There are so many issues and those need to be addressed in consolidated manner for the overall development of the system. The agendas that need to be addressed are poor legislation, weak and corrupt institutional environment, lack of healthy competition, poor service quality, poor assets quality, poor governance, traditional corporate culture, weak regulatory and supervision capability and inadequacy of supportive institutions required for the financial system. Since, Nepalese financial system has been dominated by the banking sector and it itself has also been suffering of aforementioned problems. To tackle these problems, some banking reform program was also initiated in the past.

Reform Initiatives and Lessons Learned from the Past:

Nepalese Banking system has undergone through various stages of the reform process during last two decades. After the adoption of liberal economic policy by the government in mid mid 1980s, financial sector has developed a great extent and become private sector friendly. However, the qualitative aspects of the sector did not improve significantly. The reform initiatives and achievements of the past as on periodic basic can be summarized as following:

(A) During 1980s

From the early 1980s regulatory authorities had recognized that a healthy financial sector is a pre-requisite for sustained economic growth. Within the banking system, there were only two commercial banks in Nepal and both were under the government ownership. Banking sector was not opened up for private sector. These two banks were functioning more under social welfare concept rather than commercial orientations. At that time, the commercial banks had begun to exhibit serious portfolio problems. With the commercial banks had begun to exhibit serious portfolio problems. With the expansion of bank branches and their growth, the severity of problems were deepening. It was not because of their expansionary stages but because of inappropriate operational performance, mis-management and imprudent lending decisions these banks were making during those days. Therefore, correcting measure were initiated after and during Commercial Bank Problem Analysis and Strategy Study (CBPASS I & II). The reform measures were concentrated to strengthening their financial and operational performance, improving the legal and institutional environment in financial sector, enhancing the capacity of the central bank to supervise the banking system, implementation of improved regulations and rationalization of branch expansion policies. After the CBPASS, the following reform activities were completed:

With a view to strengthen and improve the performance of theses two commercial banks, government provided Rs.443 million for re-capitalization and further Rs.3.12 billion for provisioning and repayments of bad debts.

- Separate loan recovery departments were established in RBB and NBL.
- Government vested the NRB with the responsibility of implementing specific measures to strengthen these two banks for this, guidelines on a new system of loan classification, single borrower limits (1989) and accounting policies for interest suspension and provisioning were issued.
- Freedom to fix interest rates on deposits and credits on their own discretion in 1989.
- Government made a payment towards government guaranteed bank loans to public enterprises of Rs.400 million in 1990 and second payment of Rs.260 million therafter.

- Some technical assistance was also provided by the IMF to strengthen the banking supervision and inspection functions of the NRB. Accordingly, the Inspection Department of NRB was expanded and strengthened with more man power.
- Legislative changes were enacted to permit the NRB to spervise NIDC.
- The amendments of the commercial bank Act complemented in 1989 and Amendment of the NIDC Act was enacted in January 1990.
- Credit Information Bureau was set-up in 1989 to blacklist the bad borrowers.
- Joint venture banks began to be established from 1984, the first joint venture bank being the NABIL Bank.
- Recovery target were fixed for RBB and NBL.

(B) During 1990s

Similarly, in the line of liberal economic policy adopted in the past decade financial sector begun to enjoy several private sector friendly measures. Some of these were liberal entry policy for non-banks, withdrawal of statutory liquidity ratios, granting of authority in maintaining foreign exchange exposure for commercial banks and opening of personal foreign currency accounts. Similarly, cash reserve ratio and refinance rates had been reduced several times. With a view to introduce private sector culture and strategic alliance the shareholding in NBL was offloaded. Accordingly, some standardization on regulatory norms were also designed for regulating commercial banks on capital adequacy (1991), loan classification (1991), provisioning requirements (1991), liquidity (1996) along with new definitions on core capital and supplementary capital (1996), increment in the capital (1996), rediscounting of treasury bills with NRB (1993). Some norms were also established on case by case basis. During the same period, with a view to develop and maintain managerial capabilities, some chairpersons, board of directors, and CEOs were appointed among the professionals from the central bank and government sectors as well. All these attempts and initiations, however, could not exhibit satisfactory performance in terms of efficacy and efficiency within the financial system. In this scenario, NRB conducted a study in the name of "Reconciliation Project" in Rbb with the help of Nepalese auditors to identify the real financial soundness and quality of financial statement in 1999. This study revealed many discrepancies in the financial strength and in the soundness of the RBB. Consequently, another study was conducted and report was submitted by KPMG an International auditors group on June 30, 2000. Although, the financial indicators of the banks were reflecting poor condition of the banks, these two studies highlighted extremely serious position of RBB and NBL. The report highlighted that these banks were lacking serious shortfalls in all aspects of their governance, management and operation as well. The KPMG report also showed that loan assets are highly overstated and extremely risky. The KPMG report has highlighted the following poor aspects of RBB and NBL:

- Severe governance and management shortfalls.
- Dysfunctional lending processes.
- Information systems, accounting and record keeping practices extremely poor.
- Poor strategic and business planning and budgeting.
- Low moral and numerous human resource issues.
- A negative net worth to be operated.

Hence, it is considered to be a matter of grave concern for every one as these two banks are representing around half of the total assets of the total banking system and consisting of 80 percent branches of the banking system of Nepal.

4.1.1 Current Comprehensive Reform Program (1999 - 2007)

Financial sector reforms introduced in the last one and a half decades made significant improvements in certain sectors such as liberalization of interest rates, creation of a basics regulatory and supervisory frame works, development of a longer term government securities market, establishment of several types of banking and financial institution, functioning of stock exchange, competitive environment in the insurance services. But serious problems were still remained with two largest commercial banks (RBB and NBL) and two largest development banks (ADBN) and NIDC). The World Bank, the IMF and the Asian Development Bank (ADB) identified some weaknesses in NRB's regulatory and supervisory capacity. There were Government mandates seriously distorting operation incentives of the banking sector. Commercial banks' requirement is to lend in the priority and deprived sectors.

Taking into account these serious problems in the financial sector HMGN adopted the Financial Sector Strategy Statement in December 2000. It has clearly mentioned about the need for the strengthening and autonomy of NRB, so that it can regulate and supervise commercial banks and financial institutions. It has pointed out the need for the enactment of new NRB Act to empower NRB supervise financial institutions and take over the management of troubled banks and punish those financial institutions, which are found engaged in serious irregularities. It has also pointed out the need of having deposit taking instruction act, which is an umbrella act of all deposit taking institutions. Some of the main elements of financial sector reform strategy published by HMGN in December 2000 are as follows:

1. Implementing restructuring plans for the to large commercial banks the RBB and NBL.
2. Identifying restructing strategies for the two development banks, ADBN and NIDC.
3. Strengthening banking sector regulation and accounting and auditing standards.
4. Strengthening the NRB's supervisory capacities and its ability to enforce compliance with prudential regulation.
5. Improving the rugulation and supervision on non banking deposit taking institutions.
6. Modernizing the legislative frame work with a view to reducing legislative overlap and the segmentation and fragmentation.
7. Strengthening corporate governance and the framework for loan recovery.
8. Phasing out the role of NRB and commercial banks in providing directed credit.

As per the commitment of HMG/N to reform RBB and NBL, the Nepal Banking Reform Project was started with funding assistance of the World Bank and DFID (UK). The KPMG Barents Group, the international expert team associated with the Baking Reform Project, started the reform project since 15 November 1999. They broadly recognized that Nepal's financial sector still faced following systemic prblems:

1. Poor bank governance
    - Political interference and

- Insider lending

2. Lack of rational banking strategies as well as modern skills and international banking experience to support them
3. Lack of independent, capable supervision
4. Weak legal and accounting practices
5. Difficult and deep seated issue of RBB and NBL to be addressed.

The KPMG Barents review of the RBB and NBL found that both banks were deeply impaired in virtually all areas of their operations:

1. Overall bank governance and management weak by modern standards.
2. Deep flaws in lending process, loan files and loan portfolio
3. Primitive financial accounting with large pockets of "double counting", unsubstantiated assets and major items that should be written of by international standards.
4. No business strategies, weak planning and budgeting processes, lack in foundation, follow up, rewards and penalties.
5. Low morale of employees, low pay scales, low skills and counterproductive union oriented actives.
6. Primitive management information record keeping and control system.

The governance and management of RBB and NBL took politically driven decisions. They had negative net worth and insufficient capital adequacy. Their human resource management was found extremely weak in all. Their situation seemed clearly worse than in 1992. The KPMG Barents Group recommended following actions to be take for RBB and NBL.

1. Support Government efforts to create an independent, commercially run banking system and declare banking reform policies fostering sound banking system.
2. Upgrade Board, senior management and staff skills, capabilities and processes.
3. Design and invest in comprehensive banks restructuring programs
4. Support and assist in implementing long range plans to correct environmental weakness.

5. Support central bank strengthening and independence and provide full enforcement powers.
6. Depoliticize and commercialize the banking system.

The KPMG report concluded that loan assets RBB and NBL were highly overstated and extremely risky. As a result, both of them were technically insolvent. As of mid 1998, they had losses of around US$ 450 million, which was equivalent to around 46% of the annual budget of HMG/N or 8.6 percent of GDP. The assessment confirmed that the management of two banks basically dysfunctional. It recommended the reduction of the role of HMGN in the financial sector as a direct owner of bank and financial institutions beginning with RBB and NBL.

As per the recommendation of the KPMG report, NRB removed the NBL Board on March 8, 2002, on account of failure to manage the bank properly and replaced it with an NRB appointed Board. In mid July, the management of NBL was handed over to ICC Bank Ireland, for RBB, an international banking expert has been selected after Deloitte Touche Tohmatsu broke the contract, there are several international and domestic banking and financial experts have already completed HRD plan, Lean Policy and Guidelines, Computerization Policy and Programs, portfolio review and Loan Recovery and restructuring of RBB and NBL, both of them have implemented VRS plans and reduced their staff considerably. [28]

HMG/N has enacted the NRB Act, 2002, the Debt Recovery Act, 2002 and the Banking and Financial Institution Ordinance, 2004, the Public Debt Act and the Foreign Exchange Regulation Act were amended in 2002, the draft of the secured Transition Ordinance has been sent to HMG/N for its approval, which would address the weaknesses in the legal enforcement mechanism and judiciary capacity, the Credit Information Bureau is going to be established as a public limited company, the Debt Tribunals have already started its operation, the Asset management Company is going to be established, the ASB has completed the studies of ADBN and NIDC has issued prudential regulations to all banking and financial institutions including micro finance development banks. The supervision manuals both for on site and off site have been prepared and implemented. The NRB has started the reengineering process. The first phase of VRS is complete and the second phase of VRS has been announced. There is going to formulate its long-term strategic plan in the near future. It will turn the central bank into a modern central bank.

28 Economic Report (2002/03), Nepal Rastra Bank

There has been new development in the financial markets as well. New money market instruments are being introduced; the activities of the inter bank call money market are increasing. The secondary markets for government have helped to expand secondary market of government securities. The holders of government securities can turn their securities to liquid assets. Commercial banks have introduced credit cards and debit cards. Some of them have even managed to provide ATM and electronic banking services. The clearinghouse is going to be automated in the future and the modern payment, clearing and settlement system, which is one of the most important elements of the modern financial system.

NPL in the Nepalese Financial System

1. Introduction:

Nepal Rastra Bank being the regulator and supervisor of the financial system of Nepal, it has got clear and mandatory responsibilities as prescribed in the Nepal Rastra Bank Act, 2058. These responsibilities as prescribed in the Nepal Rastra Bank Act, 2058. These responsibilities have been assigned to it in order prevent the interest of the depositors and stakeholders of the financial system. The clear objectives and responsibilities of the bank as specified in the NRB Act, 2058 in relation to financial system are as follows:

- To promote stability and liquidity required in the banking and financial sector.
- To develop a secure, health and efficient system of payments
- To regulate, inspect, supervise and monitor the banking and financial system
- To promote entire banking and financial system of Nepal and to enhance public credibility towards the system.

It should be noted that the stability of the banking system could not be ensured unless and until the banks and financial institutions run in the prudent and sound manner. Accordingly, the liquidity required in the economy could be supplied and maintain at the desired level if banks are not operated in the sound and proper way. Banks could not maintain their financial health if there are a lot of defaulters on its portfolio of loan and advances. A lot of defaulters in the loan portfolio indicate poor and weak health of the institution. If there are sure type of walk banks and financial institution, they will not be able to financial the resource as needed by the private sector to boost up the economic Therefore, the system should be managed in the discipline way and the players of the system should also react in the discipline way. That's why each players of the system should maintain and exhibit financial discipline in each and every aspect. If the financial discipline is weak in the system, there will be lapses either in lending or recovery and there will be a reflection of it in the form of weak portfolio, i.e. high level of non-performing loans NPL. The high level of NPL in the system is in indicator of financial crisis and it should be resolved as soon as possible.

To over come from this situation, great effort is needed in the recovery of loan and advances by the banks and financial institutions themselves. Recovery of distress loan is a challenging task for banks and financial institution. This is a disposal, sale or acquiring of borrower's assets and legal proceeding is likely to happen in most of the cases. In the banking experience, almost in all the big loans of the banks, borrowers are appealing in the court to restrain the recovery process. Therefore, to materialize the recovery process for banks and financial institution, the role of judiciary has been extremely import on Nepal. This is because the say order can restrain the recovery process and vacant of stay orders can facilities banks to recovery the loan. Therefore, the role of judiciary has an extremely important role in resolving the problem of NPLs of the Nepalese financial system.

2. The banking system and NPLs

We all know that collection of deposits and making of loan and advances are core function of banks and financial institution. While collecting the deposits the banks has to provide interest to the depositors, It is cost to the banks. The money collected in the formed of deposits is against translated into loans and advances and banks get interest income. On this transformation process banks have a small interest spread from which they have to meet the operating expenses, Cost of bad debt and small profit margins. In order to pay the interest to the depositors and meet the withdrawals of depositors, these should be regularly repayments of principles and interest of loan from the borrows as per agreed schedule. In order to make this system interrupt banks should have all the loans as performing assets, i.e. good loans. Good loan and advances are called performing assets. Banks and financial institution always try to have almost all the financial assets as performing assets to make them sound, sustainable, profitable and health within the system. Sometimes, unfavorable internal economic shocks and other discrepancies affect the quality of such assets. Deterioration in the quality of loans and other assets, give birth to non-performing loans and ultimately invests the financial crises. In Nepalese case, the quality of loan has been deteriorated mostly not because of the unfavorable economic condition of the nation but because of the bad intention of the borrows. This is because, If we study the defaulted loan files of the banks we can find that most of the loan had been default from the long back when the economic situation was favorable to the borrowers and also economic was achieving a higher level of economic growth. Their track record is not good and even in that time they have not paid the bank as per agreement. It is business principle that entrepreneur has full right over profit and responsibilities to bear the losses of the business if any. It there will be a continuous loss in the business, or any symptoms of losses is envisaged then borrower should either change the business or stop the operation to control further losses. This is because; borrows has to meet the obligation of loss from its own resources. In such cases, borrower needs to liquidate their assets for debt servicing. If we see the scenario of defaulted borrowers, they have not gone to use this option, If they were serious to repay the loans, they would have been using available options such as liquidation of their personnel assets and cut down the cost for luxurious life in order to repay the bank's debt.

3.Level of NPL in the Financial system

The government of Nepal has been endeavoring a lot of effort to make the Nepalese financial health and prudent through various reform initiatives. Despite various effort within reform program, the level of NPL in the Nepalses Banking system has not come down to an acceptable level. The effort to date succeeded only to reduce the NPL to some extent but it still not sufficient to maintain the sound health of the system to the desired level. The level of NPL was around 30 percentage thereafter with the implementation of FSRP. It has decreased to 18.04 percent in july 2005 and 14.22 percentage in july 2006

ON the other hand the level of NPL is still increasing in the Development banks and financial discipline and level of NPLs is improving in banks, Where as the problems in Development banks and financial companies are deteriorating. The table provided below highlights the fact.

4.2 Ratio Analysis of Rastriya Banijya Bank

The main objective of this study is the proper management of NPA in RBB. The government has initiated Financial Sector Reform Program for this purpose so the ratio analysis is divided into two phases before and after the initiation of the program.

4.2.1 Performing Assets to Non performing Assets Ratio

Table No.1

Year	**performing Assets** (In Million Rs)	**Non-performing Assets** (In Million Rs)	**Ratio**
Before initiation of F.S.R.P			
2058	14192	13183	1.076
2059	12148	14889	0.816
After initiation F.S.R.P			
2060	10604	16005	0.663
2061	10635	14471	0.735
2062	13312	13689	0.972
2063	15055	8048	1.871
2064	17989	7405	2.429
Mean			1.223
Standard deviation			0.618
Coefficient of Variation			0.505

Source : Appendix

Table no 1 show the non- performing loan and the performing loan and their ratio for the study period of 2057/58 to 2061/62. Before and after the initiation of Financial Sector Reform program. The higher the ratio between the performing loans to non-performing loan better the banks efficiency can be. The ratio of performing and non-performing loan 1.076,0816 and 0.663.0.735 and 0.972 in the financial year 2058 to 2064 respectively. The mean ration is 1.223, which means performing loan is 122.3% more than the non- performing loan in the study period. The ratio in the fiscal year 2058 and 2059 is more than the mean. That is a positive indication. But after the fiscal year 2059 the ration are lower in 2060, 2061, 2062 than the mean value. That means the non-performing loan is more than the performing loan from the fiscal year 2058 to 2062. These are not good sign for any financial institution where the non-performing loan part are huge in total loan and in the fiscal year 2062 .Similarly the C.V. of the seven year period is 0.505 which means the five years average deviation is 50.5%. The trend of the non-performing loan is of increasing one up to the fiscal year 2059/60. In the fiscal year 2060/2061 to 2064 non- performing assets is lower than the previous year .While the performing assets is of decreasing trend up to the fiscal year 2059/2060 Which is again increasing trend thereafter up to the fiscal year 2064. It is a good indication that the non- performing assets have decreasing in the fiscal year 2061 to 2064 in contrast with the previous fiscal year, which is a sign of progress in terms of non-performing assets after the initiation of F.S.R.P.

4.2.2 Non- Performing Assets to Assets Ratio

Table No.2

Year	**performing Assets** (In Million Rs)	**Non-performing Assets** (In Million Rs)	**Ratio**
Before initiation of F.S.R.P			
2058	13183	52824	025.0
2059	14890	44969	033.1
After initiation F.S.R.P			
2060	16004	43172	0.371
2061	14471	45056	0.321
2062	13689	56822	0.241
2063	8048	49010	0.164
2064	7405	47911	0.155
Mean			0.262
Standard deviation			0.006
Coefficient of Variation			0.023

Source : Appendix

Table No.2 presents the non- performing loan to total assets ratio of Rastriya Banijaya Bank for the study period of 2058 to 2064, before and the initiation of financial Sector Reform program. The ratios for seven years were 0.250, 0.331,0321 and 0.241, 0.164 and 0.155 respectively. Accordingly the mean ratio is 0.262, It means the non-performing loan is 26.2% of the total assets. According to the Nepal Rastriya Bank directives, Non-performing loan should be 10% or below the total assets. This means the Bank in not being able to maintain the non-performing loan to total assets Ratio according to the directives. Even after the initiation of the F.S.R.P the ration is still much higher in 2060 to 2061 than the standard. In 2062/63 and 2064, the ratio has been slowly gone down but is still higher than standard. The higher the non-performing loan to total assets ratio the less efficient the banks performance would be. Before the initiation of the F.S.R.P, ratio in the fiscal year 2058 is less than the mean ratio .Next three years ratios are above the mean ratio while the later these final year's is blow the average. The total assets are in decreasing trend up to the fiscal year 2060. It has increased in the fiscal year 2060 and 2062 while the trend of non- performing loan is vice-versa. Non-performing loan have decreased in the fiscal years 2062/2063/2064 it may be because of recovering some of the non-performing loans through bringing new rules and regulation and by written down some loans and by recovering receivables from the HMG/N. It can be seen as a positive achievement of the new management

4.2.3 Loan Loss provision to Total Loan Ratio

Table No.3

Year	Loan Loss Proviso (In Million Rs)	Total Loan (In Million Rs)	Ratio
Before initiation of F.S.R.P			
2058	7577	27376	0.277
2059	13347	27038	0.494
After initiation F.S.R.P			
2060	14929	26608	0.561
2061	14275	25106	0.569
2062	13570	27001	0.503
2063	8441	23103	0.365
2064	6804	25394	0.268
Mean			0.434
Standard deviation			0.119
Coefficient of Variation			0.274

Source : Appendix

Table No.3 presents the loan loss provision to total loan of Rastriya Banijaya Bank for the study period of 2058 to 2064, before and after the initiation of financial Sector Reform program. The average ratio for the study period is 0.424, Which mean the loan provision is 43.4% of the total loan after the initiation of the program the ratio in the fiscal years, 2060 to 2062 much more higher than the average ratio i.e. 0.561, 0.503. The trend of the total loan is of decreasing till the fiscal years 2061/61 and fluctuated in the final year 2062/63/ and 2064. While the trend of loan loss provision is vise versa. C.V. of the ratio is 0.274 that means seven years average fluctuation is about 27% Higher ratio of loan loss provision to total indicates that the bank has should make higher percentage of provision for the non-performing loans. Nepal Rastriya Bank has directed the commercial banks to maintain the level of loan loss provision for doubtful debt while the provision for good loan is just 1% Even though the total loan is in the decreasing trend, the loan loss provision has also decreased after the initiation of the F.S.R.P It means the new management has improved the loan standard hence the minimum loan loss provision has been to maintain. In 2063 and 2064 the loan loss provision decreased which is below average ratio or 43.4%.

4.2.4 Loan Loss provision to Total Loan Ratio

Table No.4

Year	**Loan Loss proviso** (In Million Rs)	**Total Loan** (In Million Rs)	**Ratio**
Before initiation of F.S.R.P			
2058	122	14192	0.0086
2059	110	12148	0.0090
After initiation F.S.R.P			
2060	98	10604	0.0092
2061	428	10625	0.4045
2062	125	12146	0.0103
2063	141	13820	0.0102
2064	253	16685	0.0152
Mean			0.0147
Standard deviation			0.0107
Coefficient of Variation			0.7279

Source : Appendix

Table no. 4 present the comparatives analysis of the pass loan to total pass loan of Rastriya Banijaya Bank of the study period of 2058 to 2064, Before and after the initiation of the financial Sector Reform program the ratio should be at certain level. According to the Nepal Rastriya Banijaya Bank's directives the provision for the pass loan should be 1% of total pass loan. Express provision for the pass loan provision could tie the capital for the investment purpose. The average ratio the seven year is 0.0147. That means the bank has maintained a pass loan provision at 1.47% total pass loan in the study period. Before the initiation of F.S.R.P, from the provision was less than 1% But the ratio was much higher than average, in the fiscal year 2060/61 i.e. 0.404. In the fiscal year 2062/63.64 the ratio are 0.0103,0.102 and 0.0152 which means the ratio , is in the standard of Nepal Rastriya Bank. It shows the positive reform towards banking activities specially loan management which has occurred after F.S.R.P. i.e. due to new management of R.B.B. The seven year C.V is 0.07279 that means average deviation for seven year is about is 0.0107.

4.2.5 Substandard Loan Loss provision to Total Substandard LoanRatio

Table No.5

Year	Prov. For Substandard loan (In Million Rs)	Total Substandard Loan (In Million Rs)	Ratio
Before initiation of F.S.R.P			
2058	550	4440	0.124
2059	587	2660	0.221
After initiation F.S.R.P			
2060	294	1414	0.208
2061	157	708	0.222
2062	124	519	0.239
2063	57	255	0.223
2064	18	255	0.231
Mean			0.21
Standard deviation			0.171
Coefficient of Variation			

Source : Appendix

Table No-5 presents the substandard loan provision to total substandard loan of Rastriya Banijaya Bank for the study period of 2058 to 2064, before and after initiation of the financial sector Reform program. Substandard loan falls under the category of non- performing assets, according to the Nepal Rastriya Banks classification. Although the provision could lessen the burden of substandard loan and is necessary, high provision for the substandard loan also indicates that the banks have a high amount of substandard loan. The directives of N.R.B. have directed to make provision of 25% for substandard loan. From the above table it can be seen that the calculate rations are less than the given standard in each fiscal year. In the fiscal year 2057/58, It is much less than the given standard and mean ratio i.e. 0.124. The average ratio is 0.21 that means the bank has 21% provision for substandard loan in the study period, which is also less than the N.R.B standard. But the individual rations are higher than the average in each fiscal year, except in the fiscal year 2057/58. The ratio shouldn't be more Or less than the standard because excess provision can increase the non-performing assets while low provision cannot secure the loan in the future, the trend of substandard loan is of decreasing one, So as the provision for the substandard loan. That is a good indication C.V. for the seven year in 0.171% that means the average deviation of ratio in the five year period is 171% Even the new management is unable to meet the standard of N.R.B to maintain the provision for substandard loan, after it took control of the bank.

4.2.6 Provision for Doubtful Debt to Total Doubtful Debt Ratio

Table No.6

Year	**Prov. for Doubtful Debt** (In Million Rs)	**Total Doubtful Debt** (In Million Rs)	**Ratio**
Before initiation of F.S.R.P			
2058			0.473
2059			0.471
After initiation F.S.R.P			
2060			0.447
2061			0.434
2062			0.454
2063			0.486
2064			0.453
Mean			0.46
Standard deviation			0.016
Coefficient of Variation			0.035

Source : Appendix

Table no-6 presents the ratio pf provision doubtful debt to total debt to Rastriya Banijaya Bank for the study period of 2058 to 2064, Before and after the initiation of Financial sector Reform program. Doubtful debt falls under the category of non-performing assets. So the high amount of doubtful and its provision is not good for the banks performance of the reasonable standards. Nepal Rastriya Banijiya Bank has set a standard for the provision for doubtful debt to total doubtful debt at maintain the given standard in each fiscal year, before or after the initiation of the F.S.R.P But the compliance is even weaker, It seems, after the banks management is handed over to the new management. Even the average ratio is not near the standard, which is 46% on average in the study period. The trend of both the doubtful debt is of decreasing till the fourth year and again increasing in the 5th year then decreasing and increasing in 6th and 7th year respectively C.V. of five year is 0.035% that means five years-average deviation of ratio is 3.5%.

.4.2.7 Provision for Bad Debt to Total Bad Debt Ratio

Table No.7

Year	**Prov.For for Bad Debt** (In million Rs)	**Total Bad Debt** (In million Rs)	**Ratio**
Before initiation of F.S.R.P			
2058	2132	2210	0.965
2059	6349	6601	0.962
After initiation F.S.R.P			
2060	9906	10294	0.962
2061	11422	11969	0.954
2062			
2063	11919	12588	0.947
2064	6028	7199	0.839
Mean			0.936
Standard deviation			0.042
Coefficient of Variation			0.046

Source : Appendix

Table no-7 presents the ratio for the provision for bad debt in respect to the total volume of bad debt of Ratriya Banijiya Bank for the study period of 2058 to 2064, before and after the initiation of the financial sector Reform program; this provision ratio is 0.96 for each fiscal year, from 2056/57 to 2058/59. Before the initiation of F.S.R.P After the initiation of the program the ration is 0.96 in 2059/60 and 0.95 in the both fiscal year 2060/61 and 2061/62. This means the ration in the study period are almost similar. The mean ratio is 0.925 due to the ratio 0.87 in 2064 other then the mean ratio also would be same i.e. 0.96. That means the banks has a provision of 95% for the bad debt in the six year period and overall 92.5% in the seven year period. Provision for bad debt should be according the standard set by the central bank of a country .According to Nepal Ratrya Banijaya Bank directives the provision for bad debt should be 100% of the total bad debt, Above tables suggests that R.B.P. has failed to comply the standard set to the Nepal Rastriya bank even after the banks management has been handed over to the new management. The trend of bad debt is of increasing so does the provision for the bad debt. Increase in the bad debt till 2062 can be subjected to the new classification of loan according to the N.R.B. directives and increase in provision can be subjected to the compliance of standard provision by making additional provision for the preceding years.

In year 2063 and 2064 the total Bad debt has been decreased as comparison than above so that the provision for bad debt also decreased but ratio between them us not different than above years. In year 2063 and 2064 the total Bad debt has been decreased as comparison than above so that the provision for bad debt also decreased but ratio between them us not different than above years. C.V. ratio is 0.046. That means average deviation of ration in seven year is only about 4.6%

4.2.8 Interest Expenses to Total Expenses Ratio

Table No.8

Year	**Interest Expenses** (In Million Rs)	**Total Expenses** (In Million Rs)	**Ratio**
Before initiation of F.S.R.P			
2058	2571	4182	0.615
2059	2347	3349	0.701
After initiation F.S.R.P			
2060	2108	5602	0.376
2061	1495	2631	0.568
2062	1005	2050	0.490
2063	850	1884	0.451
2064	839	2102	0.399
Mean			0.514
Standard deviation			0.110
Coefficient of Variation			0.214

Source : Appendix

Table no 8 presents the interest expenses to total expenses ratio, of Rastriya Banijya Bank, for the study period 2058 to 2064 before and after the initiation of Financial Sector Reform Program. Average ratio for the seven year is 0.514 which means, on an average RBB is marinating the level of interest expenses to 51.4% of the total expenses. C.V. of the seven year period is 0.214 which means seven year average deviation is about 21.4. The higher ratio of interest expenses to total expenses denotes that the bank has more interest bearing deposits. This could increase the cost of funds and to pay the interest bearing deposits. This could increase the cost of funds and to pay the interest, the bank has to increase the interest in lending, which could in term decreases the mobilization of deposits. Before the initiation of the F.S.R.P the ratio is ranged from 61% to 70%. Comparing with the average ratio, the ratios are higher in each fiscal year. After the initiation of the program the ratio was lower than the average in the fiscal year 2060 and more than the average in the fiscal year 2060/61 but again less than the average in the last fiscal year 2062, 2063 and 2064. the total expenses and interest expenses are in decreasing trend after the initiation of the F.S.R.P. Although the total deposit has increased in the fiscal year 2061/62 the interest expenses have decreased, it means the bank has raised its deposit through non-interest bearing deposits.

4.2.9 Interest Income to credit and Investment Ratio

Table No.9

Year	**Interest Income** (In Million Rs)	**credit and Investment** (In Million Rs)	**Ratio**
Before initiation of F.S.R.P			
2058	2734	33022	0.083
2059	1745	31196	0.056
After initiation F.S.R.P			
2060	2051	31231	0.066
2061	2237	28223	0.079
2062	2329	35417	0.066
2063	2283	34730	0.066
2064	2355	38110	0.062
Mean			
Standard deviation			0.009
Coefficient of Variation			0.132

Source : Appendix

Table No. 9 presents the comparative analysis of interest income of creadit investment of Rastriya Banijiya bank for the study period of 2058 to 2064 before and after the financial sector reform program is initiated. The Ratio is ranged from 6% to 8% in the study period. The average Ratio is 0.066. This means, the bank is earning the interest in the credit and investment on average of 6.6% in the seven year period. The higher the Ratio the better is the banks profitability position. The C.V. of the seven year period is 0.132 which means the five year average fluctuation is about 13.2% . Comparing with the average ratio, the five in the fiscal year 2058 and 2061 is higher than the rest of the year before and after the imitation of the F.S.R.P decreasing trend before the initiation of the program but after the imitation of the program, the interest income has been increasing trend. In 2061 credit and investment is only 28223 (Million) but the interest income is in better collection position. After that, interest income and the credit and investment were in fluctuation.

4.2.10 Total Interest Income to Total Revenue Ratio

Table No.:10

Year	**Total Interest Income** (In Million Rs)	**Total Revenue** (In Million Rs)	**Ratio**
Before initiation of F.S.R.P			
2058	2734	3031	0.902
2059	1745	2123	0.822
After initiation F.S.R.P			
2060	2051	2356	0.870
2061	2236	3766	0.594
2062	2329	3510	0.664
2063	2283	4298	0.531
2064	2355	4240	0.555
Mean			0.701
Standard deviation			0.145
Coefficient of Variation			0.207

Source : Appendix

Table no 10 presents the total interest income to total revenue ratio or Rastriya Banijya Bank for the study period of 2058 to 2064 before and after the initiation of the financial sector reform program. The mean ratio is 0.701 which means total interest has 70.1% of contribution in total revenue of the bank. The ratios, before the initiation of F.S.R.P, are more than to the average ratio. After the initiation of the program, the contribution of interest income in the total revenue, decreased than in the past, C.V. of ratio is 0.207 that means the average deviation of ratios is 20.7% in the seven year period. The high contribution of interest in total revenue is indication that other sources of revenues like commission and discount, exchange rate fluctuation, have little contribute in the total revenue. Increase in the interest income can be subjected to the increase in due interest income or decrease in interest suspense and interest mismatch.

4.2.11 Return on Total Assets Ratio (ROA)

Table No 11

Year	Net Profit After Tax (In million Rs)	Total Assets (In million Rs)	Ratio
Before initiation of F.S.R.P.			
2058	-7084	52824	-0.134
2059	-7068	44969	-0.157
After initiation of F.S.R.P.			
2060	-4840	43172	-0.112
2061	1040	45056	0.023
2062	1323	56892	0.023
2063	1592	49010	0.032
2064	1682	47911	0.035
Mean			-0.041
Standard Deviation			0.0581
Coefficient of Variation			-1.976

Source : Appendix

Table no 11 presents the comparative analysis of return on total asset of Rastriya Banijya Bank for the study period of 2058 to 2064, before and after initiation of the financial sector reform program. The bank has a very poor performance in terms of profitability. It was in constant loss up to the fiscal year 2060. The average ratio of return on total assets for the study period is -0.041 that means the bank is in loss of 4.1% on average. Before the initiation of the F.S.R.P, the ratio in the fiscal year 2058 and 2059 is much lower than the average. That means loss is higher in the fiscal year 2057/58 and 2058/59. After the initiation of the program the ratio in the fiscal year 2059-60 is -0.112. This is lower than the average ratio. The ratios are 0.023, 0.023, 0.032 and 0.035 in the fiscal year 2061, 2062, 2063 and 2064 respectively, after the new management took control of the bank. Even after the initiation of the F.S.R program the bank has not been able to generate profit in the first fiscal year 2060. This indicates that the bank is not being able to manage the asset in the efficient way. But since the new management has shown a promising start by earning profit it can be said encouraging. After the initiation of the program the trend of total assets is of increasing one while the net profit after tax is also increased. The average C.V. of return on total assets for is 1.196, which means the average deviation of return on total assets for seven year is about 119.6% which can be regarded as high deviation.

4.2.12 Return on Net Loan and Advances Ratio

Table No 12

Year	Net Profit After Tax (In million Rs)	Net Loan And Advance (In million Rs)	Ratio
Before initiation of F.S.R.P.			
2058	-7084	19798	-0.358
2059	-7068	13690	-0.516
After initiation of F.S.R.P.			
2060	-4840	11379	-0.414
2061	1040	10631	0.098
2062	1323	13431	0.098
2063	1592	14662	0.109
2064	1682	18590	0.090
Mean			-0.128
Standard Deviation			0.265
Coefficient of Variation			-2.070

Source : Appendix

Table no 12 presents the comparative analysis of return on net loan and advances of Rastriya Banijya Bank, for the study period of 2058 to 2064 before and after the initiation of Financial Sector Reform program. The average ratio for the study period is -0.128. That means the banks return on net loan and advance in negative with 12.8% in the seven year period. The higher the positive ratio the better is the banks profitability. But the ratios, before the initiation of the F.S.R.P, are negative and, higher than the average. After the initiation of the program the ratio is negative in the fiscal year 2059/60. The bank is being able to generate profit from the fiscal year 2060/61 till 2064. The average C.V. of the ratio is -2.070. That means the average deviation on the seven year ratio is 207%. This can be regarded as a higher deviation. The trend of net loand and advances is of decreasing one while the net profit was negative up to the fiscal year 2060. After analyzing this table we can conclude that Rastriya Banijya Bank has low performance in terms of return on loan and advance except in fiscal year 2061, 2062, 2063 and 2064. In these fiscal year the banks has been able to generate positive return on net loan and advance, after the new management took control of the bank, because of increase in interest income, commission and discount, increase expense and employee expenses.

4.2.13 Net Profit on Total Revenue Ratio

Table No 13

Year	Net Profit After Tax (In million Rs)	Total Revenue (In million Rs)	Ratio
Before initiation of F.S.R.P.			
2058	-7084	3031	-2.337
2059	-7068	2123	-3.329
After initiation of F.S.R.P.			
2060	-4840	2356	-2.054
2061	1040	3766	0.276
2062	1323	3510	0.377
2063	1592	4298	0.370
2064	1682	4240	0.397
Mean			-0.9
Standard Deviation			1.493
Coefficient of Variation			-1.659

Source : Appendix

Table no 13 presents the net profit on total revenue of Rastriya Banjiya Bank for the study period of 2058 to 2064, before and after the initiation of Financial Sector Reform program. The net profit after tax is negative from fiscal years 2057/58 to 2059/60. That means the total expenses are higher than the total income in these years. The seven years average ratio of net profit on total revenue is -0.9. That means net profit on total revenue is negative by 90%, in the study period. The ratio in the fiscal year 2057/58 and 2058/59 is much higher than the average ratio before initiation of the F.S.R.P. That means before the initiation of the F.S.R.P, negative net profit is higher in the fiscal year 2057/58 and 2058/59. After the initiation of the program the ratio in the fiscal year 2059/60 is still higher than the average. In this fiscal year 2061, 2062, 2063 & 2064 the ratios are positive. That means total income is higher than the total expenses in the fiscal years. The C.V. of net profit on total revenue was -1.659, which means the average deviation of these seven years is about 165.9%. Net profit after tax is negative up to the fiscal year 2059/60 because of higher interest expenses, employee expenses, non - operating expenses and provision for loans than the interest income, commission and discount and other incomes. But higher interest income and other incomes than the total expense helps to earn net profit in the fiscal year 2060/61, 2061/62m 2062/63 and 2063/64.

4.2.15 Current Ratio

Table No. 15

Year	Current Assets (In million Rs)	Current Liabilities (In million Rs)	Ratio
Before initiation of F.S.R.P.			
2058	5089	22291	0.228
2059	4526	23271	0.194
After initiation of F.S.R.P.			
2060	4476	26003	0.172
2061	7119	35552	0.200
2062	5553	29788	0.186
2063	5229	17176	0.304
2064	6151	12537	0.492
Mean			0.254
Standard Deviation			0.011
Coefficient of Variation			0.044

Source : Appendix

Table no 15 exhibits the current ratios of Rastriya Banijya Bank for the study period of 2058 to 2064, before and after the initiation of Financial Sector Reform Program. The average ratio of the seven year period is 0.254. The ratios before the initiation of the F.S.R program were 0.298 and 0.194 respectively. Comparing to the seven year average, in the fiscal year 2058 and 2059, the ratio are less than the average i.e. 0.298 and 0.194. After the initiation of the F.S.R.P, the ratios were 0.172, 0.20, 0.304 and 0.492 respectively. That means the ratio in 2063 and 2064 is more than the average. The higher the ratio the better is the liquid position of the bank. The C.V. of current ratio was 0.044 which means the average deviation of these seven years is about 4.4%. The trend of current liabilities if of increasing one, where as current assets is in increasing trend up to the fiscal year 2060/61. But from the fiscal year 2062, the trend of current liabilities has been decreased. Thought the new management also failed to maintain the standard of liquidity position of the Bank but it is better position than previous years i.e. before initiation of F.S.R.P. The difference between current assets and current liabilities has been decreased in the fiscal year 2063 and 2064. It is good sign for RBB that the less difference between them has been decreased the negative working capital.

4.2.16 Cash and Bank Balance to Total Deposit Ratio

Table No 16

Year	**Current Assets (In million Rs)**	**Current Liabilities (In million Rs)**	**Ratio**
Before initiation of F.S.R.P.			
2058	5089	40774	0.125
2059	4526	38993	0.116
After initiation of F.S.R.P.			
2060	4476	39402	0.095
2061	7119	40867	0.172
2062	5553	42016	0.129
2063	5229	46195	0.113
2064	6151	50346	0.122
Mean			0.125
Standard Deviation			0.019
Coefficient of Variation			0.152

Source : Appendix

Table no 16 presents the cash and bank balance to total deposit ratio of Rastriya Banijya Bank, for the study period of 2058 to 2064, before and after the initiation of the Financial Sector Reform Program. The average ratio for the study period is 0.45. That means the bank has 12.5% of cash and bank balance to total deposit. Adequate cash and bank balance is necessary to maintain the liquidity position. Too much of it can make the excess money useless and lost the opportunity cost and before the while too less will reduce the capacity of a bank to pay its customers principal and interests. So the liquidity should be in certain standard. After the adoption of economic liberalization, Nepal Rastra bank has withdrawn the statutory liquidity ratio. So there is not any certain standard for the compulsory cash and bank balance. But 5 to 10% of liquidity is necessary to maintain the banks credibility. But R.B.B has maintained the cash and bank balance more than 10% except in the fiscal year 2059/60. Before the initiation of the F.S.R.P the ration in the fiscal year 2057/58 and 2058/59 is less than the average i.e. 0.12. After the initiation of the program the ratio in the fiscal year 2059/60 is less than average i.e. 09. The ratio is more than the average in the fiscal year 2060/61 i.e. 0.172 and just equal to the average in the fiscal year 2061/62 i.e. 0.129. Total deposit is increasing in the last five years after the initiation of the F.S.R.P. It means depositors have increased their belief in RBB after the new management has taken the command of RBB. C.V. of ratio is 0.152. That means average deviation of the ratio is about 15.20% for the seven years period.

4.2.17 Credit Deposit Ratio

Table No. 17

Year	Total Credit (In million Rs)	Total Deposit (In million Rs)	Ratio
Before initiation of F.S.R.P.			
2058	27375	40774	0.671
2059	27037	38993	0.693
After initiation of F.S.R.P.			
2060	26608	39402	0.675
2061	25106	40867	0.614
2062	27001	43016	0.628
2063	23103	46195	0.500
2064	25394	50346	0.504
Mean			0.612
Standard Deviation			0.074
Coefficient of Variation			0.121

Source : Appendix

Table no 17 presents the credit deposit ratio of Rastriya Banijya Bank for the study period of 2058 to 2064, before and after the initiation of the Financial Sector Reform Program. In the fiscal year 2057/58 and 2058/59 the ratios are 0.671 and 0.693, which means in average almost 64.2% of the total deposit is mobilized before the program got started. The two years average is more than the mean average of seven year i.e. 0.612. In the fiscal year 2060, 2061, 2062, 2063 and 2064 the ratios are 0.675, 0.614, 0.628, 0.5 and 0.504 respectively. That means 58.42% of deposit is mobilized in the five fiscal years after the initiation of the program. The last five years average is less than the mean average. The more the ratio the better be the bank earning capacity. The V.V. of five year is 0.045, which means average deviation of five year is about 12.1%. The trend of total deposit is in increasing trend. Before the initiation of the financial sector reform program total deposits is higher in the fiscal year 2057/58. After the initiation of the program, it is higher in the fiscal year 2064. Total credit is in fluctuating trend. The mobilization of total deposit decreased substantially after the F.S.R.P initiated. The main reason behind this decreasing trend could be the tight control on credit by the new management. focus on recovering the non-performing loan than the credit mobilization.

4.2.18 Total Credit and Investment to Total Deposit Ratio

Table No 18

Year	Total Credit and Investment (In million Rs)	Total Deposit (In million Rs)	Ratio
Before initiation of F.S.R.P.			
2058	33022	40774	0.81
2059	31196	38993	0.800
After initiation of F.S.R.P.			
2060	31231	39402	0.793
2061	28223	40867	0.691
2062	35417	43016	0.823
2063	34730	46195	0.752
2064	38110	50346	0.757
Mean			0.775
Standard Deviation			0.042
Coefficient of Variation			0.054

Source : Appendix

Table no 18 exhibits the credit and investment to total deposit ratio of Rastriya Banijya Bank for the study period of 2058 to 2064, before and after the Financial Sector Reform Program is initiated. These ratios of three years seem quite consistent except in the fiscal year 2059/60. In the fiscal year 2061/62 it is 0.823, where as it is 081,080,0.793, 0.691 in the fiscal year 2057/58 to 2060/61 respectively with the C.V. of 000164. Which means seven years average deviation is 5.4%. The high the ratio between the credit and investment and total deposit the better will be the banks earning. The mean ratio is 0.775 that means about 77.5% of total deposit is mobilized in the credit and investment. The two - year ratios before the initiation of the F.S.R.P are more than the seven year average. After the initiation of the program the ratio in 2059/60 and 2061/62 are more than mean value while the ratio in the 2061, 2063 and 2064 are way behind the mean. That means mobilization of total credit and investment has decreased in the first two years and increased again in the final year after the initiation of F.S.R.P. Total credit and investment is in fluctuating trend after the fiscal year 2059/60 while the total deposit is in increasing trend. the first fiscal year of program has show some hopeful signs in terms of credit and investment, the second fiscal year 2060/61 has not shown encouraging results but the final years shows positive sign again.

4.3 Trend analysis of Different Financial Indicators

All the commercial banks do have the different financial indicators, which represent the actual financial position of the bank in different aspects. Therefore, to find out the trend of different financial indicator of Rastriya Banjiya Bank, seven years financial summary is tried to analyze.

4.3.1. Trend Analysis of Non - performing Loan and Total Assets

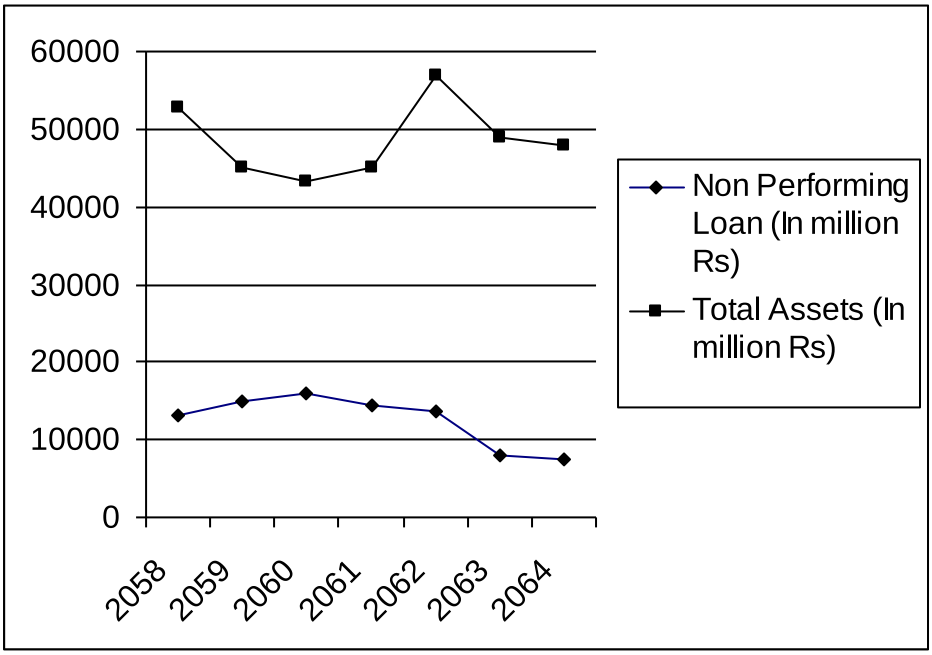
Table No 19

Year	Non-performing loan (In million Rs)	Total Assets (In million Rs)
Before initiation of F.S.R.P.		
2058	13183	52824
2059	14890	44969
After initiation of F.S.R.P.		
2060	16004	43172
2061	14471	45056
2062	13689	56822
2063	8048	49010
2064	7405	47911

Source : Appendix

Trend Analysis of Non - performing Assets and Total Assets

Figure No 1



The above table no 19 and figure no 1 shows the trend of Non - performing Assets and Total Assets of RBB of the seven years period from the 2058 to 2064. The Total Assets decreasing till 2059/60 and then increasing up to the fiscal year 2061/62 But first final, two year, 2063 and 2064 the total assets is decreasing. NPL is increasing till 2059/60 and then decreasing up to 2061/62. So the figure shows the opposite trend of Non-performing. Assets and Total Assets in the seven years period. But later final two years both total assets and NPL are decreasing.

4.3.2 Trend Analysis of Credit and Deposit

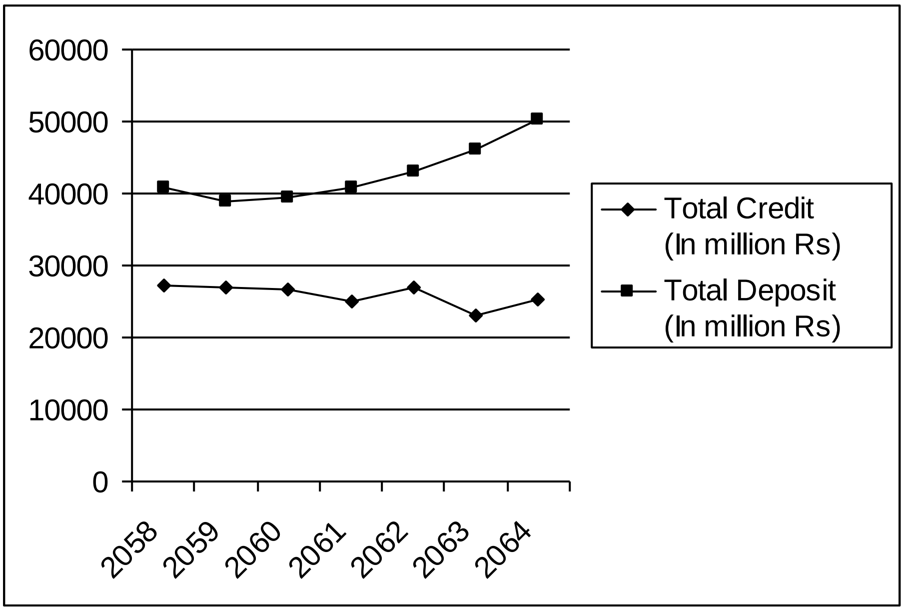
Table No 20

Year	Total Credit (In million Rs)	Total Deposit (In million Rs)
Before initiation of F.S.R.P.		
2058	27341	40774
2059	27037	38993
After initiation of F.S.R.P.		
2060	26608	39402
2061	25106	40867
2062	27001	43016
2063	23103	46195
2064	25394	50346

Source : Appendix

Trend Analysis of Credit and Deposit

Figure No 2



The above table no 20 and figure no 2 shows the trend of Total Credit and Total Deposit of RBB of the seven years period from the 2057/58 to 2061/62. The total deposit is decreasing in the first two years 2057/58 to 2058/59 and then increasing up to the fiscal year 2064. Total credit is decreasing till 2060/61 and then increasing in the fiscal year 2061/62 and then again decreasing in fiscal they 2063 and lastly increasing in final year 2064. So the figure shows the opposite trend of Total Credit and Total Deposit in the seven years period.

4.3.3 Trend Analysis of Return on Net Loan and Advances

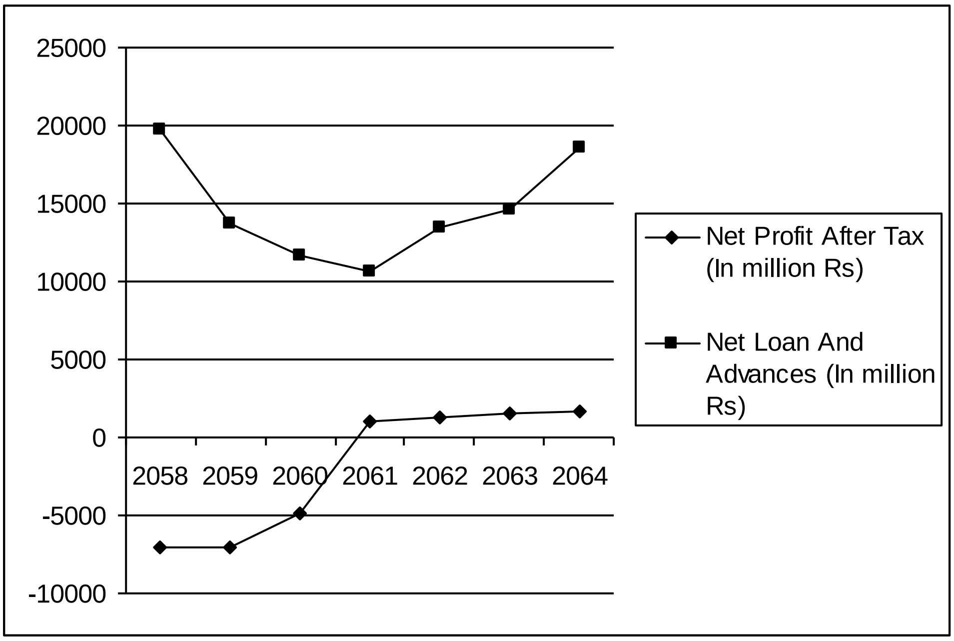
Table No 21

Year	Net Profit After Tax (In million Rs)	Net Loan And Advances (In million Rs)
Before initiation of F.S.R.P.		
2058	-7084	19798
2059	-7068	13690
After initiation of F.S.R.P.		
2060	-4840	11679
2061	1040	10631
2062	1323	13431
2063	1592	14662
2064	1682	18590

Source : Appendix

Trend Analysis of Return on Net Loan and Advances

Figure No 3



The above table no 21 and figure no 3 shows the trend of Net Profit After Tax and Net Loan And Advances of RBB of the seven years period from the 2058 to 2064. The Net Profit After is negative till the fiscal year 2059/60 and lat four years 2061, 2062, 2063 and 2064 respectively. Net Loan And Advances is decreasing till 2060/61 and then increasing in the last three fiscal year 2062, 2063 and 2064. So the figure shows the trend of Net Profit After Tax is decreasing up to 2060/61 and increasing in the final year while the trend of Net Loan And Advances is in increasing in the last three years period.

4.3.4 Trend Analysis of Total Interest Income to Total Revenue

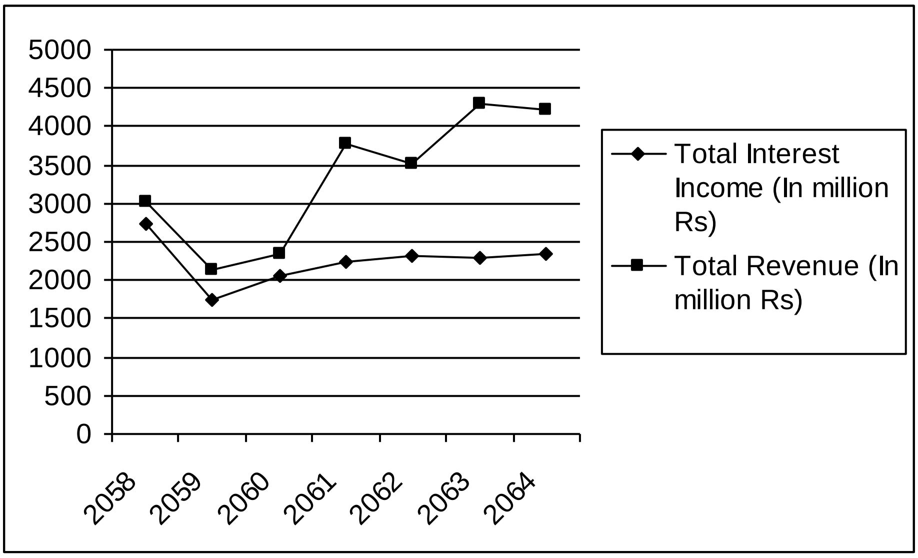
Table No 22

Year	Total Interest Income (In million Rs)	Total Revenue (In million Rs)
Before initiation of F.S.R.P.		
2058	2734	3031
2059	1745	2123
After initiation of F.S.R.P.		
2060	2051	2356
2061	2236	3766
2062	2329	3510
2063	2283	4298
2064	2355	4210

Source : Appendix

Trend Analysis of Total Interest Income to Total Revenue

Figure No. 4



The table no 22 and figure no 4 shows the trend of Total Interest Income and Total Revenue of RBB of the seven years period from the 2058 to 2064. The trend of Total Interest Income and The Total Revenue is same till the fiscal years 2060/61. Both are decreasing from the fiscal year 2057/58 to 2058/59 and increasing in 2060/61. The Total Revenue is increasing till the year 2062 but Total Interest is decreasing in the year 2062. So the trend of Total Revenue is decreasing first and increasing but the trend of Total Interest Income is fluctuating.

4.3.5 Trend Analysis of Total Credit and Investment and Total Deposit

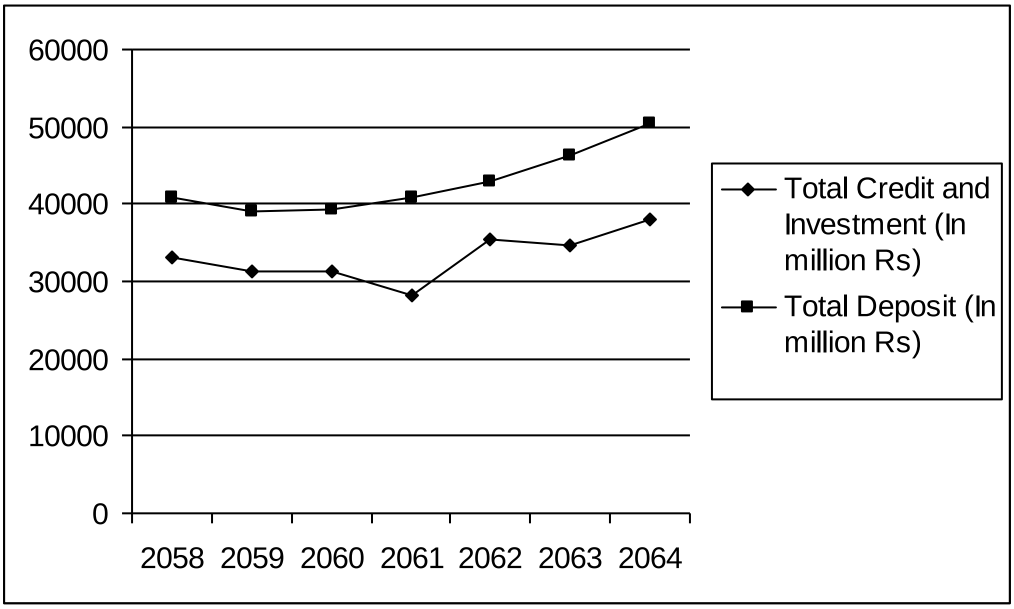
Table No 23

Year	Total Credit and Investment (In million Rs)	Total Deposit (In million Rs)
Before initiation of F.S.R.P.		
2058	33022	40774
2059	31196	38993
After initiation of F.S.R.P.		
2060	31231	39402
2061	28223	40867
2062	35417	43016
2063	34730	46195
2064	38110	50346

Source : Appendix

Trend Analysis of Total Credit and Investment and Total Deposit

Figure No. 5



The above table no 23 and figure no 5 shows the trend of Total Credit and investment and total deposit of RBB of the seven years period from 2058 to 2064. The trend of Total Credit and investment and total deposit is same i.e. decreasing till 2059 be for initiation of F.S.R.P. But after initiation of F.S.R.P, though the total credit and investment is fluctuating over the whole period till 2064 out the trend of total deposit is increasing.

4.5 Analysis of Correlation Coefficient

4.5.1 Correlation Coefficient Analysis of Various Variables of Rastriya Banijya Bank

4.5.1.1 Correlation between Performing Loan and Non-performing Loan

Table No 26

Years	Performing Loan (In million Rs)	Non-performing Loan (In million Rs)
2057/58	14192	13183
2058/59	12148	14890
2059/60	10604	16004
2060/61	10635	14471
2061/62	13312	136869
2062/63	15055	8048
2063/64	17989	7405
CORRELATION (r)		-0.89461

Source : Appendix

Table no 26 depicts that the coefficient of correlation between performing assets and non-performing assets in R.B.B remained -0.89461 in the study period. It signifies that a negative relation occurs between the two components. The performing asset is increasing from the fiscal year 2059/60 but the non-performing asset is fluctuating. The increase in performing assets is good sign while increase in non-performing assets is bad for the bank.

4.5.1.2 correlation between Performing Assets and Net Profit

Table No 27

Years	Performing Loan (In million Rs)	Net Profit (In million Rs)
2057/58	14192	-7083.25
2058/59	12148	-7068.25
2059/60	10604	-4839.78
2060/61	10635	1040.101
2061/62	13312	1322.89
2062/63	15055	1592
2063/64	17989	1682
CORRELATION (r)		-0.23159

Source : Appendix

Table no 27 depicts the coefficient of correlation between performing assets and net profit in R.B.B. remained 0.23159. It indicates that the net profit and performing assets of the bank are negatively related. Furthermore, the bank can raise its net profit by increasing performing assets. In spite of fluctuation performing assets in the fiscal year 2060/61 and 2061/62 the bank has been able to register net profit in these years.

4.5.1.3 Correlation between Net Worth and Net Profit

Table No 28

Years	Net worth (In million Rs)	Net Profit (In million Rs)
2057/58	-10378	-7084
2058/59	-17450	-7068
2059/60	-22399	-4840
2060/61	-21437	1040
2061/62	-20100	1323
2062/63	-18719	1592
2063/64	-17213	1682
CORRELATION (r)		-0.6176

Source : Appendix

Table no 28 depicts that the coefficient of correlation of net worth and net profit in R.B.B. remained -0.61776. This implies that there is negative correlation between and net worth and net profit. In the fiscal year 2058 net worth was (10378) while net profit was (7084) in million Rs. In 2059 net profit decreased negatively with the increase of negative net worth. But in the fiscal year 2059/60 negative net profit decreased although the negative net worth increased. In the fiscal year 2060/61, 2061/62,, 2063 and 2064 the bank has been able to achieve net profit although it has negative net worth.

4.5.1.4 Correlation between Total Deposit and Loans and Advances

Table no 29

Years	Net worth (In million Rs)	Net Profit (In million Rs)
2057/58	40774	27376
2058/59	38943	20038
2059/60	39402	26608
2060/61	40867	25106
2061/62	43016	27001
2062/63	46195	23103
2063/64	50346	25394
CORRELATION (r)		0.00388

Source : Appendix

Table no 29 demonstrates that coefficient of correlation between the total deposit and loans and advances in R.B.B. remained 0.00388. It implies that the correlation between deposit and loans and advances of the bank is positive correlation. Loans and advances seem to decrease with the rise in the volume of total deposit till the fiscal year 2060/61. While the total deposit is increased even in the fiscal year 2060/62, 2063 and 2064 but the loan and advances is in fluctuated in the final years. Overall with the increase or decrease of deposit, the credit is not inside but fluctuated in these years.

4.6 Human Resources Development and Management

To improve efficiency of human resource through the planned development of the human resources, Rastriya Banijya Bank has implemented management plan, human resource development plan, skill enhancement plans. Staff need assessment has been done. Through the voluntary retirement plant employments number has been decreased up to 3417 from 3996 in the fiscal year 2061/62. Creative trainings have been provided to the employees while facilities of higher education have also been provided. Remuneration and other fringe benefits have been increased. To improve the performance evaluation system evaluation performance based evaluation is adopted while the double promotion has been started.

4.7 Information Technology

To improve the efficiency of the banking activities, computer are provided to the banks branches. Computer trainings have been provided to the employees. Loans are provided to the employees to purchase the computer. Banks branches are joined in the computer networks. To provide fast, accessible and reliable banking services to national and international level, SWIFT (society for worldwide international funds transfer) service is in operation

CHAPTER V
SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Extension of credit of the major activities of banks and financial institution. Credit usually represents the bulk of the institution's earning assets. Therefore, interest on credits is major source of income and profitability. Therefore,, quality credit management is a subject of crucial importance in the bank and financial institution to maintain sustainability and improving operational efficiency. Poor credit management and deterioration in the quality of loans give birth to NPLs. The internal measures play significant role to control the growth of NPLs. Best credit practices, culture and policies are required to strengthen the internal factors. The banks should have a proper system and competency on risk are accurately identified, assessed and controlled properly. A proper risk management is undoubtedly an important tool for a good banking and NPL's management.

For the analysis if relationship with NPL growth and expansion of credit it has been found that there is some relationship between credit expansion and increment of NPL. NBA is increased due to having NPL. But it is not certain that NPL always creates NBA, as on some occasion bank may not auction the property or the auctioned property after acceptance of the same in the name of the bank in disposed off. Same time banks might have been sold some portion of NBA too.

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

After the analysis it was found that bad intention, weak monitoring, and mismanagement are the most responsible factor for NPL 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 NPL growth.

Further it was found that bad intension, weak monitoring and, mismanagement are the most responsible factor for NPL growth. Likewise, legal provision for recovery as a reason for increment in non-performing loan in Nepalese banks 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 commercial banks give highest priority to trade sector for lending its resources Thus, it is found that the service sector is not given much priority.

5.2 Major Findings

The chapter analyses the data, the factors, the articles, newspapers, journals and books related to the problem through using various measurement tools and techniques. Hence to find out the significance of the variables with respect to NDL, some statistical tools such as mean analysis, standard deviation and coefficient of variance analysis have been computed.

1. The reason of increase in the non-performing loan is weak follow up system in RBB. The follow up system is not effective in RBB that may also be one reason behind the increasing non - performing loan in RBB.
2. Bad intention, weak monitoring and mismanagement at the top level are the major reasons turning good loan into bad in RBB.
3. 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 shortfall on security were identified in an average level.
4. Legal provision for recovery as a reason for recovery as a reason for increment in non-performing assets in RBB. Weak supervision and monitoring is another reason.
5. Most of that important external reasons in increasing non-performing assets in RBB is recession, political and legal issues.
6. 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 NPL.
7. RBB gives priority to trade and industry sector for lending its resources.
8. RBB in recent days are facing several problems with increasing number of problems with the level of increasing NPL profitability performance of the bank has been badly affected. To find out the cause of NPL increment with commercial bank basis of loan floatation procedure, follow up practice carried out by the bank for the recovery of overdue loan outstanding internal

responsible factor causing NPL growth as well as external factor that has significant impact of NPL growth have been tried to sort out.

9. The relationship of borrowers with top management as the most basis for floating loan in RBB. Portfolio management consideration the second basis for floating loan in the certain sectors. Monitoring and control security offered and financial strength were given average emphasis. It is found that commercial banks are giving least weight on personal integrity of the borrower while giving loan.
10. The 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 RBB.
11. In regard to the internal responsible factor that contributes turning good loan into bad loan it was found that bad intention, weak monitoring and mismanagement are the most responsible factor for NAP growth. Similarly weak legal provision and credit concentration are found as the least preferred factor in turning good loan into bad. Such as lack of portfolio analysis not having effective credit policy and shortfall on security were identified as having average effect on NPL growth.
12. In connection to the external factors, it has beer found that recession, political and legal issues more relevant factors in turning good loan into bad. Likewise legal provision for recovery as a reason for increment in NPA in RBB has been found the factor having least impact, supervision and monitoring system have been identified are 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.
13. In some cases bank's policy to reward employees on the basis of loan target without considering the recovery aspect itself causes non-performing loan. Similarly the policy of the banks to provide rebate on interest in defaulted loan also provokes borrowers to postpone timely payment of interest and loan installments. In some case collusion between bankers and borrowers in the name of rehabilitation of sick units also aggravates the problem of non-performed loans.
14. Over optimism towards one's project and faulty project preparation with wrong demand projection and cash flow estimation on the part of the borrowers also creates non-performing loans. Borrowers' inability to judge downside risk and

their capability to bear such risk also make them vulnerable to downward swing in the economy.

15. Besides swings in macroeconomic factors, international scenarios, and unexpected events also lead to non-perform loans. Non-performing loans also arise due to the legal framework existing in the country.

5.3 Conclusion

Non-performing loan is a big problem not only to the financial institutions but also to the borrowers. While on one hand borrower must understand that loans obtained from financial institutions are saving of some one else and need to be repaid, financial institutions should also realize on the other that performance of business depends on many vagaries of business climate which are beyond the control of borrower and not all defaulters are willful. It is necessary to build a climate of trust and a climate for sound financial discipline where wrong-doers are penalized severely needs to be established. Maintaining financial disciple should go beyond loan defaulters and penalize any one who commits financial crime.

Growing non-performing assets is a primary reason for the negative net worth of the RBB. So the focus should be given to decrease the non-performing assets. To do this all the non-performing loans should be recovered. The management should show strong will to penalize the willful defaulters. Government should support the bank in its endeavor to recover all bad debts.

Present research is very much important to analysis caused and effect of NPL. Secondary information analysis found that profitability of RBB has been affected due to increasing level of NPL. Bad intention, weak monitoring, and mismanagement were found the major responsible factors for NPL growth.

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

5.4 Recommendation

Based on the above discussions and conclusion present research recommend few major solution to the authority, academicians, practitioners and bankers. Following are the recommendation to minimize the NPL level in RBB that may support to overcome NPL problems.

1. While disbursing loans to the client there should be the strong practice in RBB to float loans on the basis of the business position, scope of viability and business need. At the same time RBB is required to give proper attention on the personal integrity of

the borrower, too. It will prevent the possibility of lending to the purpose other than business required and as well as possibility of loan floatation to the willful defaulter. Further, the offered security should also be assessed properly as on the distress situation if the retained security is good then the loan can be recovered.

2. There should be strong follow up system in RBB 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 of follow up before the loans turn into bad loans. RBB should have proper attention towards the business position of the borrowers while floating loan.

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

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

5. One of the ways to face the problem of non-performing loans as adopted in many countries is to set up asset management companies (AMC). The function of AM are to purchase, restructure and sell the assets and receivables of financial institutions. Generally an AMC may (i) buy or sell assets or receivables of financial institutions, collect the purchase receivables and liquidate and restructure the purchased assets, (ii) provide consultancy services regarding the purchase, sale and restructure the purchased assets, (iii) Operate and issue securities, (iv) purchase subsidiaries, (v) invest in securities issued by other asset management companies, and provide consultancy services to companies regarding corporate and financial restructuring, and provide consultancy services to companies regarding corporate and financial restructuring, Setting up AMC makes the loan recovery business professional and

competitive, the government should grant such companies generous tax perks when acquiring bad assets from financial institutions and selling them onto the third parties.

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

7. Banks should be capable to resist the undue pressure created for floatation of loan from politicians and bureaucrats. It most of the banks it is experienced that there is regular pressure from these parties for granting loan without being choosy and selective thus, banks should not be influenced under such pressure for availing loans.

8. In order to initiate speedy enforcement of laws against defaulting borrower, a Debt Recovery Tribhunal has been set up in Nepal. As of May 2005 the tribunal has settled about 113 cases involving Rs. 989 million. Some of the cases reported in the tribunal include over valuation of collateral through collusion between the borrower and staff of financial institutions, loans sanctioned without any collateral or improper collateral etc. It is necessary the tribunal be made more effective and powerful in the process of recovering the debt.

9. Enactment of bankruptcy act will also help to some extent to solve the problem of non-performing assets by facilitating the loan recovery process.

10. There is the provision of black listing of borrowers having Rs. 2.5 million or more debt if.

(a) the interest and principal or any installment of the principal is overdue by nine months

(b) misuse of loan and facilities provided

(c) value of collateral is inadequate to cover up the loan amount.

(d) misuse of collateral

(e) disappearance of borrower

(f) borrower is declared bankrupt

(g) loan is not recovered despite notification

(h) case filed against the borrower.

(i) if borrower is involved in financial crime.

11. As is often cited one of the reasons for non-performing loans is also collusion between the borrower and staff of financial institutions in loan approval. It is very much necessary to improve the governance of financial institutions and make the staff involved in such collusion liable for the loss. Improvements are necessary not only at the middle level but also at the top level because the problem of non-performing loans is acute due to large borrowers.

Securitization of debt and proper enforcement of laws and regulations also help to reduce the magnitude of non-performing loans.

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APPENDIX

<u>Mid - July (Asadh End)</u>

(Rs. In Million)

S.N.	Particulars	A.D.2007	2006	2005	2004	20
		B.S.2064	**2063**	**2062**	**2061**	**20**
1	Performing Loan	17989	15055	13312	10635	10
2	Non-Performing Loan	**7505**	**8048**	**13689**	**14471**	**16**
3	Total Assets	47911	49010	56822	45056	43
4	Loans Loss Provision	6804	8441	13570	14275	14
5	Total Loan	**25394**	**23103**	**27001**	**25106**	**26**
6	Pass Loan Provision	253	141	125	428	9
7	Provision for substandard loan	18	57	124	157	2
8	total Sub Standard Loan	**78**	**255**	**519**	**708**	**14**
9	Provision for doubtful debt	58	189	264	788	19
10	Total doubtful debt	128	389	582	1794	42
11	Provision for bad debt (loss)	**6028**	**6851**	**11919**	**11422**	**99**
12	Total bad debt	7199	7404	12588	11969	10
13	Interest expenses	839	850	1005	1495	21
14	Total expenses (Interest staff to their)	**2102**	**1884**	**2050**	**2631**	**50**
15	Interest Income	2355	2283	2320	2236	20
16	Credit (Principal) & investment	38110	34730	35417	28223	31
17	Total interest income	**2355**	**2283**	**2329**	**2236**	**20**
18	Total Revenue	4240	4298	3510	3766	23
19	Net Profit after tax	1682	1592	1323	1040	-4
20	Net loan and advances	**18590**	**14662**	**13431**	**10631**	**11**
21	Current assets	6171	5229	5553	7119	44
22	Current liabilities	12537	17176	29788	35552	26
23	Cash and bank balance	**6151**	**5229**	**5553**	**7019**	**37**
24	Total Deposit	50346	46195	43016	40867	39
25	Total Credit (Principal)	25394	23103	27001	25106	26
26	Net Worth (Share Cap. + Res. fund)	-17213	-18719	-20200	-21437	-22