A Comparative Study on – "Nepalese Commercial Banks"

"A Comparative Study on NRB Directives and its Implementation In Nepalese Commercial Banks"

Submitted By
Mila Barahi
MBS, Roll No.: 556/061
T.U. Regd. No. 7-1-258-43-99
Shanker Dev Campus

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RECOMMENDATION

This is to certify that the thesis:

Submitted by

Mila Barahi
Shanker Dev Campus

T.U. Regd. No. 7-1-258-43-99

MBS Roll No.: 556/061

entitled

"A Comparative Study on Implementation of Nepal Rastra Bank's Directives in Nepalese Commercial Banks"

(A case study of Everest Bank Ltd., Nepal Bangladesh Bank Ltd. and Lumbini Bank Ltd.)

has been prepared and approved by this department in the prescribed format of Faculty of Management. This thesis is forwarded for examination

………………………………
Prof. Bal Krishna Man Suwal
Shaker Dev Campus
Thesis Supervisor

…………………………………
Mr. Ghanendra Fago
Shanker Dev Campus
Thesis Supervisor

……………………………………
Campus Chief
Shanker Dev Campus

Ref No. ……….. Date : ……………………

VIVA VOCE SHEET

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

Mila Barahi
Shanker Dev Campus

T.U. Regd. No. 7-1-258-43-99

MBS Roll No.: 556/061

entitled

"A Comparative Study on Implementation of Nepal Rastra Bank's Directives in Nepalese Commercial Banks"

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and found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for

Master Degree in Business Studies (M.B.S)

<u>Viva-Voce Committee</u>

Head of Research Department: ………………………………

Member (Thesis Supervisor): ………………………………

Member (Thesis Supervisor): ………………………………..

Member (External Expert) : …………………………………

Date:

Declaration

I hereby declare that the work done in this thesis entitled "A Comparative Study on NRB Directives and its Implementation in Nepalese Commercial Banks" that has been submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original research work prepared in the form of partial fulfillment of the requirement of Master of Business Studies (M.B.S.) under the guidance and supervision of Prof Bal Krishna Man Suwal and Mr. Ghanendra Fago, Shanker Dev Campus, Tribhuvan University.

Mila Barahi

Date:……………………

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Mila Barahi

Date :

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LIST OF ABBREVIATION

A.D.	Anno Domini
ADB	Agricultural Development Bank
Adv.	Advances
BP	Bills Purchase
B.S.	Bikram Sambat
BFIRD	Bank and Financial Institutions Regulation Department
CA	Capital Adequacy
CAR	Capital Adequacy Ratio
CB	Commercial Bank
CEO	Chief Executive Officer
Chap.	Chapter
CIB	Credit Information Bureau
CRR	Cash Reserve Ratio
Dev.	Development
EBL	Everest Bank Limited
Ed.	Edition
Etc	Etcetera
Fig.	Figure
FY	Fiscal Year
HMG	His Majesty Government
ICD	Inland Container Depot
INGO	International Non Government Organization
Jan.	January
JVB	Joint Venture Bank
KP.	Kathmandu Post
LBL	Lumbini Bank Limited
Ltd.	Limited
NBBL	Nepal Bangladesh Bank Limited
NBL	Nepal Bank Limited
NGO	Non Government Organization
No.	Number

NPA	Non-Performing Asset
NPL	Non- Performing Loan
NRB	Nepal Rastra Bank
P.	Page
pc	Percentage
PL / Ac	Profit Loss Account
PNB	Punjab National Bank
RBBL	Rastriya Banijya Bank Limited
RRDB	Regional Rural Development Banks
Rs.	Rupees
RWA	Risk Weighted Assets
SAARC	South Asian Association of Regional Cooperation
SCT	Smart Choice Technology
Sep.	September
TRWA	Total Risk Weighted Assets
TU	Tribhuvan University
UAE	United Arab Emirates
UK	United Kingdom
Vol.	Volume
W.r.t.	With Respect To
Wt.	Weight
www	World Wide Web

Chapter One
Introduction

1.1 Focus of the Study

Nepal is a developing country with an agricultural economy. 8 out of 10 Nepalese are engaged in farming and it accounts for about 38% of the GDP, (Mrs. Pradhan & Mrs. Shrestha, 2004:64). In recent years, the country's efforts to expand into manufacturing industries and other technological sectors are in a progress. Farming is the main economic activity followed by manufacturing, trade and tourism. The chief sources of foreign currency earnings are merchandised export, services, tourism and remittances. In the absence of a stable political environment, structural reforms have been delayed, new investments are sluggish, pervasive weaknesses in the fiscal and financial sectors persist, and a backdrop for sustained economic growth has been impaired. Repeated threats to business and industrial communities and growing industrial insecurity have added uncertainties to long-term investment in the country.

Nepal's foreign trade is growingly re-concentrating towards India. Till mid 1980s, about half of the country's trade used to be concentrated with India. By the end of the 1980s, the share of India in Nepal's total trade came down to a quarter. In the recent years, both exports to and imports from India are growing at faster rate than the overall growth. Healthy growth of the trade and financial sector is essential for sustainable economic development since it plays the important role of efficiently allocating funds. Allowing the financial sector to play its important role in Nepal's economic development necessitates financial sector reforms. Towards this goal, Nepal has initiated a financial reform project in association with the Asian Development Bank. So far, an examination of the status and the planned management change of major government owned banks have been carried out. Additionally, a study on reforms of the banking regulation to strengthen the supervisory function of the Nepal Rastra Bank (NRB) has also been completed. All these reforms are aimed towards having the financial sector which play crucial role in economic development of Nepal. While the progress of these financial sector reforms thus far has been satisfactory, challenges like growing non-performing assets, high operational expenses, and narrow banking coverage exist in the financial system.

Banking system is becoming much important to meet more effectively and adequately, the needs of the development of the economy and to promote the welfare of the people's. Commercial banks are the heart of the modern business. They pool together the savings of the community and arrange for their productive use. They act as bridge between the two parties of society (I.E. money borrowers and lenders). They have significant role in the smooth functioning of economy. Accepting deposits is the most important function of commercial banks and the deposits collected from the customers are the main source of the required fund of banks.

In fact, banks played a pioneering role in the enhancement of economy of the country and hence, it is the life-blood of the modern commerce and can be said that modern commerce is so much dependent upon banking that any cessation of banking activities even, for a couple of day will completely paralyze the modern business and economic life of a nation. Modern bank had gained paramount trust in the public.

After the restoration of multiparty democracy, openness and liberalization policy in the financial system several commercial banks started its business and at present commercial banks hold a large share of economic activities of the country. Not only in the numbers of financial institutions, have the significant improvements also been seen in the quality of services and technologies of the Nepalese financial system. Most of the financial institutions have been automated. Advanced technologies such as Internet banking, mobile banking, ATM cards facility, Credit cards, Visa cards, Master cards has been started to be adopted. The products or services offered are not limited up to deposits and credits only but has also been extended up to safe deposit lockers, door-step facilities etc.

The bank is offering so many products and facilities to its customers. Nepalese people have also started feeling the need of banking and banking facilities. But as most of the Nepalese are living under the poverty line and more that 30% of Nepalese are illiterate, developing banking habit among these people has become a challenging job, Banking facilities are accessible only to urban areas and its accessibility to rural areas is nominal. Even in urban areas there are lots of willful defaulters who hesitate to return back the loan amount. As on Mid-July 2007, the Non-Performing Loan of the Commercial banks stood at 1.06 % of the total loan amount (30.40% on 2002). In conclusion, banking sector in Nepal has entered a developing era but still there are lots of stages of development to pass by.

The deposit mobilization of the commercial banks reached to 3263644.30 lakhs (Banking and financial statistics). This is not a small amount , so it needs to be secured and for this NRB, the Central Bank of Nepal has to play a pioneer role. Central bank being the leader of entire banking system needs to maintain the financial sector stable. So for the effective functioning of the commercial banks, central bank issues some directives to the commercial banks. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public credibility towards it.
Commercial Banks have not only increased in number but has also increased in figures and financial indicators.

The size of the total assets of the financial sector has been increased significantly over the last six and half years. But the market share of banks and non banking financial institutions has not changed in a huge range. Still, commercial banking sector is holding a dominant position in financial market. Of the total asset and liabilities of financial sector, 85.43% has been held by commercial banks till mid-January 2007. Commercial Banks and development banks altogether held 88.81% of total assets/liabilities of the financial system. In mid-Jan 2007, the share to the total assets of financial system owned by development banks and others were 3.38% 8.53% , 1.83% and 0.83% respectively.

Under mentioned table shows the profitability and the Non-Performing Loans of commercial banks reflecting the soundness of Commercial Banks:

Table-1.1

Indication of Sound Indicators of Commercial Banks

Indicators	**Mid-July**						**Mid Jan 2007**
	2001	2002	2003	2004	2005	2006	
Profitability (in million)	-7843	-9428	-3317	3707	5205	7983.51	3395.9
NPL as Percentage of Total loan	29.3	30.4	28.8	22.8	18.94	14.22	14.08

Above table shows the negative profitability and Non-Performing Loans of Commercial banks in initial periods. This negative figure is mainly due to the huge loss and bad debts suffered by two giant banks, Nepal Bank Ltd. and Rastriya Banijya Bank. However the successful restructuring of these banks in later periods resulted in better performance of whole commercial banking system. Till mid-July 2003, the banking system was facing a continuous losses trend. But it turned to post a net profit of Rs. 3707 million in mid-July2004 which further increased to Rs. 5205 million in 2005 and to Rs. 7983.51 million in 2006; it declined to Rs. 3395.9 million in mid Jan 2007. (Banking and Financial Statistics, 2007).

The credit for this significant growth in the Commercial Banking activities goes to Nepal Rastra Bank. The two huge commercial banks – Nepal Bank Ltd. and Rastriya Banijya Bank had almost gone to bankruptcy because of Non-Performing Loans. But they again regained their strength as they were guided by the policies of NRB known as the ***NRB directives.***

The study is intended towards measuring the success of these NRB directives and for these purpose three banks, Everest Bank Ltd, Lumbini Bank Ltd. and Nepal Bangladesh Bank Ltd which represents almost 13% of the total population has been selected.

1.2 Introduction of Nepal Rastra Bank

1.2.1 Introduction

Nepal Rastra Bank (NRB), the central bank of Nepal, was established in 1956 A.D. (2013 B.S) as per NRB act 2012. It was established to discharge the central banking responsibilities including guiding the development of the embryonic domestic financial sector. Since then, there has been a huge growth in both the number and the activities of the domestic financial institutions.

To reflect this dynamic environment, the functions and objectives of the Bank have been recast by the new NRB Act of 2002, the preamble of which lays down the primary functions of the Bank as:

- To formulate necessary monetary and foreign exchange policies
- To maintain the stability in price and consolidate the balance of payments for sustainable development of the economy of the Kingdom of Nepal;
- To develop a secure, healthy and efficient system of payments; to make appropriate supervision of the banking and financial system in order to maintain its stability and foster, its healthy development;
- And to further enhance the public confidence in Nepal's entire banking and financial system.

For the achievement of the above objectives in the present dynamic environment, sustained progress and continued reform of the financial sector and management and supervision of the monetary and credit system of the country is of utmost importance. In order to exercise adequate control and supervision over the banking and credit system of the country, NRB has been given wide regulatory responsibility under the various provisions of the following legislations:

1. Nepal Rastra Bank Act 2012 B.S (1955 AD), 2058 B.S
2. Commercial bank act 2031 BS (1974 AD)
3. Foreign exchange act 2019 B.S (1962 AD)
4. Bank and Financial Institutions ordinance, 2060 B.S
5. Bank and Financial Institutions Debt Recovery Act, 2058 B.S(2002 A.D)

The regulatory responsibilities are performed by the following departments of the bank:

1 Banking operation department

2 Inspection and supervision department

3 Foreign exchange department

4 Development finance department

Vision:
"A modern, dynamic, credible and effective Central Bank"

Mission
"To maintain macro-economic stability through sound and effective monetary, foreign exchange and financial sector policies."

Objectives:

- Formulate necessary monetary and foreign exchange policies in order to maintain the price stability and balance of payment for sustainable development of the economy and manage it.
- Promote stability and ensure liquidity required by the banking and financial sector
- Develop a secure, healthy and efficient payments system.
- Regulate, inspect, supervise and monitor the banking and financial system;
- Promote and develop the overall banking and financial system and enhance its public credibility.

1.2.2 Nepal Rastra Bank Directives

Since the establishment of Nepal Rastra Bank, there has been a huge growth in both the number and the activities of the domestic financial institutions. As the result of the significant growth in the financial sector of Nepal, the necessity had emerged to control the activities of the financial institutions to generate healthy competition and to uplift the economy of the country. NRB as the central bank of the country is entrusted

with responsibility of management and supervision of the monetary and credit system of the country. The NRB Act 1955 introduced in 1955 has empowered NRB to supervise and control the financial institutions' activities and can direct them for the necessary improvements. NRB for this purpose has introduced a defined set of rules which all the financial institutions of Nepal must abide with. These rules and regulations issued by Nepal Rastra Bank are known as the directives of Nepal Rastra Bank.

NRB has issued its set of directives directing in ten sectors to the commercial banks so as to strengthen the commercial banking institutions, ensure corporate governance, consolidate their financial situation, improve the people's confidence in them and contribute to the overall health and stability of the financial system. The directives related to different areas of regulation are as follows:

- Maintenance of minimum capital fund
- Loan classification and loan loss provisioning
- Limit of credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy
- Accounting policies and formats of financial statements
- Minimization of risk,
- Good corporate governance
- Time-frame for implementation of regulatory directives issued in connection with inspection and supervision of bank
- Investment in shares and securities
- Statistics reporting by commercial bank to NRB
- Regulation relating to transfer or sale of promoter's share of the banks.

NRB has also issued directives to the finance companies, development banks and co-operatives with the views of bringing about the desirable institutional growth and operational improvements in the non-bank financial structure. Minimum paid-up capital requirement has been increased for the commercial banks, development banks, finance companies and co-operatives for the near future. Inspection manual has been prepared for the effectiveness of the inspection and supervision of the commercial banks and other financial institutions. Training programmes have also been implemented for the

same purpose. In-house central banking modernization activities, as a part of financial sector reform, are proceeding in full swing in NRB. IMF technical assistance has also been utilized for this purpose.

However, this study is concentrated only to the directives of NRB related with Capital Adequacy, Loan Classification and Provisioning. Only three commercial banks, Everest Bank Ltd., Lumbini Bank Ltd. and Nepal Bangladesh Bank Ltd. have been taken for the case study.

1.3 Introduction of Selected Banks for Study

Everest Bank Ltd.

Everest Bank Ltd. (EBL) was established in 1994 and started its operations with a view and objective of extending professionalized and efficient banking services to various segments of the society. EBL joined hands with Punjab National Bank (PNB), India as its joint venture partner in 1997. PNB is the largest Public Sector Bank of India having 109 years of banking history with more than 4400 branches allover India and is known for its strong systems and procedures and a distinct work culture.

The Paid-Up Capital has increased to 5180 lakhs against the Authorized Capital of 6000 lakhs and the Issued Capital of the Bank is around 5298 lakhs till 16th July 2006 (Annual Report of EBL, 2005/06). The local Nepalese promoters hold 50 % stake in the Bank's equity, while 20% of the equity is contributed by joint venture partner PNB whereas remaining 30% is held by the public.

Its operating profit have grown by 20.79% during the fiscal year 2062/63, the net profit has increased by 38.88%. The average credit growth has been over 28.30% reaching a figure of 10136.2 million, deposits having reached a figure of 13802.4 Million. A notable feature of the bank's achievement is its containment of NPAs with gross NPAs restricted to 1.72% of the total credit whereas net NPA is reduced to 0.8%.

The bank provides a wide range of banking facilities through a wide network of 24 branches covering all the 5 regions of the country and over more than 250 reputed correspondent banks across the globe. All the branches inside and outside the valley are interconnected through Anywhere Branch Banking Systems (ABBS), a facility which enables its customers to do banking transactions from any of these branches irrespective of their having accounts in the other branch.

Being a pioneer in opening a representative office in New Delhi, India, EBL has successfully taken another historical step in the banking history of the country. EBL is playing a pivotal role in facilitating remittance to and from across globe. The bank has a Drafts Drawing Arrangement with more than 175 branches of PNB all over India. The bank is also offering Cash Management System for managing the funds of corporate exporting to India by collecting their funds from about 183 locations in India. With the aim to help Nepalese citizens working abroad, the bank entered into arrangements with banks and finance companies in different countries which enable quick remittance of funds by the Nepalese citizens in countries like UAE, Kuwait, Bahrain, Qatar, Saudi Arabia, Malaysia, Singapore and U.K.

Not to be left behind in technology advancement, a continuous review and upgrading of the technology is undertaken for the convenience of its customers. The bank has also introduced "EBL Debit Card". The bank has tied up with Smart Choice Technology (SCT) for ATM switch shoring. Beside this, the bank has also linked up its ATM services with PNB, India which has made it possible to use EBL Debit Cards in ATM terminals in Indian and PNB Debit cards in Nepalese terminals.

Recognizing the value of offering a complete range of services to corporate as well as individual customers, EBL has pioneered in extending various customer friendly products such as Home Loan, Education Loan, EBL Flexi Loan, EBL Property Plus (Future Lease Rentals), Home Equity Loan, Car Loan, Loan Against Shares, Loan Against Shares, Loan Against Life Insurance Policies and Loan for Professionals.

Serving the valued customers and the society for 13 years means knowing each other better, building relationships, bonding as partners in progress and will continue working with each other by meeting customer's expectations. Thus, the outstanding performance and the commitment to the customer satisfaction have earned bank the reputation of being "The Name You Can Bank Upon".

Table - 1.2
Capital Structure of Everest Bank Ltd. (In Lakhs "00000")

Authorized Capital	10000.00
Issued Capital	7298.00
Paid Up Capital	5180.00

(Source: Annual Report of EBL, 2006/07)

Table - 1.3
Share Holding Pattern of Everest Bank Ltd.

Types	Percentage	Amount Rs.
Nepalese promoters	50%	190080000
Punjab National Bank	20%	76032000
General Public	30%	111888000

(Source: Annual Report of EBL, 2006/07)

The local Nepalese promoters hold 50% stake in the Bank's equity, while 20% of equity is contributed by joint venture partner PNB and remaining 30% is held by the public.

Nepal Bangladesh Bank Ltd.

Nepal Bangladesh Bank Ltd. was established in June 1994 with an authorized capital of Rs. 240 million and Paid up capital of Rs. 60 million and as a Joint Venture Bank with International Finance Investment and Commerce Bank Limited (IFIC Bank Ltd.) of Bangladesh. The bank's Head Office is situated at New Baneshwor, Bijuli Bazar, Kathmandu. -The bank has introduced its first ATM facility at Kathmandu Plaza, Putali Sadak Branch to give 24 hours 365 days banking services to their valued costumers.

Top Exporters and Importers of the country have established banking relationship with the Bank with a substantial volume of foreign business which has enhanced the Bank's popularity in the International Trade front. Bank has developed Agency and Correspondent relationship with more than 200 prominent Foreign Banks in the world.

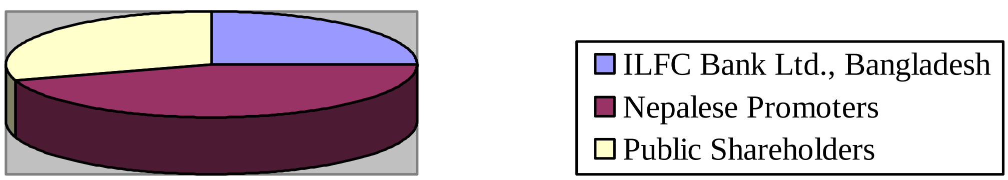
The prime objective of this Bank is to render banking services to the different sectors like industries, traders, businessmen, priority sector, small entrepreneurs and weaker section of the society and every other people who need Banking Services. During the successful stint of its 13 years of operation, it has accommodated a large number of clients and has been able to provide excellent services to its clients through a wide network of 17 branches. The bank is always focused towards providing effective, efficient and quality services to its valued customers.

The Shareholding Pattern of NBBL is as under:

- ILFC Bank Ltd., Bangladesh 25%
- Nepalese Promoters 45%
- Public Shareholders 30%

Fig – 1.1

Share Holding Pattern of NBBL



Based on the un-audited financial result of FY 2062/063, the bank accumulated a total deposit of Rs 13015.14 million and extended its' credit facilities up to Rs 9796.38 million Similarly, the bank has recorded a net loss of 14566.36 lakhs as on Ashad end 2063 (Source: NB Bank, www.nrb.org.np, NB Bank brochures).

Lumbini Bank Ltd.

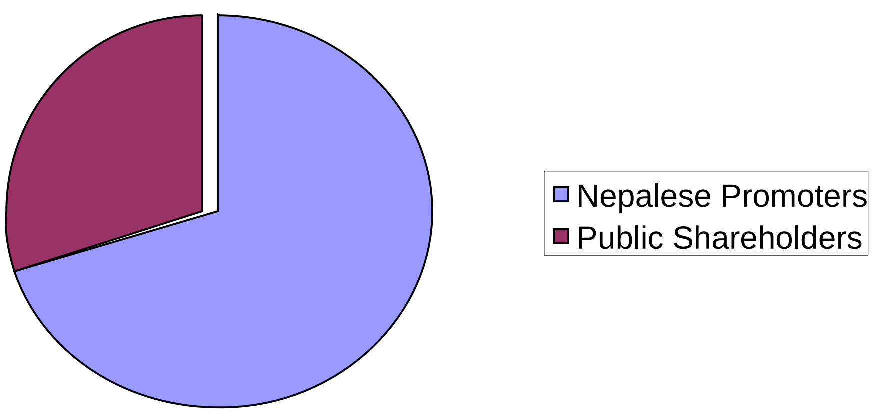
Lumbini Bank Ltd. was established on 2054 B.S in the investment of Nepalese investors with an authorized capital of Rs. 1000 million and paid up capital of Rs. 35 million. It started its operations from 2056/02/28. Its corporate office is situated in Durbarmarg, Kathmandu and its central office is in Narayangarh. Currently, the bank is operating with paid up capital of Rs. 600 million and the branches have been opened in Durbarmarg, Narayangarh, Hetauda, Butwal and Biratnagar.

The Shareholding Pattern of LBL is as under:

Nepalese Promoters	70.00%
Public Shareholders	30.00%

Fig – 1.2

Share holding pattern of LBL



In f.y 2063/64, the bank has achieved more than targeted progress in its management plan. In comparison to the target, it has achieved 10.29% excess in its total deposit, 6.49% in its total loan and 10.74% excess in its net profit.

As per the annual report of LBL for f.y 063/64, total deposits collected by the bank is Rs. 6024.60 million and has extended the loan amount of Rs. 3840.69 million. The bank has made the net profit of Rs. 192.40 million in f.y 063/64.

The main target of the bank for the fore coming years has been to organize the improvements made and to provide continuity to such improvements further as well as to increase the income of the bank by develop the new sources of income. Loan administration will be further improved to decrease the NPL ratio. Different Procedural Manuals will be formulated and implemented.

The bank has been giving special importance to Information Technology. Management Information System is being made more efficient. Budgetary Control Mechanism is being implemented in the bank more effectively. The long term goal of the bank has been establish Lumbini Bank as one of the financial strong and well established financial institution of the nation

1.4 Statement of the Problem

The current economic scenario of the country is worsening. Still there is a mushrooming growth of commercial banks in private sector as well as in joint venture. The number of competitors is large and area to serve is limited. Under such circumstances a fierce competition has been raised among the financial institutions with regular increase in number of financial institutions. Despite the competition and increase in the number of players for the same market, most of the commercial banks are generating higher profits than that in previous years. This indicates that there may be offering of uneconomic rate of interest, indulging in risky enterprises, unhealthy competition etc. Such situation may endanger the deposits of general public. Hence it is imperative to scrutinize the performance of these commercial banks.

In order to safeguard the public deposits and ensure the economic stability in the country, NRB issues Directives time to time. The directives are related to various performances of the banks and the banks are required to follow the directives.

The directives thus issued by NRB, if not addressed properly, have potential to wreck the financial system of the country, as they are only the tools of NRB to supervise and monitor the activities of the financial institutions. It must be formulated taking into consideration, the positive as well as negative impact on the commercial banks. Issue of wrong or unsuitable directives may ruin the conditions of commercial banks instead of enhancing its situation.

NRB takes necessary actions to ensure that its recent directives have been compelled by all commercial banks equally. Any activities operated by the financial institutions deviating from these guidelines will be penalized by the central bank (NRB) that may range from reprimanding to snatching the license of the institutions. Because of the strict policy of NRB, the financial system has gained momentum not only in the number of institutions but also has helped them to improvise their quality by reducing the unnecessary risks and unfair market competition.

In the beginning due to lack of proper regulations Nepalese Commercial Banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector faced the problem of bad debts, overdue loans, accrued interest, accumulation of non-banking assets and excess liquidity in the banking system. Viewing the need of structural reform amidst these adverse implications, NRB felt it must to issue suitable directives to run commercial banks in a healthy competitive environment to ensure the sustainable developments of the overall banking system.

In the year 2001, NRB issued a set of directives to commercial banks consisting of nine parts; claiming that these directives are based on internationally accepted banking norms of Basel Committee. NRB ordered the commercial banks to increase its authorized capital to Rs. 1 billion which was almost impossible for Nepalese commercial banks. Such regulation may have negative impact on commercial banks and may ruin the conditions of commercial banks. Later on commercial banks were allowed to comply with the norms, stage by stage within specific time period. So the impact of NRB Directives must be regularly studied and examined so that the shortcoming in the directives can be eliminated and healthy directives are ruled. However there is no specific period when NRB may change their directives. They introduce new directives, amend the necessary ones and remove the existing directives any time as deemed necessary by them. Because of this, the commercial banks are facing difficulty in implementing the directives in a proper manner.

The problem of this study is to find out whether Everest Bank Ltd. Lumbini Bank Ltd and Nepal Bangladesh Bank Ltd., which represents almost 13% of the total population, implement the directives issued by Nepal Rastra Bank regularly or not and an attempt has been done to make comparative study between the banks with respect to Capital Adequacy, Loan Classification and Provisioning along with the changing directives.

In conclusion, following are the questions that may rise while discussing the impacts of NRB Directives in Nepalese financial context:

- To which extent the NRB Directives have succeeded to safeguard the public deposits and ensure the economic stability in the country.
- To which extent the guidelines issued by NRB have the positive or negative impact on commercial banks as issue of wrong or unsuitable directives may ruin the conditions of commercial banks instead of enhancing its situation.
- To which extent NRB has been ensured that the directives thus issued by it are being followed by the commercial banks because the issued directives, unless and until followed up strictly can't yield desired output.

1.5 Objectives of the Study

The main objective of the research is to examine the implementation of NRB Directives by the selected Commercial Bank related to Capital Adequacy, Loan Classification and Provisioning in their activities.

Other specific objectives are as follows:

- To conclude the impact of NRB Directives on safety of general public's deposit and on enhancement of the situation of commercial bank's situation.
- To make a comparative study between Everest Bank Ltd., Lumbini Bank Ltd. and Nepal Bangladesh Bank Ltd. with respective to Capital Adequacy, Loan Classification and Provisioning as given in the directives of NRB.

1.6 Significance of the Study

NRB Directives being only the tools for NRB to supervise, monitor and control the financial institution, it obviously play important role in the development of commercial banks of Nepal. It is therefore, necessary to conduct a detail research on impact and implementation of NRB Directives from time to time. This research will help commercial banks to reassess their strategies and policies to cope with the development created by the recent changes made in the directives of NRB. It helps NRB to find out their shortcoming and take necessary actions.

Today, especially in developing countries, the financial system in general and the banking system in particular have been progressively oriented towards meeting national, socio-economic objectives, including rural development and upliftment of the weaker sections of the society.

As commercial banks and financial institutions play a vital role in the economy, their regulation and supervision by central bank is considered still more important aspect of sound monetary policy as effective, regulation and supervision leads banking industry to operate in a competent and constructive way. Realizing the fact, NRB had issued a set of guidelines to the financial institutions which is amended, added and removed as deemed necessary by NRB.

The directives of NRB, which regulate the functioning of financial institutions of Nepal, have the power to drive the financial system of the country. If these directives are formulated without proper groundwork, the players of the financial system may not be able to implement them and there may arise unfair competition in the market. Not only this, the development of the banks also largely depends upon these policies; the wrong formulation of which can create the financial crises in the country, deteriorating the economy of the country as a whole. The NRB directives thus shall not just focus on increasing the number of financial institutions but shall also focus on improving the quality of banking in Nepal. Also, formulating the policies in itself does not improve the quality of the banking. There should be a continuous monitoring if the policies designed is been able to attain it's objective or not. It has, therefore become imperative that a detail research study be taken on the directives of NRB and its' impact on the banks.

This research study, though small in size is expected to insight the effects of NRB directives on the commercial banks and the extent of their implementation. The comparative study among commercial banks will help the researchers, investors, creditors and other stakeholders to analyze the financial position of the firm.Further, without any doubt, this research study will be very helpful to other researchers for similar studies.

1.7 Limitations of the Study

The effort has been made to present and analyze the fact clearly, truly and within the boundary. But reliability of tools, lack of research experience, and lack of data are the primary limitation of this report. Other limitations are:

- The research is confined to only three commercial banks of Nepal; Everest Bank Ltd, Lumbini Bank Ltd and Nepal Bangladesh Bank Ltd. Hence the conclusion drawn from this study may be limited for universal application.
- NRB, the Central Bank, has set directives to the commercial banks, which are mainly related to the capital, loans, deposit and borrowing rates, exchange facilities, expansion and contraction of branches, investments, share proportions etc. All these directives are not included in the study. The study is focused at examining and analyzing the Norms and Standards laid by Nepal Rastra Bank only relating to;

  Capital Adequacy

  Loan Classification and Provisioning
- The study is focused on only three directives among eleven directives issued by NRB for commercial banks namely Capital Adequacy, Loan Classification and Provisioning on Credit and Introduction of stringent blacklisting procedure for loan defaulters.
- The findings of the study are based on direct interview and secondary data received from NRB and other commercial banks. It is maximum dependent upon interviews and secondary data rather than primary data.
- Among 23 commercial banks, the study is based on only three banks namely Everest Bank Ltd., Lumbini Bank Ltd. and Nepal Bangladesh Bank Ltd. Hence the result drawn from the study may not be applicable to other commercial banks.
- In some cases, independent assumption has been made; therefore the validity of results can be question marked.
- Past seven years data (Fiscal Year 2057/58 to 2062/63) are taken to study and analyze.

1.8 Organization of Studies

Chapter 1: Introduction:

This chapter includes Focus of the study, introduction of NRB, brief explanation of NRB Directives, introduction of selected commercial banks, statement of problem, objectives of the study, significance of the study and limitation of the study.

Chapter 2: Review of Literature:

This part of the chapter includes conceptual review, review of thesis and research gap.

Chapter 3 Research Methodology:

The method of conducting the research shall be explained in this part. Research design, Population and Sample, Nature and Sources of data, Data Collection procedures, research variables, method of data analysis, tools used for analysis and limitation of the methodology have been included in this chapter.

Chapter 4 Data Presentation and Analysis:

This chapter is the heart of research study. It deals with analysis of capital, comparison of capital adequacy ratio, loan classifications and provisions, Non-Performing asset and major findings of the study.

Chapter 5, Summary, Conclusion and Recommendations:

The last or fifth chapter will contain finding, summary, conclusion and recommendations of the thesis.

Chapter Two
Review of the Literature

This chapter includes Theoretical reviews and Reviews of the previous studies with respect to capital adequacy norms, loan classification and loan loss provision and blacklisting of willful defaulter. This is also devoted to theoretical analysis and brief review of related literature available, Journal, article review etc. This chapter includes the views of different persons regarding the financial sectors. The historical movements of NRB, an overview of the responsibilities and its changing roles to generate healthy competition in the market shall be reviewed. The directives set up by the NRB regarding capital adequacy, Loan classification and provisioning, time frame for implementing it and action against non-compliance shall be done in brief.

2.1 Conceptual Review

2.1.1 Concept of Bank

There is a general consensus among the economist that the stability and the efficient operation of the financial institutions, especially of commercials banks, are so important to the public that its failure in part or in substance would have a high economic cost. For this reason, the banking system is highly regulated.

The term '***bank***' though has become the backbone of every country; there is no consensus view about the origin of the word 'banking'. Vaidya, in his book, Banking and Insurance Management, 2001 mentioned that that the term bank is derived from the Latin word *bancus*, which refers to the bench on which the banker would keep its money and records. Some persons trance its origin to the French word 'Banquee' and the Italian word 'Banca' which means a bench for keeping, lending and exchanging of money or coins in the market place by moneylenders and moneychangers.

The ***central bank*** is the bank that control and supervise the activities of all the commercial banks of the country.

Kisch and Elkin have defined central banking as, “the maintenance of stability of the monetary standard which involves the control of the monetary circulation.” (Vaidya, Banking and Insurance Management, 2001)

Thus, the Central Bank is the highest authority for the monetary and banking structure of country and it performs distinct functions from those of commercial banks, industrial banks, agriculture banks, investment banks etc. It is the central bank that supplies currency and credit to all other existing banks and credit institutions of a country. It acts as a custodian of national economic interest as a banker’s bank and assist in the implementation of the economic policy of the government. It regulates and issues currency performs agency and banking services and manages the foreign currency reserve of the whole country. It also works as the lender of the last resort, clearing house service, and controls credits.

2.1.2 Review of Nepal Rastra Bank Directives

Central Bank being the leader of entire banking system needs to maintain the financial sector stable. So for the effective functioning of the commercial banks, central bank issues some guidelines to the commercial banks, which we called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public credibility towards it..

The financial sector reform of Nepal was initiated in mid 1980s and from then onwards Nepal Rastra Bank has been playing pioneer role by issuing guidelines to the financial sector. At present the number of guidelines issued by Nepal Rastra Bank to commercial bank reaches eleven which are as follows:

Directive no. 1: The provision of minimum Capital fund to be maintained by the commercial banks.

Directive no. 2: The provision of Loan Classification and Loan Loss Provisioning on the Credit.

Directive no. 3: The provision relating to single borrower limit.

Directive no. 4: The provision of accounting policy and the structure of financial statements to be followed by the commercial banks.

Directive no. 5: Minimization of risk inherent in the activities of commercial banks.

Directive no. 6: The provision of institutional good governance to be followed by commercial banks.

Directive no. 7: Time frame for implementation of regulatory directives issued in connection with inspection and supervision and supervision of the commercial banks.

Directive no. 8: Time frame for implementation of regulator directives issued in connection with inspection and supervision and supervision of the commercial banks.

Directive no. 9: The provision of submission of statistical data to the Nepal Rastra Bank, Banking Management Division and Inspection and supervision Division.

Directive no. 10: The provision of sale and re-registration of foundation shares of commercial banks.

Directive no. 11: Introduction of stringent blacklisting procedure for loan defaulters.

2.1.3 Role of NRB for Regulatory and Supervisory

Central Bank has power and full authority to supervise and regulate the banking sector. The main objective of supervising the banks is to establish financially sound, well managed banks not posing a threat to the interest of their depositors. A central bank makes rules, issues instructions from time to time.

NRB as a central bank has been empowered by the NRB act 1955 to supervise and control the commercial banking operations and to direct necessary movements. For this NRB established Banking Operation and Development Department in 1966 A.D to effectively mobilize the capital for promoting industry and the banking system. In December 1974 AD, Agriculture Loans Department and Industrial Loans Department were merged and the Department was renamed as Banking Operation and Loans Department. Again in 1986 AD, it was divided into two different departments namely Bank Operation and Development Finance Department. In 2002 A.D, it came in its present form of Bank and Financial Institutions Regulation Department (BFIRD).

The main function of the BFIRD include steering the financial sector reform, providing license to banks and financial institutions, issuing regulations and directives to the banks and financials institutions, refinancing the commercial banks to rehabilitate and sick industries, devising laws relating to banks and financial institutions and make timely amendments, compiling, processing and publishing the data on banking and financial sectors.

But making the rules and regulations is not sufficient for making the national economy sound. A system must supervise the activities continuously and strictly without which there always exists a fear of exploitation to the public by these banks. The Bank's Inspection and Supervision Department and the regulation department carry out this responsibility (NRB annual publication in its 34th Anniversary, 2046 B.S).

Various financial innovations introduced by a number of financial institutions in recent years in a more competitive manner have significant impact on the formulation and implementation of monetary policy. These new instruments if have widened the scope of choices for customers then they also have altered the definition and measurement of the money which has important implications on the supervisory and examining roles of the central bank. Thus, it has become imperative for the central banks to keep pace with these developments and carry out their continuous monitoring.

Initially to ensure that the financial institutions of Nepal are operating according to the NRB directives, NRB used to inspect the banks only once in a year and the inspection was limited to the foreign transactions only. Later on, the bank prepared a comprehensive manual for the inspection with many objectives. Generally NRB inspect the commercial banks by two methods:

1 Off-Site Inspection
2 On-Site Inspection

Off Site Inspection

This inspection involves the financial analysis of the banks on the basis of profit and loss account, balance sheet and other data received by the central banks. This inspection reviews and analyzes the matters like Capital Adequacy, Cash Reserve Ratio (CRR) requirement, loan classification and provisioning profitability, priority and deprived sector credit etc.

On Site Inspection

Under this method, the inspector or the team of inspection visits the commercial banks and carries out the direct inspection. It provides the independent check on the bank's operations, income and expenses, provisioning for expenses etc are inspected to assure that they comply with the existing rules.

The central bank then prepares the report on findings and finds out the deviations if any. In case of irregularities and deviations, instructions are given to rectify them. If any bank violates such instructions, the actions taken may range from reprimanding to snatching the license. The take over of Lumbini Bank by NRB directives, where NRB dissolved the existing board of directives of the bank and brought the management under its own control is a glaring example of the action taken against a commercial bank by the central bank.

Another important role of central bank as a regulator and promoter of financial sector is to assist the problem of financial institutions and their resuscitation. In this context, central bank has become more alert for the safety and soundness of banks and financial institutions to command public trust and confidence.

NRB's ongoing re-engineering to upgrade its inspection, supervision and regulation capacity at par with the international standard is another important of the reform process. Improved central bank supervision and regulation can do much to revitalize not only the financial system by focusing on the quality of assets, but also by identifying problem and ascertaining financial conditions of the banks, Hence, NRB has directed its attention towards the analysis of solvency, profitability, risk exposure and the operational procedures.

The functions of the Department have been guided by its goal to develop a healthy, transparent and competitive financial system in the country. In this connection, it has issued a new directive to the commercial banks and financial institutions on Credit Information and Black Listing of defaulting borrowers.

2.1.4 Capital Adequacy and Directives of NRB

How much capital is required to be maintained by a commercial bank is the subject matter of discussion since a long time. Holding too much capital than its requirement may have lower return from their investment and similarly holding too little capital may mean reverse of the former. So there must be optimum level of capital in a bank. While deciding on an optimum level of capital, several factors are to be taken into consideration. So it is worthwhile to know the meaning of capital and terms related to it.

Meaning of Capital

Capital can be defined as the money invested in the business. It is required to conduct the business activities and is the primary requirement for initiation of business.

"Capital is a stock of resources that may be employed in the production of goods and services and the price paid for the use of credit or money, respectively."(Microsoft Encarta reference Library, 2003).

Accordingly, effective from 16th July 2001 (1st Shrawan 2058 B.S) capital of the bank has been categorized into two parts by NRB as follows: (Source : www.nrb.org.np)

1 **Tier-1 Capital/ Core Capital**, which consists following components:

- **a.** Paid up capital
- **b.** Share premium
- **c.** Non-Redeemable Preference Share
- **d.** General Reserve Fund
- **e.** Accumulated Profit and Loss Account
- **f.** Capital Redemption Reserve
- **g.** Other free Reserve

Tier one capital is capital which is permanently and freely available to absorb losses without the bank being obliged to cease trading. An example of tier one capital is the ordinary share capital of the bank Tier one capital is important because it safeguards both the survival of the bank and the stability of the financial system.

2 **Tier – 2 Capital / Supplementary Capital**, which consists following components:

a. General Loan Loss Provision(GLLP)

Under this head, provision made only against the Pass loan shall be included. The full amount of excess provisioning made against the pass, substandard, doubtful and bad than those prescribed by NRB, as well as loan loss provision made against restructuring and rescheduling loan can be included as the additional loan loss provision under supplementary capital. Previously, the total amount of loan loss provision made for all the six categories of loan used to be included in the supplementary capital but now with the new directives, the amount of general loan loss provision shall be included in the supplementary capital as per the following time table.

Table – 2.1

Provision Available for Inclusion in the Supplementary Capital.

Time Table	**Provision for inclusion in the Supplementary Capital**
FY (058/59)	Pass, Sub-standard and Doubtful Loans.
FY(059/60)	Pass and Substandard.
FY (060/61 – 062/063)	Pass Loan

b. Asset Revaluation Reserve:

The amount of Assets Revaluation Reserve can be included for the purpose of calculating Supplementary Capital subject up to 2% of the Total Supplementary Capital, inclusive of the amount of this Reserve.

c. Hybrid Capital Instruments:

This includes the following instruments that have the characteristics of both debt and equity.

1) Unsecured, Fully paid up instruments issued by the banks that are subordinated to (priority of payment after) depositors and creditors, and available to absorbed losses as well as convertible into ordinary capital.

2) Instruments, which are non-redeemable at the option of the holder except with the approval of Nepal Rastra Bank.

3) Perpetual or long-term preference stock (shares) convertible to common stock if the profit and loss account becomes negative.

However, the licensed institutions cannot hold (purchase) Hybrid Capital Instruments issued by another licensed institution.

d. Unsecured Subordinated Term Debt

It includes unsecured and subordinated debt instruments (priority of payment after the depositors) with a minimum maturity term of over five years and limited life redeemable preference shares. To reflect the diminishing value of these instruments, a discount (amortization) factor of 20 percent during the last five years shall be applied. The issue of these instruments by banks shall not exceed 50 percent of their core capital.

Further other components that are included in supplementary Capital are:

a. Interest Rate Fluctuation Fund

b. Other Free Reserves (Investment Adjustment Reserve etc) not allocated for specific reserves.

Tier two capital is capital which generally absorbs losses only in the event of a winding-up of a bank, and so provides a lower level for protection for depositors and other creditors. It comes into play in absorbing losses after tier one capital has been lost by the bank. An example of tier two capital is subordinated debt. This debt ranks in priority behind all creditors except shareholders. In the event of a winding-up, subordinated debt holders will only be repaid if all other creditors (including depositors) have been already repaid.

Note:

- GLLP up to 1.25% of total risk weighted assets is considered as Supplementary capital.
- Gain from revaluation of asset is transferred to Asset Revaluation Reserve but fund in Asset Revaluation Reserve up to 2% of Supplementary Capital is treated as Supplementary Capital.
- If the average interest spread between deposit and loan exceeds 5%, the excess interest is to be deposited in Interest Spread Reserve/ Interest Rate Fluctuation Fund.

2.1.4.1 Need and Maintenance of Capital Fund

The sum of core capital and supplementary capital is called Total capital fund. Capital Adequacy Ratio is calculated on the basis of core capital, supplementary capital and risk weighted assets.

Clark (1999) has defined Capital Adequacy as a legal requirement that a financial institution should have enough capital to meet all its obligations and fund the services it offers.

Shrestha, R L (2006) in his article on '**Capital Adequacy of a Bank: the Nepalese Context**' opines that the main objective of the capital base is to have the capacity to absorb loss. So it should be at such a level, which is sufficient to absorb probable loss. Degree of probable loss refers to the risk. Thus, progressive nations have linked capital adequacy with the level of risk associated with the bank. . In some countries, it is related with the liabilities side of the balance sheet while some countries consider both liabilities and assets side of the balance sheet for deciding capital adequacy. Most of the countries are following the standard international practice for maintaining the capital known as BASEL. The basic norms of BASEL are defined in the later sections.

The central bank of Nepal has come up with its commitment to adopt Basel II from year 2007. (NRB Publication-Banking Pravardhan, 2006, P 73)

However, though the capital adequacy ratios are above the minimum levels recommended by the Basel Capital Accord, the safety of banks can't be guaranteed because Capital Adequacy ratios are concerned primarily with credit risks. There are the risks that Capital Adequacy ratios don't recognize, such as: probabilities of losses due to internal frauds, losses on trading different financial instruments etc. So Capital Adequacy ratios are not the sole indicators to judge a bank's financial soundness.

2.1.4.2 Capital Fund Ratio and NRB Provision for Maintenance of Capital

Capital adequacy ratio is the ratio which determines the capacity of the bank in terms of meeting the time liabilities and other risks such as credit risk, operational risk etc, and are a measure of the amount of a bank's capital expressed as a percentage of its risk-weighted credit exposures. It is the ratio of a bank's capital to its Risk- weighted assets. It is sometimes abbreviated as CAR, where CAR = capital / total assets. It is also known as CRAR abbreviated as capital to risk weighted assets ratio.

The provision of minimum Capital Fund to be maintained by the commercial banks as per directed by NRB since fiscal year 2058/059 are as follows:

Table - 2.2
Capital Fund to be maintained

Time Limit	Capital Fund in % on the basis of Total Risk Weighted Assets		
	Core Capital	Supplementary Capital	Capital Fund
F.Y 2058/059	4.5	4.5	9.0
F.Y 2059/060	5.0	5.0	10.0
F.Y 2060/61	5.5	5.5	11.0
From F.Y 2061/062 onwards	6	6	12.0

Banks are required to submit the report of Capital Adequacy along with other required data related with it, on a quarterly basis within one month from the end of each quarter starting from Ashwin, Poush, Chaitra and Ashadh of every fiscal year. In case capital adequacy ratio is found shortfall, banks are required to cover the shortfall within next six months by the way of reallocating assets or by issuing new share or by appropriating from the net profit. While increasing its paid-up capital, it should increase its paid-up capital at least by 10% per year.Action against not fulfilling the requirement of Capital Adequacy Ratio:

- Prohibition on opening of new branch,
- Prohibition on loan distribution,
- Prohibition on accepting new deposits,
- Refinancing facility from NRB is not provided, and
- Any other actions may also be initiated under section 100 of Nepal Rastra Bank Act – 2058.

$$\text{Capital Adequacy Ratio} = \frac{\text{Core Capital + Supplementary Capital}}{\text{Sum of Risk Weighted Assets}} \times 100$$

2.1.4.3 NRB Directives Regarding Capital Adequacy Ratio

As per NRB Directives effective from F.Y. 2062/63 (2005/06), the licensed institutions shall maintain minimum capital fund on the basis of their risk-weighted assets in order to safeguard the money of the depositors against any possible loss. The risk-weighted assets have also been classified into two components:

a) On-Balance Sheet Risk-Weighted Assets
b) Off-Balance Sheet Risk-Weighted items.

Banks are required to maintain capital adequacy mainly in three different ways, the core capital adequacy ratio, the supplementary capital adequacy ratio and the total capital adequacy ratio. The reporting requirement of capital fund, time period for fulfilling the shortfall in capital fund and actins for not complying the directives relating to capital fund have been mentioned in the NRB Directives issued under the prudential norms/regulations.

For the calculation of capital fund ratio, first, the bank shall calculate the total risk weighted assets. Both the on balance sheet and the off balance sheet assets shall be considered for the purpose of calculation of total risk weighted assets.

For determining the Total Risk-Weighted on Balance Assets, the amount as exhibited in the balance sheet assets shall be multiplied by their respective risk-weights and then added together. For the purpose of calculation of risk-weighted assets, the gross value of the assets shall be considered. Accordingly, for determining the Total Risk-Weighted off Balance Sheet assets, the amount of such transactions shall be multiplied by their respective risk-weights and then added together. More the liquidity and risk, more is the weightage and vice versa.
The total risk weighted assets is calculated as follows:

$$\text{CAR} = \frac{\text{Core Capital + Supplementary Capital}}{\text{Sum of risk weighted assets}} \times 100$$

Sum of risk-weighted assets = Total on-Balance sheet risk weighted assets + Total off-Balance sheet risk weighted items.

a) Risk-Weighted On Balance-Sheet Assets

For the purpose of calculation of Capital Fund, the On-Balance Sheet Assets are divided as follows with assignment of separate risk weightage. Accordingly, for determining the Total Risk-Weighted Assets, the amount as exhibited in the balance sheet assets shall be multiplied by their respective risk-weights and then added together.

Table – 2.3

Risk –Weighted On-Balance Sheet Items

On Balance Sheet Assets	**Risk weightage %**
Cash Balance. Stock of Gold Balance with Nepal Rastra Bank. Investments in Govt. securities. Investments in Nepal Rastra Bank Bonds. Fully secured loan against own Fixed Deposit Receipt Fully secured loan against Govt. Securities Accrued interest on Savings Bond	0%
Balances with Domestic and Financial Institutions. Balance with Foreign Banks. Money at call. Other investments with internationally rated/ foreign banks	20%
Investments in share, Debenture and Bonds. Investment in Public (Govt.owned) Enterprises. Other Investments. Loans, Advances & Bill Purchased/ Discounted. Fixed Assets. All other Assets.	100%

b) Risk Weighted Off -Balance Sheet Assets

For the purpose of calculation of capital fund, the Off-Balance Sheet items are divided as follows with assignment of separate risk weightage. Accordingly, for determining the Total Risk-Weighted off Balance Sheet assets, the amount of such transactions shall be multiplied by their respective risk-weights and then added together.

Table – 2.4

Risk –Weighted Off –Balance Sheet Items.

Particulars of Off-Balance Sheet Items.	**Risk Weightage (%)**
Bills Collection	0
Forward foreign exchange contract	10
L/C with maturity of less than 6 months (full value)	20
Guarantee provided against counter guarantee of internationally rated/ foreign banks.	20
L/Cs with maturity of more than 6 months (full value)	50
Bid Bond	50
Performance Bond	50
Advance Payment Guarantee	100
Financial Guarantee	100
Other Guarantee	100
Irrevocable loan commitment	100
Contingent liability in respect of Income Tax	100
All other contingent liabilities	100

2.1.4.4 The Basel Capital Accord

The "Basel Committee" (centered in the Bank for International Settlements), which was originally established in 1974, is a committee that represents central banks and financial supervisory authorities of the major industrialized countries (the G10 countries). The committee is concerned with ensuring the effective supervision of banks on a global basis by setting and promoting international standards. Its principal interest has been in the area of Capital Adequacy ratios. In 1988, the committee issued a statement of principles dealing with Capital Adequacy ratios. This statement is known as the "Basel Capital Accord". It contains a recommended approach for calculating capital adequacy ratios and recommended minimum capital adequacy ratios for international banks. The Accord was developed in order to improve capital adequacy ratios (which were considered to be too low in some banks) and to help standardize international regulatory practice. The Basel Accord is adopted by the central banks of more than 100 countries as a basis of risk management.

2.1.5 Loan and Loan Loss Provision

In short, loan means money lent at interest. In commerce and finance term Loan is used as the transfer of money or other property on promise of repayment along with interest, usually at a fixed future date. Loan loss provision is an arrangement made in order to safeguard from bankruptcy if loaned amount is not recovered or if the debtors default on repayment of loan. It provides buffer against future unexpected losses.

Loan and advances are the most profitable of all the assets of a commercial bank. This is the primary source of income and the most profitable of all the assets of the bank. Loan and advances account for the largest part of the revenue of the bank. But bank needs to be careful about the safety of such loan and advances because bank may be influenced by bad debts and since loan and advances are least liquid of the entire banker's assets it may feel difficult to realize them on short notice.

There are different types of loan and advances such as secured and unsecured loans. Those loans which are granted against the personal security of the borrower is secured loan i.e. against the promissory notes. While unsecured loan means they are not backed by any tangible assets or securities.

Effective from 16th July 2001 (1st Shrawan 2058 B.S), NRB has classified the loan and Advances on the basis of aging of the principle into four types.

- Pass Loan:Loans and advances not past due and past due up to 3 months shall be included in this category. These are classified and defined as performing loan,
- Sub-standard Loan: Loans and Advances past due for a period of over 3 months to 6 months.
- Doubtful Loan: Loans and Advances past due for a period of over 6 months to 1 year.
- Loss : Loans and advances past due for a period of over 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

All the loan and advances falling in the category of sub-standard, Doubtful and Losses are classified and defined as Non Performing Loan.

Banks shall as of the end of Ashoj, Poush, Chaitra and Ashadh prepare the statement of outstanding Loan and advances classified on the basis of aging and submit the particulars to the banking operation department and inspection and supervision department of NRB within one month from the end of each quarter.

Commercial banks should classify their loan and advances on the basis of following time table:

Table – 2.5

Classification of Loan and Advances for Different Phases

Classification	For FY 2058/59	For FY 2059/60	For FY 2060/61	For FY 2061/62 onwards.
Pass	Loans not past due and past due upto 3(three) months.	Loans not past due and past due upto 3(three) months.	Loans not past due and past due upto 3(three) months.	Loans not past due and past due upto 3(three) months.
Sub-Standard	Loans and advances past due for a period of over 3 months to 1 year.	Loans and advances past due for a period of over 3 months to 1 year.	Loans and advances past due for a period of over 3 months to 9 months.	Loans and advances past due for a period of over 3 months to 6 months.
Doubtful	Loans and advances past due for a period of over 1 year to 3 years.	Loans and advances past due for a period of over 1 year to 3 years.	Loans and advances past due for a period of over 9 months to 2 years.	Loans and advances past due for a period of over 6 months to 1 years.
Loss	Loans and advances past due for a period of over 3 years.	Loans and advances past due for a period of over 3 years.	Loans and advances past due for a period of over 2 years.	Loans and advances past due for a period of over 1 year.

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

- No security at all or security that is not in accordance with the borrower's agreement with the bank
- Borrower has been declared bankruptcy,
- Borrower was lost or cannot be found,
- Discounted bills not repayable within 90 days from due date,
- Loan and advances amount not used for the actual purposes,
- Blacklisted borrowers
- Project/ Business is not in condition to operate or not in operation.
- Credit card loan is not written-off within the 90 days from the due date.

Non-Performing Loan

NPL = Total loans – Good Loans

OR

NPL = Sub-Standard Loans + Doubtful Loans + Bad Loans

$$\text{NPA \%} = \frac{\text{NPL} \times 100}{\text{Total Loans}}$$

As per the NRB directives, a minimum of 12.5 percent provision shall be made on restructured or rescheduled loans. Similarly, in respect of restructuring or rescheduling of deprived sector loan and guaranteed or insured priority sector loan, the requisite provisioning shall be only 25 percent of the above rate. If the installment of principal and interest of restructured or rescheduled loan is serviced regularly for two consecutive years, such loan can be converted into PASS loan.

Consequences to Bank for Non-Compliances to NRB Directives

1 Re-classification of loan and advances and need to made loan loss provision of such loan and advances within three months,

2 Prohibition on declaration and distribution of dividend,

3 Prohibition on loan distribution and

4 Prohibition on accepting of new deposits.

The loan loss provisioning on the outstanding loans and advances and bills purchased shall be provided on the basis of classification made as per below:

Loan Category	Loan Loss Provision
Pass	1 Percent
Substandard	25 Percent
Doubtful	50 Percent
Loss	100 Percent

Based on the directives of NRB, a 100 percent loan loss provisioning shall be provided for the amount due from **black-listed** person.

Table – 2.6

Comparative Table of Loan Classification and Provisioning

Clause no. of new directive	Old Provision	New Provision
1	Classification to be made on aging basis for small loan and on the basis of certain ratios for other loans.	Classification to be made on the basis of aging only.
2.	A loan will be treated as bad loan if it is overdue by more than five years.	A loan will be treated as bad loan if it is overdue by more than one year.(The period of overdue has been reduced form three years in 2058/59 to one year in 2061/62).
2.	Loans are to be classified in six categories: Good loan 1% Acceptable 1% Indication of substandard loan 5% Substandard loan 25% Doubtful loan 50% Bad loan 100%	Loans are to be classified in four categories only. Pass loan 1% Substandard loan 25% Doubtful loan 50% Bad loan 100%

Restrictions on Extending Loan Facilities.

All the commercial banks must extend their loans and advances based on these rules. Some of the major rules are;

a) Extension of Loans to Priority Sector
b) Extension of Loans to Deprived Sector
c) Single Borrower Obligor Limit

a) Priority Sector Lending

At present, NRB requires commercial banks to allocate 12 percent of their total loan portfolio, including credit to deprived sector, for lending to the priority sectors. However, effective from FY 2064/65, investment in priority sector shall not be compulsory (Source: R. Bajracharya & Company, 2006, Directives of NRB Volume 2).

b) Deprived Sector Lending

All credits extended for the operation of self-employment oriented micro-enterprises for the upliftment of economic and social status of deprived sector up to the limit specified by Nepal Rastra Bank is termed as Deprived Sector Credit.

Each bank is specified with the requisite amount for extension of the advances to deprived sector lending.

c) Single Borrower Obligor Limit

NRB has permitted commercial banks to extend credit facilities to a single borrower or group related borrowers up to 25 percent of the core capital fund on fund based loans and for non fund based off-balance sheet facilities like letters of credit, guarantees, acceptances, up to 50 percent of its core capital fund.

2.2 Review of Thesis

Ranjit (1989) in the study has indicated that capital funds have positive and significant relation with both deposits and loans. Increase or decrease in capital fund increases or decreases deposits as well as loans. However the degree of relationship was different. The relation of capital with profit is positive and insignificant that indicates less of increase or decrease in profit is due to capital fund or capital fund is least responsible in changing profit. So bank should increase capital fund to increase the capital fund ratio according to its increased deposits.

Shrestha (2002) in the study concluded that NRB has to play more active role to enhance the operation of commercial banks. Strengthening and Institutionalization of the commercial banks are very important to have a meaningful relationship between commercial banks and national development through shift of credit to the productive industrial sectors. At the same time the series of reforms such as consolidation of commercial banks, directing attention to venture capital financing, appropriate risk return trade off by linking credit to timely repayment schedules, avoiding imperfections, allowing flexibility in lending , one window service from NRB, need of a strong supervision and monitoring from NRB diversity scope of activities of commercial banks, professional culture within commercial banks etc. all these are necessary to ensure better future performance of commercial banks that have already been established and growing in Nepal

Karmacharya (2002) has stated that financial soundness and strength of the company is largely dependent upon the composition of the capital structure and assets. The proportion of debt and equity capital should be decided keeping in mind the effort of tax advantages and financial distress. Maintaining the improved capital structure by increasing equity base i.e. by issuing more equity capital, expanding general reserve and retaining more earnings is advantageous. As mandated by NRB, for the operation in all over Nepal, a commercial bank should have paid up capital base of Rs. 500 million. Hence, the banks should raise its paid up capital to Rs. 500 million as soon as possible.

Pandey(2002), in the thesis ‘Impact and Implementation of NRB Directives’ has written that because of the new directives issued by NRB to the commercial banks, banks have to increase the operational cost and dividends to the shareholders & bonus to the employees are scaled down due to the decrease in the profit of the banks. The reporter has observed about the protection of the deposits of public because of the reduction in the loan exposure to the single unit, .the reporter states that due to the new directives, its foresight results lead to the banks financially healthy and stronger in future. Finally the reporter laid down about the changes in the directives will bring prosperity to the shareholders, depositors, employees and the economy of the country as a whole. The reporter has also suggested in his thesis to NRB that the NRB should issued directives only after doing the proper homework. NRB must strengthen the functioning of Credit Information Bureau. The NRB should be practical and should issue directives to be applicable in the context of Nepal, not only to meet the international standards. Otherwise complaints from commercial banks may arise. However, in the present context the commercial banks have to comply such directives and maintain its policies, failing which may suffer penalties of different category. The reporter has suggested NRB to try to avoid ambiguity in the directives that are found there in the present directives and to come up with straightforward directives leaving no loopholes that can be manipulated.

Shrestha (2003) in the thesis stated that raising and utilization of funds are the primary functions of commercial banks. Commercial banks collect a large amount of deposits from general public so in order to protect such deposits capital must be sufficient otherwise the banks will use all the money of depositors in their own interest and depositors will have to suffer loss. NRB being the central bank has to be responsible to give special attention to the interest of depositors. Capital adequacy norm is required to safeguard the money of the depositors as the banks are playing with the money they collected from the depositors.

The reporter also added that depositors are not aware of the fact of the necessity of adequate capital fund to safeguard their deposits. They deposit their money to any banks regardless of adequate capital fund which may endanger safety of their money. Therefore, NRB should initiate awareness programs to make the depositors aware of such fact and think before depositing money in any commercial banks.

The reporter further stated that NRB should consult to the various bank officials before setting or resetting standards on capital adequacy norms. The complaints and criticisms of bank officials should be considered accordingly. Consequently, an optimal standard will ensure which will satisfy almost everyone.

Shrestha (2007), in the thesis on Impact and Implementation of NRB Guidelines of Commercial Banks, concluded that all the changes in NRB Directive have made both positive and the negative impacts on the commercial banks. The research concluded that the new directives of NRB have more good output than the negative on various aspects of the banks.

Study has mentioned that the changed provisions have increased the provisioning amount for the commercial banks which has decreased the profitability of the banks. Due to the changed directive of Single Obligor limit, the loan exposure has been cut down to customers which resulted decrease in the interest income resulting decrease in the profit of commercial banks and less dividends could be given to the shareholders and bonus to the employees of the banks. Besides this, the need for the increment in the core capital increased the expenses of the commercial banks and the banks are facing the problem of increasing operating cost with the decreasing loan amount, restricting the increase in the profit of the banks.

However, the study finally concluded that the prudential vies of NRB though seemed rigorous to the commercial banks will ultimately give a positive impact in the long run of the banks. The report clarifies that the restriction of borrowing limit to a single party is done with a view of reducing the bad loans to a minimum level, protecting the banks from bankruptcy as well as protection of deposits of the depositors.

Report finally recommends the NRB to do homework before changing directives, to strengthen the Credit Information Bureau and while making rules for the commercial banks of Nepal, NRB shall not focus heavily towards meeting the International Standards but it should be applied in the context of Nepal.

2.3 Research Gap

All the above mentioned reports have derived more or less universally acceptable conclusions and have been proved to be significant to different sectors in their own places. But the studies are related only with either the impact of NRB directives on commercial banking or the compliance of the capital adequacy maintained by commercial banks with the guidance of NRB Directives. But it is not sufficient to discover whether directives do have positive or negative impact on commercial banking. It is equally important to check whether the issued directives are being followed properly or not. If despite of following the directives, commercial banks are not able to enhance their situation or their situation worsens instead of enhancing, we can conclude that the directives are not user friendly. Hence along with the impact of NRB Directives, it is also necessary to study the implementation part of NRB Directives.

In another hand, directives are not just related to capital adequacy. At present the number of guidelines issued by Nepal Rastra Bank to commercial bank reaches eleven. Hence it is necessary to include other sectors of the directives in order to know whether the directives do have positive impact on banks or whether the directives are actually being followed by the banks.

Finally none of the researches have studied the strictness in monitoring and supervision of commercial banks by NRB which is the main important aspect in impact and implementation of directives.

Current research will include both impact and implementation of NRB Directives in its study. The study has included different time periods during which the amendments have been brought in directives of NRB. Also, three different sectors of Directives: Capital Adequacy, Loan Loss Provision and Supervision and Monitoring have been included. Hence the researcher claims the study to be more broad and significant in comparison to the former ones.

Chapter Three
Research Methodology

3.1 Research Design

To achieve the stated objectives, descriptive cum analytical research methodology have been followed. Analytical research design has been used on analyzing the directives of NRB relating to capital adequacy, loan classification and provisioning of three joint ventures banks for the past seven years' period. Descriptive research design has been used for the conceptual formation of the problem and evaluate research design has been followed to evaluate the importance of the NRB Directives with respect to Capital Adequacy, Loan classification and provisioning.

3.2 Population and Sample Size

Population means the whole industry and for this study, three commercial banks operating in the country represent the total population. They are: Everest Bank Ltd., Lumbini Bank Ltd. and Nepal Bangladesh Bank Ltd. that represent 13.04% of the total population. These three commercial banks have been selected since they are comparable to each other in various aspects. For the comparison, the figures of seven fiscal years (2057/58 – 2063/64) of these banks has been taken into consideration.

3.3 Nature and Source of Data

The study is based mainly on the secondary data that are available in the published form. The sources are books, annual reports, newsletters of selected financial institutions, web site of NRB, published NRB Directives etc. Likewise, the articles published in professional journals/ newspapers have also been taken into consideration. The major secondary data used in this research study are the deposit, Loans & Advances, profits, Capitals, Risk Weighted Assets of the selected banks.

3.4 Data Collection Procedure

In order to make the study more authentic, different tools and techniques are used through out the study. Primary data has been obtained through direct interviews, field visits and telephonic inquires. Further, since this research has taken Everest Bank Limited as one of the samples and the researcher is the employee of the same bank;

various discussion has been done with the management team and the concerned employees of the EBL working under respective departments. The researcher has also made several visits to Nepal Bangladesh Bank and Lumbini Bank Ltd. for collecting various data and to ensure the same. The web sites of NRB, EBL, LBBL and NBBL have been browsed many times for the collection of the data.

For secondary data annual reports, broachers, newsletters etc. has been collected from different departments of concerned banks and websites were also used for downloading the necessary information. Various related publications of NRB were collected from concerned departments of NRB, Baluwatar. Similarly, reports of Credit Information Bureau (CIB) have been collected from office of CIB, Thapathali.

3.5 Research Variables

Research has used following variables to calculate the desired conclusions.

1. Core Capital

Core capital is capital which is permanently and freely available to absorb losses without the bank being obliged to cease trading. It is the summation of following components:

a. Paid up capital
b. Share premium
c. Non-Redeemable Preference Share
d. General Reserve Fund
e. Accumulated Profit and Loss Account
f. Capital Redemption Reserve
g. Other free Reserve

2. Supplementary Capital

Supplementary capital is capital which generally absorbs losses only in the event of a winding-up of a bank, and so provides a lower level for protection for depositors and other creditors. It is the summation of following components:

a. General Loan Loss Provision
b. Asset Revaluation Reserve
c. Hybrid Capital Instrument

d. Unsecured Subordinated Term Debt
e. Interest Rate Fluctuation Fund
f. Other Free Reserves

3. Total Capital Fund

Total Capital Fund is the summation of Total Core Capital and Total Supplementary Capital. Capital Adequacy Ratio is calculated on the basis of core capital, supplementary capital and risk weighted assets.

4. Risk Weighted Assets (TRWA)

Total Risk Weighted Asset is the summation of On-Balance Sheet Assets and Off Balance Sheet Assets. The amount of On-Balance Sheet Assets and Off Balance Assets are available in the annual reports of the selected banks.

5. Capital Adequacy Ratio

The Capital Adequacy Ratio is the ratio that implies the amount of Capital the bank need to maintain in comparison to its Risk Weighted Assets in order to protect the interest of depositors and creditors by making bank keep more risk-free assets and by increasing their capital base. It is comprised by dividing total capital fund (Core capital + Supplementary) by total Risk Weighted Assets.

6. Good Loan

Loans and advances not past due and past due up to 3 months shall be included in Good Loan Category. These are classified and defined as performing loan.

$$\text{Good Loan Percentage} = \frac{\text{Total Good Loan}}{\text{Total Loan and Advances}} \times 100\%$$

7. Substandard Loan

Loans and Advances past due for a period of over 3 months to 6 months are termed as Substandard Loan..

$$\text{Substandard Loan Percentage} = \frac{\text{Total Substandard Loan}}{\text{Total Loan and Advances}} \times 100\%$$

8. Doubtful Loan

Loans and Advances past due for a period of over 6 months to 1 year comes under this head.

$$\text{Doubtful Loan Percentage} = \frac{\text{Total Doubtful Loan}}{\text{Total Loan and Advances}} \times 100\%$$

9. Bad Loan

Loans and advances past due for a period of over 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

$$\text{Bad Loan Percentage} = \frac{\text{Total Bad Loan}}{\text{Total Loan and Advances}} \times 100\%$$

10. Loan Loss Provisioning

Loan loss provision signifies the cushion against future contingencies created by the default of the borrowers in the payment of loans and ensures the continued solvency of the banks. Since low ratio reflects the good quality of assets in the volume of total loan and advances and makes efforts to cope with probable loan loss and since high provision has to be made for Non performing loans, higher ratio implies, higher portion of NPL in the total loan portfolio.

It is calculated as follows:

$$\text{Loan loss provision to Total Loan and Advances} = \frac{\text{Loan Loss Provision}}{\text{Total Loan \& Advances}} \times 100\ \%$$

Similiarly,

$$\text{Good Loan Loss Provision \%} = \frac{\text{Total Good Loan Loss Provision (Rs.)}}{\text{Total Good Loan (Rs.)}} \times 100\ \%$$

$$\text{Substandard Loan Loss Provision\%} = \frac{\text{Total Substandard Loan Loss Provision(Rs.)}}{\text{Total Substandard Loan(Rs.)}} \times 100\%$$

$$\text{Doubtful Loan Loss Provision \%} = \frac{\text{Total Doubtful Loan Loss Provision(Rs.)}}{\text{Total Doubtful Loan(Rs.)}} \times 100\%$$

$$\text{Bad Loan Loss Provision \%} = \frac{\text{Total Bad Loan Loss Provision(Rs.)}}{\text{Total Bad Loan(Rs.)}} \times 100\%$$

11. Provision Held to Non-Performing Loan

This ratio is used to find out the provision held for Non-Performing Loan. This ratio measures up to what extent of risk inherent in NPL is covered by loan Loss Provision held for NPL. Since higher ratio safeguard against future contingencies that may create due to non performing loan, higher ratio is preferred by bank or in other words banks have cushion of provision to cope the problem that may be cause due to NPL.

It is calculated as follows:

$$\text{Provision held for NPL to NPL} = \frac{\text{Provision Held for NPL}}{\text{Non-Performing Loan}} \times 100\%$$

3.6 Method of Data Analysis

The data collected from different sources have been recorded systematically as necessary. Only useful and related data are grouped as per need of the research work. The raw fact we collect in any research is known as the raw data, which must be processed further to get information through which we do our analysis.

The collected data of the banks are presented in appropriate forms of tables, graphs and charts and their interpretation has also been done. For analysis of data appropriate mathematical, financial tools are used. Some of them are Ratio Analysis, Capital Adequacy Ratio, Provision held to NPL, Loan Loss Provision etc

The financial tools commonly used to conduct this research study are:

$$\text{CAR} = \frac{\text{Core Capital + Supplementary Capital}}{\text{Sum of Risk Weighted Assets}} \times 100$$

Sum of risk-weighted assets = Total on-Balance sheet risk weighted assets + Total off-Balance sheet risk weighted items.

Non Performing Loan = Total loans – Good Loans

OR

Non Performing Loan = Sub-Standard Loans + Doubtful Loans + Bad Loans

$$\text{Non – Performing Asset \%} = \frac{\text{Non Performing Loan} * 100}{\text{Total Loans}}$$

$$\text{Loan Loss Provision to Total Loan and Advances} = \frac{\text{Loan Loss Provision}}{\text{Total Loan \& Advances}} \times 100\,\%$$

3.7 Limitations of the Study

- The study has used only simple mathematical financial tools such as ratio analysis, graphs and charts. It doesn't include statistical tools.
- The study is limited to only three sectors of the whole NRB Directives i.e. Capital Adequacy, Loan Loss Provisioning and NRB's supervision and monitoring. It doesn't encompass the NRB Directives as a whole.
- Study is limited to only three commercial banks and their figures of seven fiscal years.

Chapter Four
Data Presentation and Analysis

This chapter is the heart of this research study and includes presentation of the data and the analysis of the same. The data has been arranged in the possible simplest manner so that it can be analyzed easily and for better understanding, these are also presented with tables, charts and graphs wherever possible. Also for more clarifications, the arranged data has been interpreted in the simplest language so that it can be easily understood by everyone.

Though there are many directives issued by NRB to the commercial banks, as stated earlier, this study is limited to the capital adequacy, Loan classification and provisioning with respect to the directives of NRB and for the study, three commercial banks of Nepal, Everest Bank Limited, Lumbini Bank Ltd. and Nepal Bangladesh Bank Limited has been taken into considerations as the sample banks and a comparative study has been done between these banks.

4.1 Analysis of Capital Adequacy Ratio

Applying the minimum capital adequacy ratio serves to protect the depositors and promote the stability and efficiency of financial system.

In order to analyze the Capital Adequacy Ratio, the study had to go through following calculation procedure:

4.1.1 Total Capital Fund

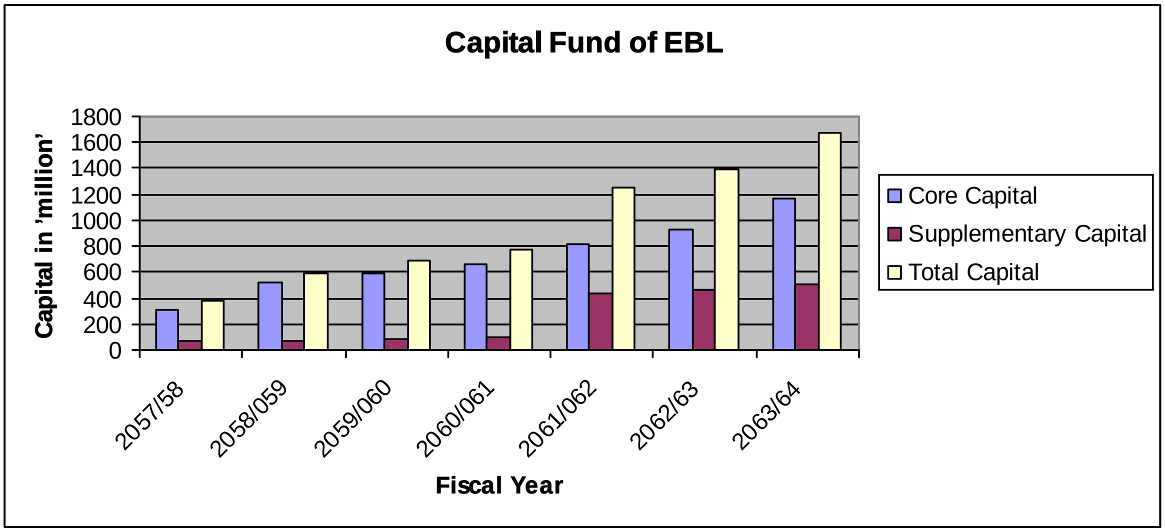
The total capital funds of Everest Bank Ltd. (EBL), Lumbini Bank Ltd. (LBL) and Nepal Bangladesh Bank Ltd. (NBBL) during last seven fiscal years are as under:

Table – 4.1

Total Capital Fund of EBL (Fig in million)

Particulars	2057/58	2058/59	2059/60	2060/61	2061/62	2062/63	2063/64
Total Core Capital (A)	310.67	516.64	597.01	663.27	815.57	927.55	1171.13
Total Supplementary Capital (B)	71.52	71.36	87.15	103.61	432.00	463.79	504.98
Total Capital Fund (A+B)	382.19	588.00	684.16	766.88	1,247.57	1391.34	1676.12

Fig – 4.1



The above data show that the capital fund, core capital and supplementary capital are in increasing trend. EBL has been increasing its Capital Funds by increasing its core capital than its supplementary capital consistently during the last five fiscal years. . The bank's Total Capital Fund has increased from Rs. 382.19 million in FY 2057/058 to Rs. 1676.12 million in FY 2063/64, thus increasing its total capital fund by net 338.56 pc. Similarly, the Core Capital and the Supplementary Capital of the bank has been increased from Rs. 310.67million and Rs. 71.52 million in FY 2057/58 to Rs. 1171.13 million and Rs. 504.93 million respectively in FY 2062/63. This represents an increment of 276.86% pc and 606 pc in the Core Capital and the Supplementary Capital of the bank during the last seven fiscal years (Source: Annexure - I). We can see that EBL has increased its capital fund by increasing its core capital than its supplementary capital. The portion of core capital in total fund is around 82.73 p.c in seven year average while that of supplementary capital is around 17.27 p.c only. It means contribution of core capital is more in growth of total capital fund Core capital play important role in safeguarding both the survival of the bank and stability of the financial system. So, commercial banks give more priority to core capital than to supplementary capital.

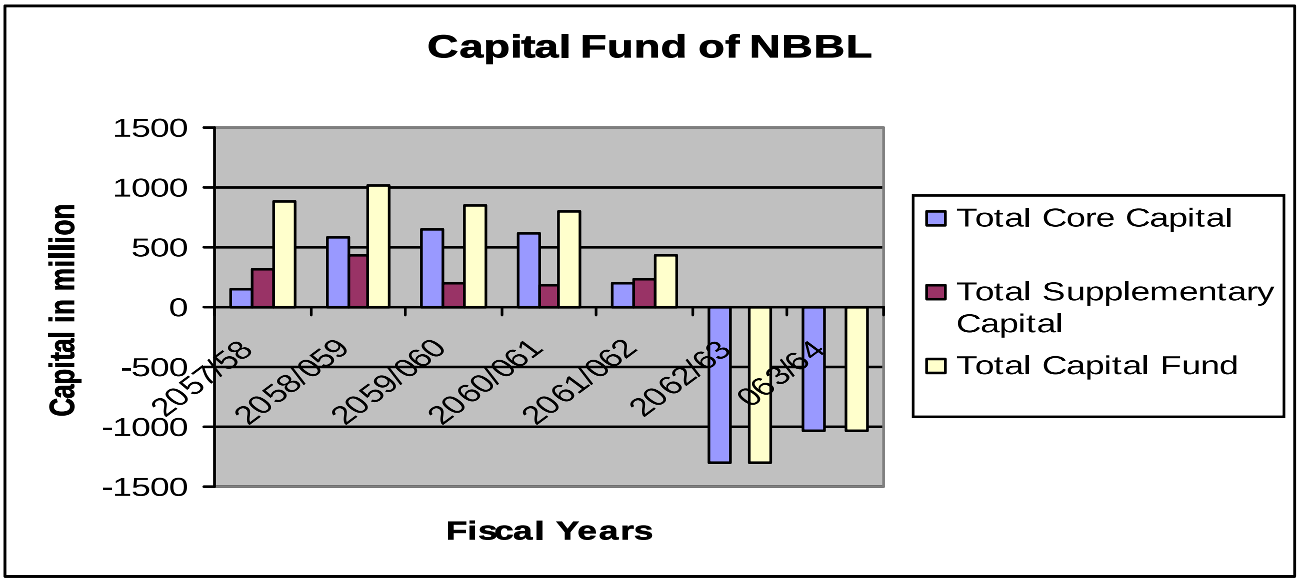
Table – 4.2

Total Capital Fund of NBBL (Fig in million)

Particulars	2057/58	2058/059	2059/060	2060/061	2061/062	2062/63	2063/64
Total Core Capital (A)	151.64	590.72	646.16	616.17	193.32	-1301.52	-1038.20
Total Supplementary Capital (B)	317.41	427.41	197.10	184.44	236.19	0	0
Total Capital Fund (A+B)	879.05	1,018.13	843.26	800.60	429.51	-1301.52	-1038.20

(Source: NBBL Annual Reports)

Fig – 4.2



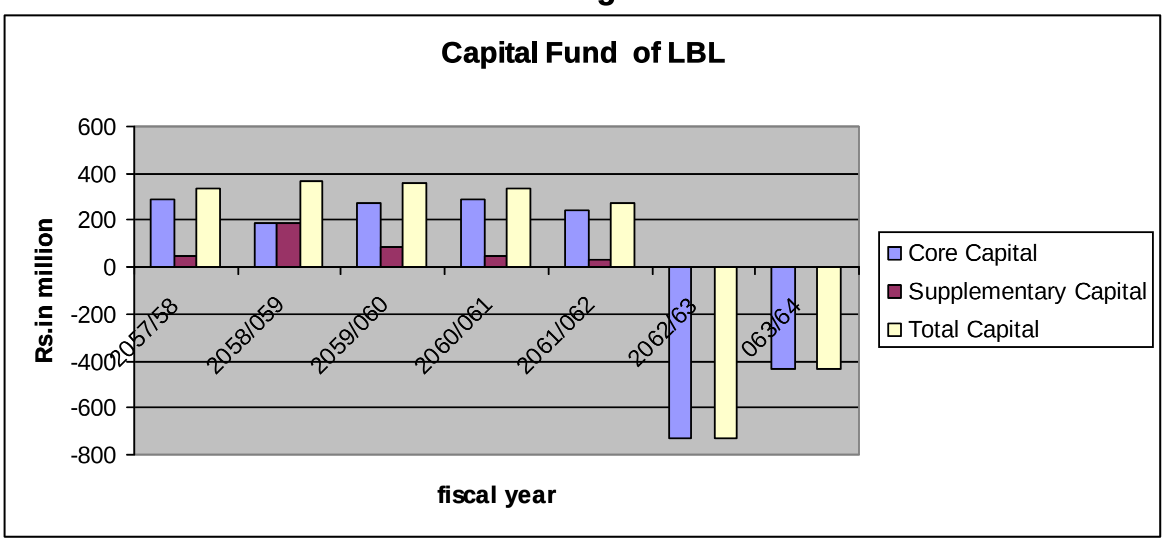
The above table shows that the total capital fund of Nepal Bangladesh Bank (NBBL) is in decreasing order for last seven years. The bank's Total Capital Fund has decreased from Rs 879.05 million in FY 2057/058 to Rs 429.51 million in FY 2061/062, thus decreasing its' total capital fund by net 51.14 pc. However, the Core Capital and the Supplementary Capital of the bank has been shown two-way trends. The Core Capital increased from Rs. 151.64 million in FY 2057/058 to Rs. 646.16 million in FY 2059/060 and then drastically decreased to Rs. 193.32 million in FY 2061/062. This represents the net decrement of 67.27 pc in the Core Capital. Similarly, the Supplementary Capital decreased from Rs. 317.41 million in FY 2057/58 to Rs. 184.44 million in FY 2060/061 and then increased to Rs. 236.19 million in FY 2061/062, resulting the net decrement of the Supplementary Capital by 9.24 pc during the period of f.y. 0574/58 to 061/62. In fiscal year 062/63, though bank had paid up capital of Rs.

719.85 million, Share Premium of Rs. 3.5 million, General Reserve Fund of Rs. 201.65 million and Capital Adjustment Fund of Rs. 803.65 million, after the adjustment of till last years' cumulative loss of Rs. 803.65 million and this year's evaluated net loss of Rs. 145.66 million, core capital and total Capital Fund has become negative i.e. -1301.523 million. The Core Capital Ratio and Capital Adequacy Ratio was -11.02%. Hence the net decrement in Core capital during seven years of study period is 784.65p.c and the decrement of Total Capital Fund during the same period is 218.11p.c.But a slight improvement has been seen in f.y 063/64 when the negative balance of core capital and capital fund decreased to Rs. 1038.20 million each. But still the Capital of the NBBL is negative and the CAR is insufficient in comparison to the NRB's standard. (Source: Annexure – II and www.nrb.org.np).

Table 4.3:
Total Capital Fund of LBL (Fig in million)

Particulars	2057/58	2058/59	2059/60	2060/61	2061/62	2062/63	063/64
Total Core Capital (A)	285.64	187.38	276.00	291.78	245.00	-727.94	-435.81
Total Supplementary Capital (B)	51.22	187.97	85.76	45.30	29.12	0	0
Total Capital Fund (A+B)	336.86	365.34	361.77	337.08	274.13	-727.94	-435.81

Fig-4.3



As per above table, the total capital fund and the supplementary capital of Lumbini Bank Ltd. has shown the two way trend but yet positive till f.y 061/62. The total capital fund has increased from Rs. 336.86 million in F.Y 057/58 to 365.34 million in f.y 058/59. But then decreased dramatically to Rs. 274.13 million on f.y 061/62 showing net decrement of 26.67 p.c. It further went negative then after and reached negative balance of Rs. 435.81 million in f..y 063/64. The supplementary capital decreased to Rs. 29.12 in f.y 063/647 from Rs. 51.22 million in f.y 057/58. The core capital is showing the fluctuating trend. It decreased from Rs. 285.64 million to Rs. 187.38 million in f.y 058/59 and again increased to Rs. 297.78 million in f.y 060/61. It decreased to Rs. 245.00 million in f.y 061/62 showing net decrement of 14.23% and then went negative to negative balance of Rs. 435.81 in f.y. 063/64. During the periods of negative balances of core capital and Total capital, the supplementary capital maintained by bank is nil. Lumbini Bank seems to be making the recovery of its losses as its cumulative loss decreased from Rs. 1245.37 million f.y 062/63 to Rs. 1091.45 million in f.y 063/64 which in turn increased its core capital and total capital. The net decrement of total capital fund of LBL during the period of seven years is 229.37p.c and the decrement of core capital during the same period is 252.57p.c.

The Core Capital Ratio and Capital Adequacy Ratio is -7.80%. Hence, the Capital of the LBL has shown the negative growth during last fiscal years and the CAR is insufficient in comparison to the NRB's standard.

4.1.2 Total Risk Weighted Assets (TRWA)

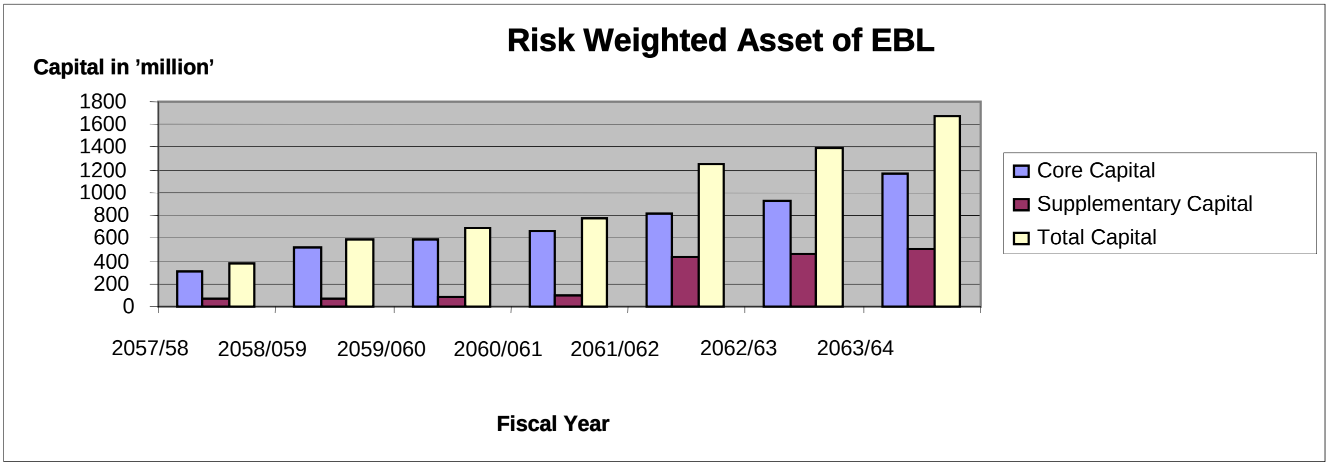
Total Risk Weighted Assets of EBL, LBL and NBBL have been shown below:

Table – 4.4

Total Risk Weighted Assets of EBL (Fig in million)

Particulars	2057/58	2058/059	2059/60	2060/61	2061/062	2062/63	2063/64
Total On-Balance Sheet Assets	3358.60	4,028.56	5,130.82	6,217.43	8,140.68	10476.98	14099.27
Total Off-Balance Sheet Assets	221.90	244.38	576.22	707.38	1,054.91	814.16	877.46
Total Risk Weighted Assets (TRWA)	3580.50	4,272.93	5,707.03	6,924.81	9,195.59	11291.34	14976.74

Fig – 4.4



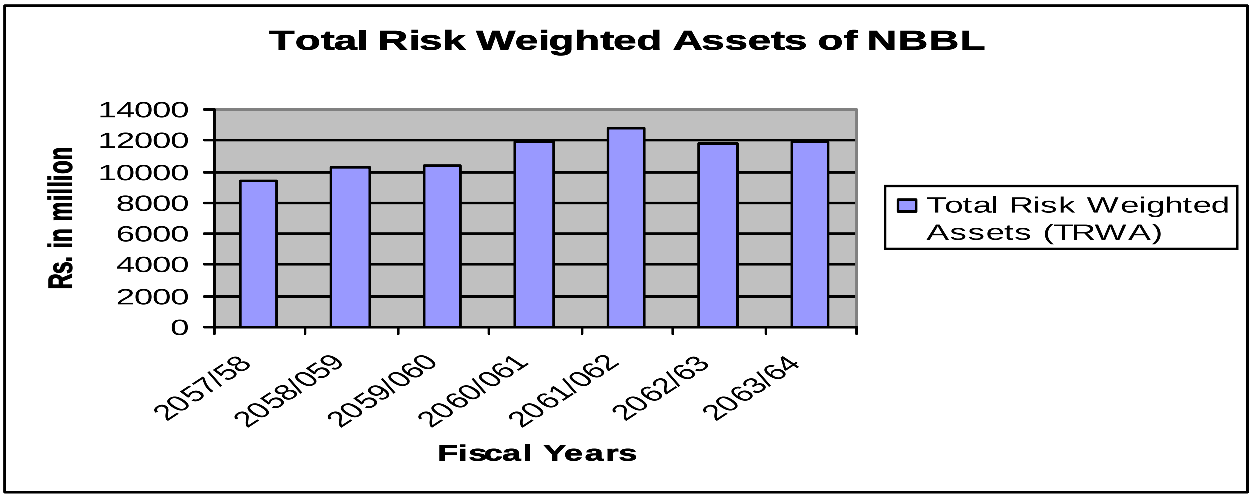
The total weighted risk assets of EBL has been increased from Rs. 3580.50 million in FY 2057/58 to Rs. 14976.74 million in FY 2063/64, thus increasing such assets by 318.29%. This increment is mainly due to increase in Loans and advances (including bills purchased) of the bank from Rs 3005.76 million in FY 2057/058 to Rs 13664.08 million in F.Y 2063/64 where the bank have to give full weightage to On-Balance Sheet Risk Weighted Assets category. Out of total weighted risk assets of EBL, the weighted risk asset of Loan and Advances including bills purchased alone represents approximately 86 pc (Source: Annexure - III)

Table – 4.5

Total Risk Weighted Assets of NBBL (Fig in million)

Particulars	**2057/58**	**2058/59**	**2059/60**	**2060/61**	**2061/062**	**2062/63**	**2063/64**
Total On-Balance Sheet Assets	7987.12	8,636.37	8,945.29	10,231.21	11,325.17		
Total Off-Balance Sheet Assets	1464.49	1,630.30	1,450.57	1,679.35	1,491.80		
Total Risk Weighted Assets (TRWA)	9452.00	10,266.68	10,395.86	11,910.56	12,816.97	11808.421	11960.83

Fig – 4.5



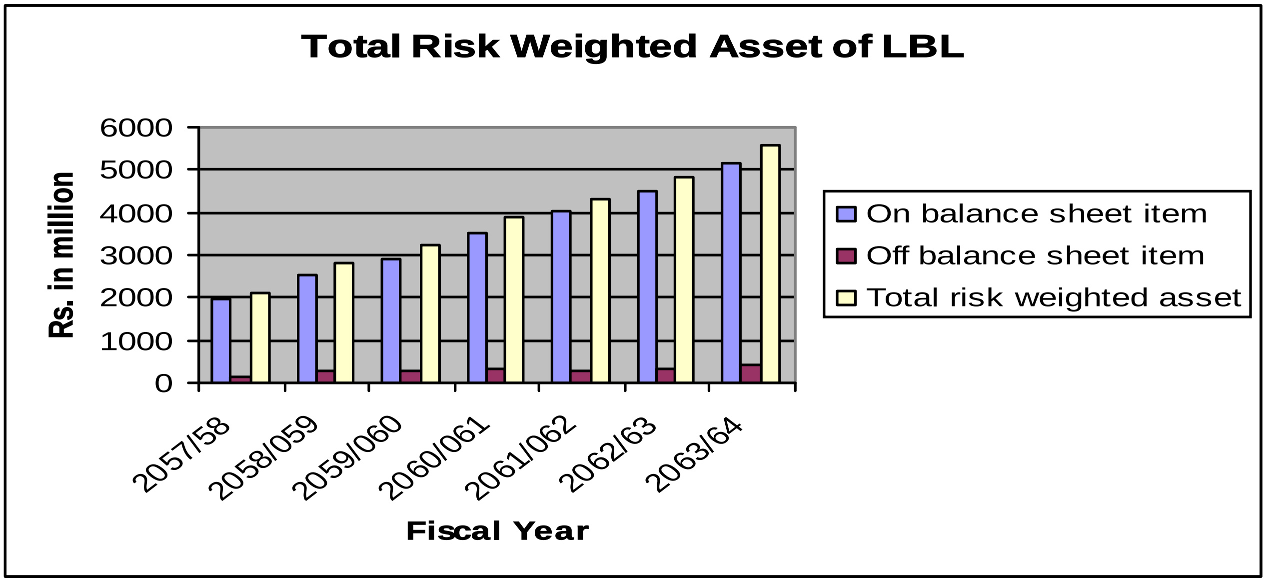
The total weighted risk assets of NBBL has been increased from Rs 7987.12 million in FY 2057/058 to Rs 12816.97 million in FY 2061/062. The main reason behind this increment is the increase in Loans and advances (including bills purchased) of the bank from Rs 7538.67 million in FY 2057/058 to Rs 9626.91.10 million where the bank have to give full weightage to On-Balance Sheet Risk Weighted Assets category. But this Risk Weighted Assets decreased to Rs. 11960.83 million if f.y 063/64 as the result of the decrease in Loan and Advances to Rs. 5854.58 during the same period. The net decrease in the Loan and Advances enhanced during the period of seven fiscal years is 26.70%. (Source: Annexure - IV and www.nrb.org.np).

Table -. 4.6

Total Risk Weighted Assets of LBL (Fig in million)

Particulars	2057/58	2058/59	2059/60	2060/61	2061/62	2062/63	2063/64
Total On-Balance Sheet Assets	1980.30	2541.44	2912.73	3534.18	4040.65	4487.27	5178.45
Total Off-Balance Sheet Assets	139.85	270.12	300.38	335.66	273.87	331.37	407.89
Total Risk Weighted Assets (TRWA)	2120.15	2811.56	3213.11	3869.85	4314.52	4818.65	5586.35

Fig. 4.6



The total weighted risk assets of LBL has been increased from Rs 2120.15 million in FY 2057/058 to Rs 5586.35 million in FY 2063/64 which is an increment of 163.49 pc(Source: Annexure-VI). The main reason behind this increment is the increase in Loans and Advances (including bills purchased) of the bank from Rs 1786.13 million in FY 2057/058 to Rs 4944.50 million where the bank have to give full weightage to On-Balance Sheet Risk Weighted Assets category.

Comparatively, the increment rate of total risk weighted assets of EBL is much higher than that of NBBL and LBL. This increment is mainly because the rise in Loans and Advances of EBL is higher than that of NBBL where the banks have to give 100 pc weightage as risk assets. The increment in Loan and Advances including Bills Purchase of EBL is 138.67p.c during the seven years period where as the same for NBBL is only 15.01 p.c and for LBL is 114.13 p.c. Though both NBBL and LBL are negative in their CRR and CAR, the CRR and CAR position of LBL is higher due to its higher increment in Loan and Advances. (Source: Annexure V)

On the basis of Risk Weighted Assets, we may rank EBL in the first position with the highest Risk Weighted Asset due to highest growth in Loan and Advances. LBL comes in the second position with higher Risk Weighted Asset than that of NBBL due to higher growth in Loan and Advances than that of NBBL. NBBL stands in last position with lowest Risk Weighted Asset due to negative growth in Loan and Advances' growth.

4.1.3 Provision for the Capital Fund:

The capital adequacy ratios to be maintained by commercial banks are being frequently changed by NRB. The changing required capital fund ratios determined by NRB along with changing time periods are as follows:

Table – 4.7

Required Capital Fund On the Basis of Weighted Risk Assets.

Year	Required Capital Fund On the basis of Weighted Risk Assets (in percentage)	
	Core Capital	**Total Capital Fund**
For FY 2057/58	4%	8%
For FY 2058/59 2001/02	4.5%	9.0%
For FY 2059/60 2002/03	5.0%	10.0%
For FY 2060/61 2003/04	5.5%	11.0%
For FY 2061/62 2004/05	5.5%	11.0%
For F.Y 2062/63 2005/06	5.5%	11%

The capital adequacy ratios will be calculated by using the formula and the comparison of the calculated ratios will be first made with the above rates and then with each other in order to derive the conclusion regarding the capital adequacy position of the three banks.

4.2 Comparison of Capital Adequacy Ratio

4.2.1 Calculation of Capital Adequacy of EBL, LBL and NBBL

The main motive behind this calculation is to see the impact of the changes in NRB provisions for capital adequacy on the minimum fund maintenance of the commercial banks with respect to the corresponding years. Secondly it will be analyzed, to which extent banks have been able to meet the minimum requirements set by NRB. The data has been analyzed and consolidated in a single table and for more clarification. The same has been depicted in graphs wherever possible.

4.2.1.1 Capital Adequacy of EBL

Table – 4.8

Capital Adequacy of EBL Vis-à-Vis NRB Directives (Fig in million)

Particulars	**057/58**	**058/059**	**059/060**	**060/061**	**061/062**	**062/63**	**063/64**
A) TRWA of the Bank	3580.50	4,272.93	5,707.03	6,924.81	9,195.59	11291.14	14976.74
Core Capital to be maintained (%)	4.00	4.50	5.00	5.50	5.50	5.50	5.50
B) Core Capital to be maintained (Rs in million)	143.22	192.28	285.35	380.86	505.76	621.01	823.72
C) Core Capital Maintained by Bank (Rs in million)	310.67	516.64	597.01	663.27	815.57	927.56	1171.13
Core Capital Maintained by Bank (%)	8.7	12.09	10.46	9.58	8.87	8.21	7.8
Excess/ Shortfall in Core Capital (Rs in million) (C-B)	167.45	324.36	311.66	282.40	309.81	306.54	347.41
Excess/ Shortfall in Core Capital (%)	4.7	**7.59**	**5.46**	**4.08**	**3.37**	**2.71**	**2.3**
Supplementary Capital maintained by Bank (Rs in million)	71.52	71.36	87.15	103.61	432.00	1391.34	504.98
Supplementary Capital w.r.t. TRWA(%)	2.00	1.67	1.53	1.50	4.70	12.32	3.4
Capital Adequacy to be maintained (%)	8.00	9.00	10.00	11.00	11.00	11..00	11.00
D) Capital Adequacy to be maintained (Rs in million)	286.44	384.56	570.70	761.73	1,011.51	1242.03	1647.44
E) Capital Adequacy Maintained by Bank (Rs in million)	382.19	588.00	684.16	766.88	1,247.56	1391.34	1676.12
Capital Adequacy Maintained by Bank (%)	10.7	13.76	11.99	11.07	13.57	12.32	11.2
Excess/ Shortfall in Total Capital (Rs in million) (E-D)	95.75	203.43	113.46	5.15	236.05	149.31	28.67
Excess/ Shortfall in Total Capital Adequcay (%)	**2.7**	**4.76**	**1.99**	**0.07**	**2.57**	**1.32**	**0.20**

(The required data for the above analysis has been extracted from the annual reports of EBL)

Fig - 4.7

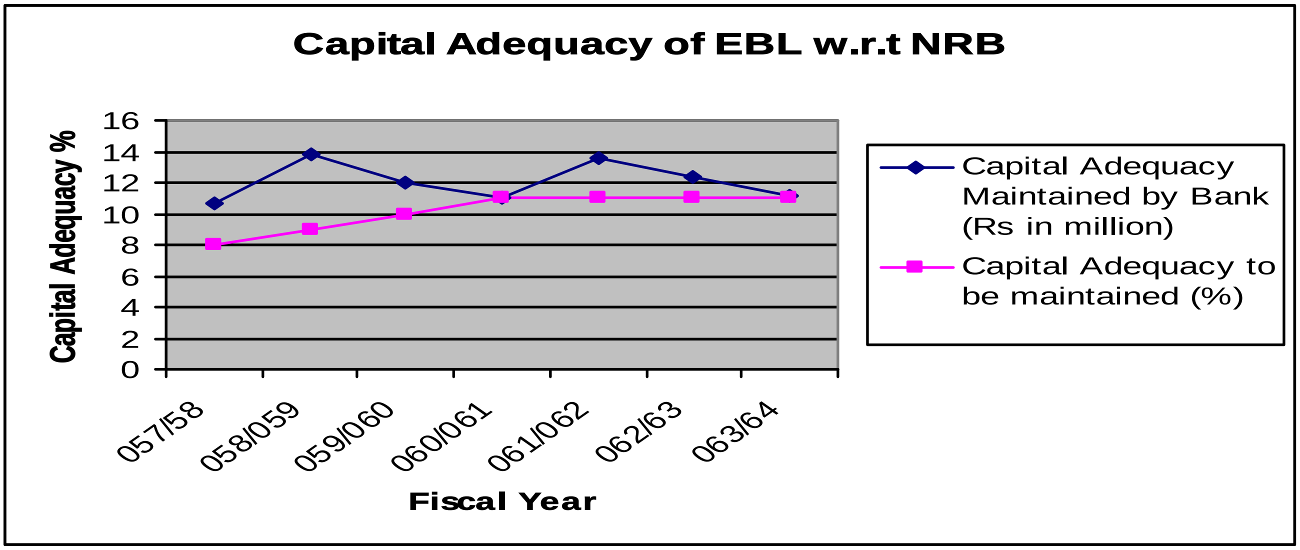
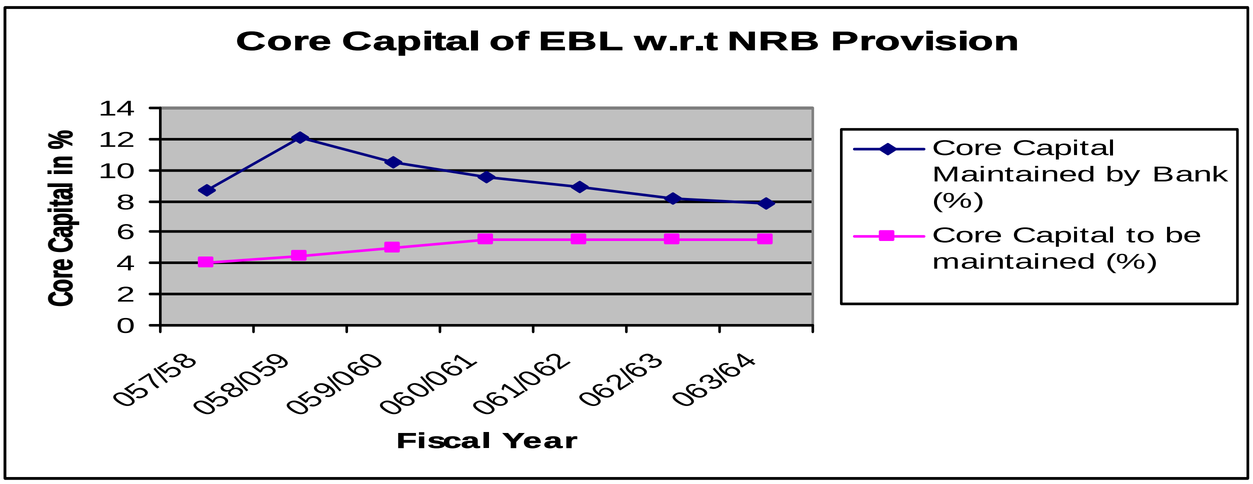


Fig – 4.8



It has been clear from the above table that NRB has changed the provisions for maintaining the capital adequacy for three times during the review period of seven fiscal years.

For the fiscal year 057/58, the standard for capital adequacy ratio was 8% of the total risk weighted assets with 4% each for core capital and supplementary capital. For this period, EBL maintained the CAR of 10.7% with 8.7% core capital and 2.00% 058/59 supplementary capital. For the fiscal year, the standard for capital adequacy ratio increased to 9% of the total risk weighted assets with 4.5% each for core capital and supplementary capital (Table – 17, P 92). Capital adequacy maintained by EBL during this period was 13.76% of the total risk weighted assets, contributing 12.09% of it by the core capital and remaining by supplementary capital. Thus the total capital adequacy maintained was almost 4.76% above the benchmark. The standard was then changed to 10% in f.y. 2059/60 and to 11% then after. EBL is consistently maintaining the capital adequacy ratio as per the NRB norms. Its capital adequacy in f.y. 2063/64 is excess by 0.20% of the requirement of 11% prescribed by NRB.

4.2.1.2 Capital Adequacy of NBBL

Table – 4.9

Capital Adequacy of NBBLVis-à-vis NRB Directives **(Fig in million)**

Particulars	057/58	058/59	059/060	060/061	061/62	062/63	063/64
A) TRWA of the Bank (Rs in million)	9452.00	10,266.68	10,395.86	11,910.56	12,816.97	11808.421	11960.83
Core Capital to be maintained (%)	4.00	4.50	5.00	5.50	5.50	5.50	5.50
B) Core Capital to be maintained(Rs in million)	378.08	462.00	519.79	655.08	704.93	649.46	657.85
C) Core Capital Maintained by Bank (Rs in million)	561.64	590.72	646.16	616.17	193.32	(13015.23)	(1038.20)
Core Capital Maintained by Bank (%)	5.83	5.75	6.22	5.17	1.51	(11.02)	(8.68)
Excess/ Shortfall in Core Capital (Rs in million) (C-B)	183.56	128.72	126.37	(38.91)	(511.61)	(24823.65)	(1696.05)
Excess/ Shortfall in Core Capital (%)	**1.964**	**1.25**	**1.22**	**(0.33)**	**(3.99)**	**(16.52)**	**(14.18)**
Supplementary Capital maintained by Bank (Rs in million)	317.41	427.41	197.10	184.44	236.19	0	0
Supplementary Capital w.r.t. TRWA(%)	3.30	4.16	1.90	1.55	1.84	0	0
Capital Adequacy to be maintained (%)	8.00	9.00	10.00	11.00	11.00	11.00	11.00
D) Capital Adequacy to be maintained (Rs in million)	756.16	924.00	1,039.59	1,310.16	1,409.87	1298.93	1315.69
E) Capital Adequacy Maintained by Bank (Rs in million)	879.05	1,018.13	843.26	800.60	429.51	(13015.23)	(1038.20)
Capital Adequacy Maintained by Bank (%)	9.13	9.92	8.11	6.72	3.35	-11.02	-8.68
Excess/ Shortfall in Total Capital (Rs in million) (E-D)	122.89	94.13	(196.33)	(509.56)	(980.35)	(14314.16)	(2353.89)
Excess/ Shortfall in Total Capital Adequcay (%)	**1.30**	**0.92**	**(1.89)**	**(4.28)**	**(7.65)**	**(22.02)**	**(19.68)**

Fig – 4.9(a)

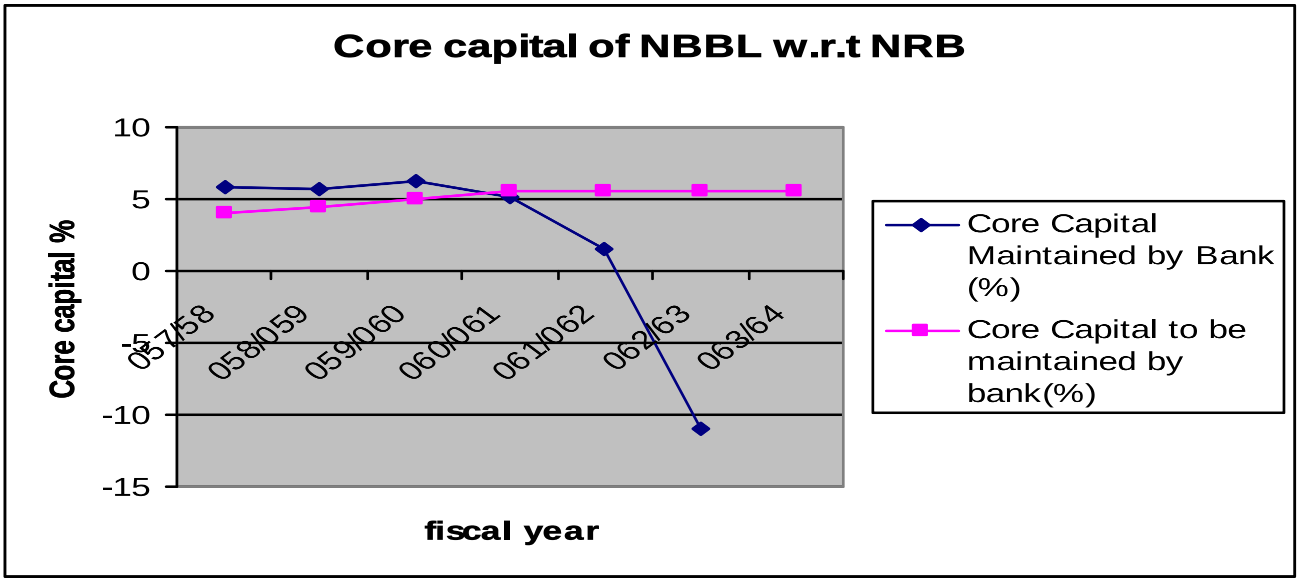
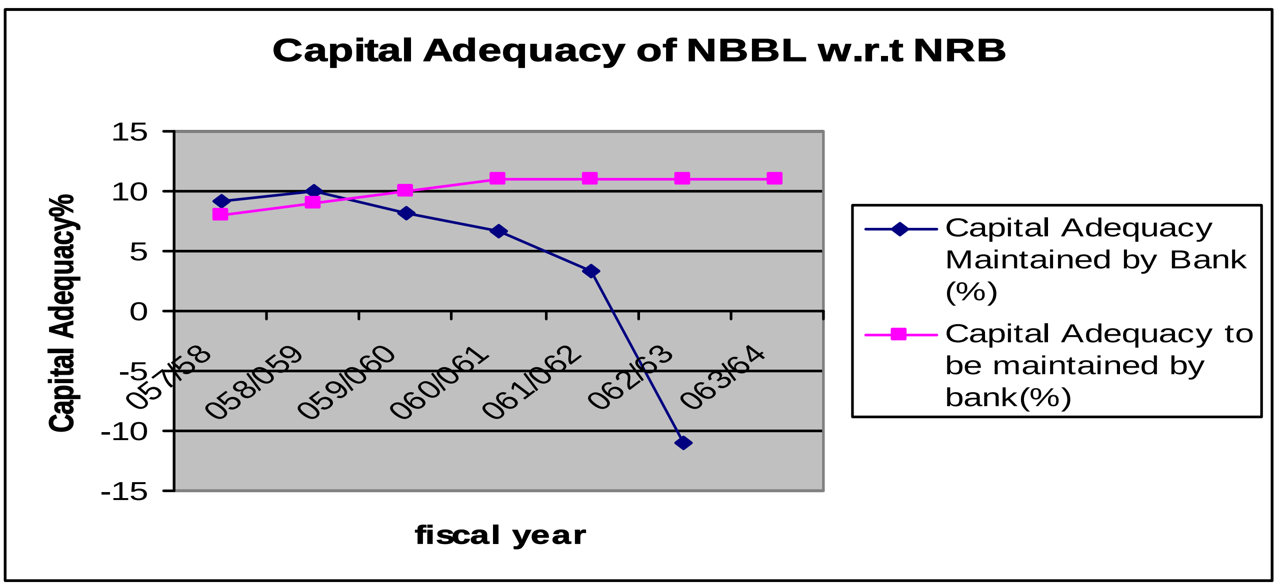


Fig-4.9(b)



Above graph explains that NBBL is continuously falling behind to meet the capital adequacy standard prescribed by NRB. During f.y 057/58, it maintained the capital adequacy ratio excess by 1.30% than the NRB standard. During f.y. 058/59, it was able to maintain an adequacy ratio slightly above the benchmark of NRB i.e. by 0.92%. But when NRB standard further increased, it continuously failed thereafter and the gap between required p.c and maintained p.c of capital fund increased more and more. However, core capital was still in excess till f.y 059/60. **It should be noted that the shortfall in the supplementary capital can be compensated by the use of the**

excess amount of core capital, but the shortfall in the core capital cannot be compensated by the excess amount of supplementary capital. In f.y. 062/63, the total capital to be maintained by NBBL is Rs. 1298.93 million with core capital contribution of Rs. 649.46 million. But the actual capital maintained shows negative balance of Rs. 13015.23 million after adjustment of previous year's cumulative net loss and current year's gross loss which is -11.02% of the total risk weighted assets thus resulting the shortfall of Rs. 14314.16 million i.e. 22.02% of total risk weighted assets. Similarly, the shortfall of core capital is Rs. 24823.65 million, which is 16.52% less in comparison to NRB's benchmark. But in f.y 063/64, a slight recovery has been made in the context of capital adequacy by reducing the shortfall of capital fund and core capital to Rs. 2353.89 million and 1696.05 million respectively which represents 19.68% and 14.18% of total risk weighted assets respectively. But yet, such shortfall in maintaining the required capital is not a good symptom for the bank's future.

4.2.1.3 Capital Adequacy of LBL

Table- 4.10

Capital Adequacy of LBL Vis-à-vis NRB Directives (Fig in million)

Particulars	057/58	058/59	059/60	060/61	061/62	062/63	063/64
A) TRWA of the Bank (Rs in million)	2120.15	2811.56	3213.11	3869.85	4314.52	4818.65	5586.35
Core Capital to be maintained (%)	4.00	4.50	5.00	5.50	5.50	5.50	5.50
B) Core Capital to be maintained(Rs in million)	84.81	126.52	193.49	212.84	237.30	265.03	307.25
C) Core Capital Maintained by Bank (Rs in million)	285.64	187.38	276.00	291.78	245.00	-727.94	-435.81
Core Capital Maintained by Bank (%)	13.47%	6.66%	8.59%	7.54%	5.68%	-15.11%	-7.80%
Excess/ Shortfall in Core Capital (Rs in million) (C-B)	200.83	60.86	82.51	78.94	7.7	-992.97	-743.06
Excess/ Shortfall in Core Capital (%)							
Supplementary Capital maintained by Bank (Rs in million)	51.22	187.97	85.76	45.30	29.12	0	0
Supplementary Capital w.r.t. TRWA(%)	2.42%	6.68%	2.67%	1.17%	1.25%	0%	0%
Capital Adequacy to be maintained (%)	8.00%	9.00	10.00	11.00	11.00	11.00	11.00%
D) Capital Adequacy to be maintained (Rs in million)	169.61	253.04	321.31	425.68	474.60	560.05	614.50
E) Capital Adequacy Maintained by Bank (Rs in million)	336.86	365.34	361.77	337.08	274.13	-727.94	-435.81
Capital Adequacy Maintained by Bank (%)	15.89%	13.35	11.26	8.71	6.93	-15.11	-7.80
Excess/ Shortfall in Total Capital (Rs in million) (E-D)	167.25	112.3	40.46	-88.6	-200.47	-1287.99	-1050.31
Excess/ Shortfall in Total Capital Adequcay (%)	**7.89**	**4.35**	**1.26**	**-2.29**	**-4.07**	**-26.11**	**-18.8**

Fig - 4.10(a)

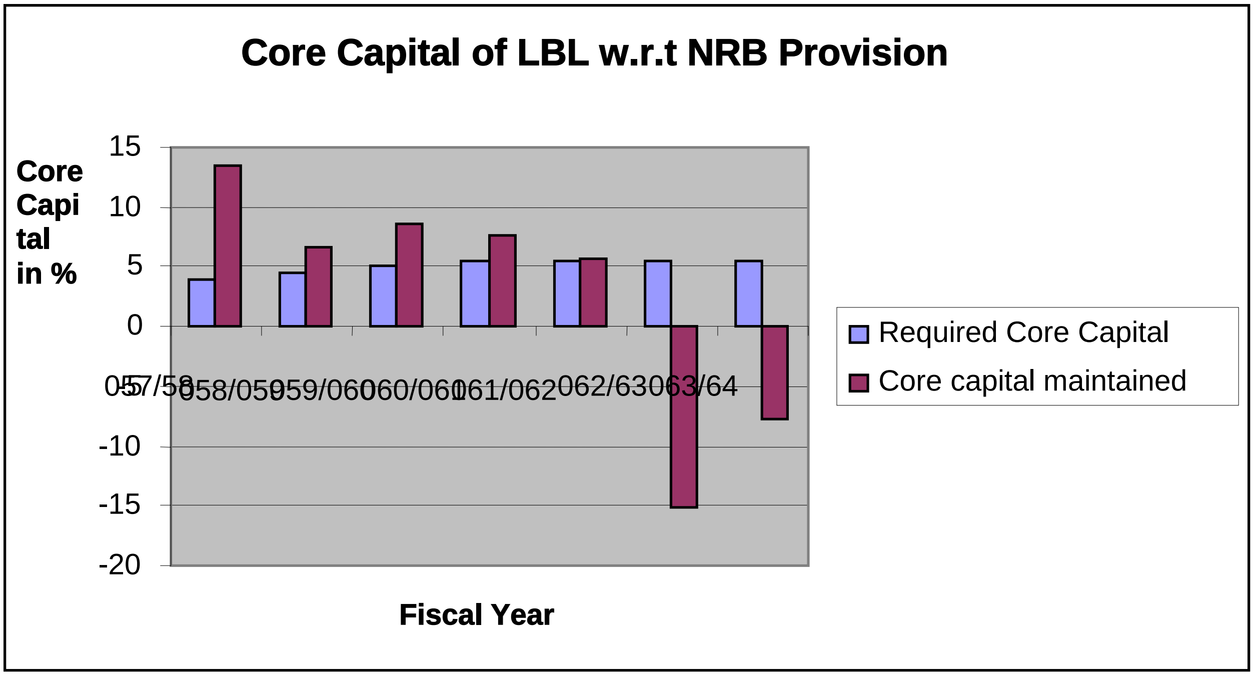
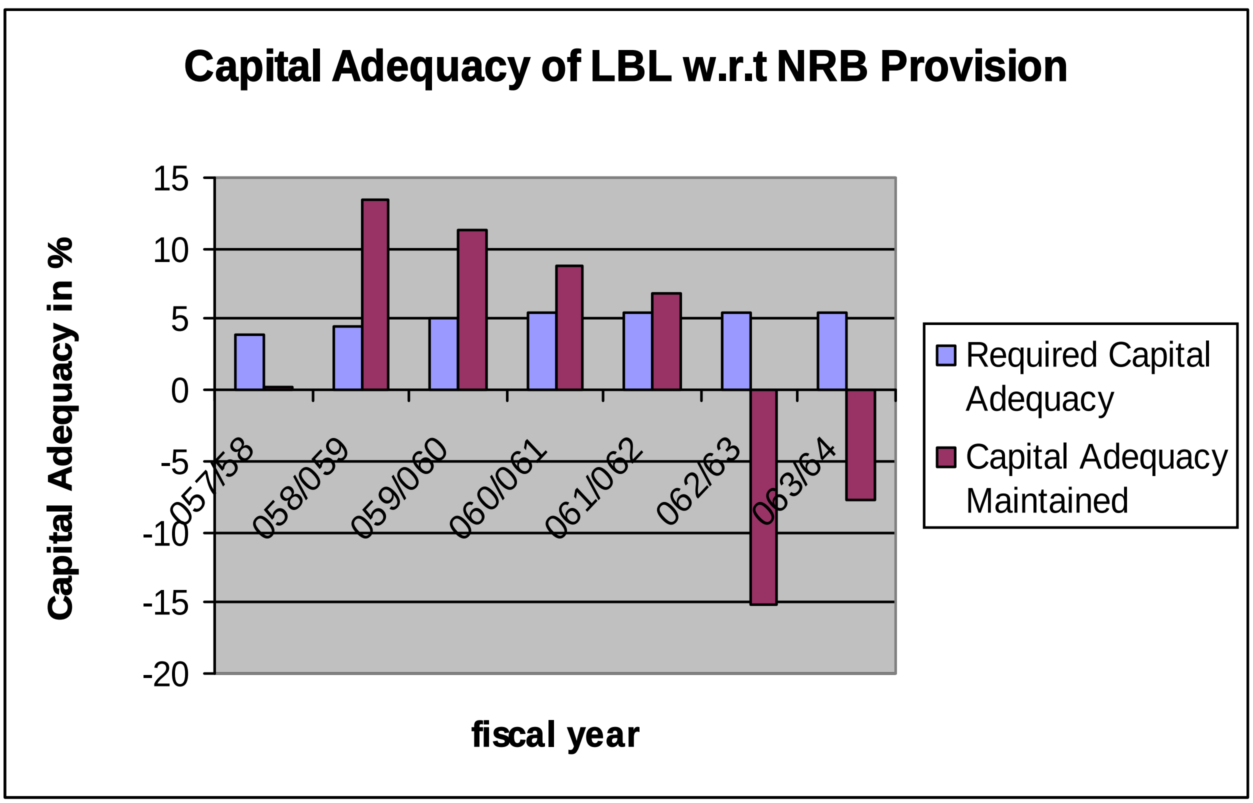


Fig - 4.10(b)



Similar to NBBL, LBL is also continuously falling behind to meet the capital adequacy standard prescribed by NRB. During f.y 057/58, it maintained the capital adequacy ratio excess by 7.89% than the NRB standard. During f.y. 059/60, it was able to maintain an adequacy ratio slightly above the benchmark of NRB i.e. by 1.2665%. But it continuously failed thereafter and the gap between required p.c and maintained p.c of capital fund increased more and more. However, core capital was still in excess till f.y 0261/62. In f.y. 063/64, the total capital to be maintained by LBL is Rs. 614.50 million with core capital contribution of Rs. 307.25 million. But the actual capital maintained shows negative balance of Rs. 435.81 million after adjustment of previous year's cumulative net loss and this year's gross loss which is -7.8% of the total risk weighted assets thus resulting the shortfall of Rs. 1050.31 million i.e. 18.80% of total risk weighted assets. Similarly, the shortfall of core capital is Rs. 743.06 million, which is 13.30% less in comparison to NRB's benchmark. This shortfall in maintaining the required capital is not a good symptom for the bank's future.

4.2.2 Comparative Study of Capital Adequacy of EBL, LBL and NBBL

While making comparative analysis between EBL, LBL and NBBL with respect to their TRWA, above tables show that the TRWA of EBL in f.y 057/58 is Rs. 3850.50 million and in f.y 063/64 is 14976.74 million. Similarly, the TRWA of NBBL in f.y 057/58 and 063/64 is Rs 9452 million and Rs. 11960.83 million respectively. This represents that the total increase in TRWA of EBL is 288.96% during the review of seven years' period and the increment in TRWA of NBBL during the same period is only 26.54%. TRWA of LBL in f.y 057/58 is 2120.15 million which increased to Rs. 5586.35 million in f.y 064/65 showing the net growth of 90.02 p.c. Going through these figures, it seems as if EBL is in most dangerous position than NBBL and LBL and LBL is at higher risk than NBBL. However, it's not true. This heavy rise in the TRWA of EBL is mainly due to the heavy growth in Loans and Advances of EBL than of NBBL and LBL where the banks have to give 100 pc weightage as risk assets. During the period, EBL had increased its' Loan and Advances including bills purchased by more than 138.67 pc whereas LBL by 114.13p.c and NBBL has decreased its' Loan and Advances with bills purchased by about 26.70 pc (Source: Annexure – V).

As far as the maintenance of the capital adequacy is concerned with, EBL has been consistently maintaining the capital adequacy ratio as per the directives of NRB. In fact, EBL is excess in maintaining the total capital fund requirement by 2.7p.c, 4.76 pc, 1.99 pc, 0.07 pc, 2.57 pc, 1.32 pc and 0.20p.c respectively (Table 18) during these seven years. But NBBL has fulfilled the requirement only on the first year of the review period. NBBL is in excess by only 0.92 pc in the first year and then the bank is lagging behind by 1.89 pc, 4.28 pc, 7.65 pc , -11.02 , -22.02pc and -19.68pc respectively in the remaining six years.

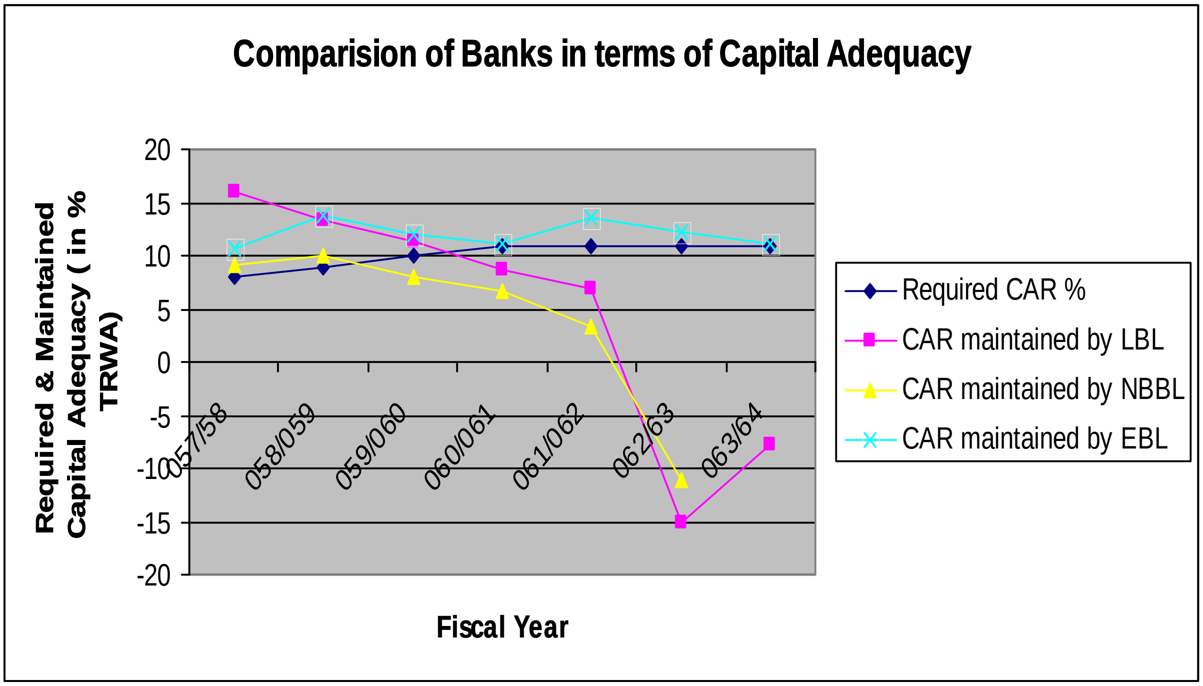
Similarly, LBL has exceeded the requirement till the third year of the review period by 7.89 p.c, 4.35p.c and 1.26 p.c respectively. Later it lagged behind by 2.27p.c, 4.09p.c, 26.11p.c and 18.8 p.c respectively(Table 20) in the remaining four years.

It should be noted that too much excess in capital adequacy and shortfall in capital adequacy, both influence the long term interest of the bank adversely. Shortfall in capital fund leads to insecurity in meeting the depositors' requirements and excess in capital fund maintenance results in reduced opportunities for the bank to invest more which ultimately hit to the profitability of the bank in a negative way. Hence the banks shall practice to maintain only the mandatory required capitals as demanded by the NRB.

While going through Table no. 18, we can observe that though the capital maintained by EBL was excess by 2.27p.c in f.y 057/58, this excess capital was minimized to 0.07 p.c in f.y 060/61 which indicates the optimum investment of the funds. Though the capital maintained increased the following years, it has decreased to 0.20% in f.y 063/64 which indicates the optimum investment of funds once again. This represents EBL in later years has invested more fund than in previous years, which is a good sign for the bank. NBBL, in this regard, has maintained a very good capital adequacy in f.y 058/59 where the excess was less than 1%. However, thenafter, the gap between the capital maintained by the bank and the required capital has shown a negative trend. This shows that there are almost no opportunities for the bank to invest more. The lesser the bank invests; the less will be the profit for the bank and high is the threat for the bank to survive in the market. LBL, in another hand has maintained excessively higher capital till f.y 059/60 indicating the idleness of the investable funds.

But on later periods, the gap between the capital maintained by the bank and the standard has shown negative trend as of NBBL resulting no opportunities for the bank to invest. Hence, LBL is also facing the threat from CAR aspect to survive in the market.

Fig – 4.11



In the above graph, the **line indicating the EBL's capital fund maintenance** is above the **standard capital adequacy ratio line** throughout the review period. These two lines are tangent in f.y 060/61. Hence, the capital fund maintained in f.y 060/61 can be regarded as the optimum fund maintenance. The lines are almost tangent in f.y 063/64 too. Hence, the capital adequacy ratio maintained by EBL in f.y 063/64 is again another optimum adequacy ratio. But the **line indicating the NBBL's capital fund maintenance** is below the **standard capital adequacy ratio** line and even negative **from f.y 059/060 till f.y 063/64.** LBL was following the standard of capital adequacy ratio till f.y 059/60. The best CAR maintained by it was on f.y 059/60 where the excess of maintained CAR over standard CAR was only 1.26 p.c. From f.y. 060/61 onwards, line indicating the LBL's capital fund maintenance is below the standard capital adequacy ratio line and even negative. This represents that LBL and NBBL are not following the NRB directives whereas EBL is regularly following the NRB directives. The actual core capital of EBL is 7.8 pc of TRWA but that of LBL and NBBL are negative i.e

-7.8% and -11.02 pc respectively despite the requirement of 5.50 pc as laid down by NRB. Also, regarding the total capital fund, EBL is in excess of 0.20 pc than the required 11 pc of TRWA whereas NBBL is in shortfall by 19.68 pc and LBL is in shortfall by 18.80p.c against the requirement. This clearly shows that EBL is in a much better position than NBBL and LBL **but NBBL and LBL both are in a critical situation.**

In order to gain an optimum position, EBL may use its remaining fund in loans & advances and investment but NBBL and LBL first of all must meet the criteria of capital adequacy before investment. As per the Capital Plan passed through NRB's management committee, in order to bring the capital reserve within the stipulated standard, remedies such as increment in loan quality to minimize the loan loss provision, increment of profit , issuance of bond, etc had been recommended but those recommendations don't seem to be brought into implementation.

Hence, in terms of capital adequacy EBL is in a much better position than of NBBL and LBL. The bank is heading forward with a healthy growth. However, LBL is in a recovering stage but the position of NBBL in terms of capital adequacy is deteriorating.

4.3 Loan Classification and Provisioning

The Loan classification and the provisioning refers to the process by which banks review their loans portfolios and assign loans to the categories or grades based on the perceived risk and other relevant characteristics of the loans. In order to monitor the quality of their loan portfolios and when necessary, to take remedial actions to counter deterioration in the credit quality of their portfolios, the process of continual review and classification of loans proves to be an essential tool.

A commercial bank is a financial intermediary between the depositors and the credit seekers. Its principal operations are concerned with the accumulation of the temporarily idle money of the general public as deposits for the purpose of advancing to other as loans for expenditure. . Extending Loans more than the capital of the bank or extending too much loans to a single unit is very risky for the depositors of the bank and there are the chances for the bankruptcy. Hence, NRB has fixed the limit on credit and facilities the commercial banks can extend. According to its directive related with credit and facilities, licensed institution may extend to a single borrower of group of related borrowers the amount of Fund Based loans and advances up to 25% of the Core Capital Fund and Non fund Based off-balance sheet facilities like letters of credit, guarantees, acceptances, commitments up to 50% of its Core Capital Fund. This restriction, in one hand has helped commercial banks to diversify their risk portfolio, but in another hand, it has also reduced the opportunity for the commercial banks to increase their loan and advances.

In a balance sheet of any commercial bank, deposits constitute a major portion of the liabilities of the bank whereas the Loans and advances constitute a major portion of their assets. An analysis of the balance sheet of EBL shows that its Loans and advances constitutes almost 65 p.c of its total assets. Similarly, the balance sheet of Nepal Bangladesh Bank Lltd as on Ashad End 2064 shows that 57.86 p.c of the total assets is contributed by loans advances and bills purchased and in case of LBL, 67.32 p.c of total assets is occupied by loans, advances and bills purchased.

A significant portion of the profit of the bank depends on the spread that it enjoys between the interest received from the borrower and that to be paid to the depositors. Hence, more the bank extends quality lending, the more profitable the bank will be. The table below reveals the position of the banks with respect to Loans and Advances, spread of income and the profit of the bank.

Table – 4.11

Comparative Study of Basic Financial Parameters of EBL, LBL and NBBL (Fig in million)

Particulars	057/58	058/059	059/060	060/061	061/062	062/63	063/64
EBL							
Deposits	4574.50	5466.61	6694.96	8063.90	10097.69	13802.44	18186.25
Loans and Advances	2999.39	4044.23	5049.58	6095.84	7900.00	10136.25	14082.69
A. Interest Paid on Deposit	236.71	257.05	307.64	316.37	299.50	401.40	517.17
B. Interest income from Loans and Advances	385.01	443.82	520.17	657.25	719.30	903.41	1144.41
Interest Spread Income (B-A)	148.31	186.77	212.53	340.88	419.80	502.01	627.24
Net Profit	69.71	85.35	94.18	143.57	170.80	237.29	296.41
LBL							
Deposits	2097.49	121.47	90.00	164.72	4031.22	4786.44	**6024.60**
Loans and Advances	1786.13	2085.33	2441.64	2980.40	3167.62	2983.90	**4944.50**
A. Interest Paid on Deposit	118.80	170.50	186.48	197.32	193.47	215.55	234.77
B. Interest income from Loans and Advances	157.43	266.38	308.68	361.24	384.60	343.82	**458.65**
Interest Spread Income (B-A)	38.63	95.88	122.20	163.92	191.12	128.27	**193.88**
Net Profit	**-36.94**	**-97.97**	**89.14**	**18.64**	**-196.77**	**-806.06**	**192.40**
NBBL							
Deposits	2097.49	2646.11	10580.65	12807.38	12125.58	13015.12	9463.92
Loans and Advances	7358.84	8083.99	7961.51	9644.70	9626.91	8478.80	5854.58
A. Interest Paid on Deposit	515.85	552.74	597.88	625.36	547.94	518.09	448.36
B. Interest income from Loans and Advances	810.05	850.53	1013.71	1095.50	876.51	955.89	998.34
Interest Spread Income (B-A)	294.20	297.79	415.83	470.14	328.57	437.79	549.98
Net Profit	198.75	65.78	71.49	2.64	(749.54)	291.51	392.70

(The required data for the above analysis has been extracted from the annual reports of EBL & NBBL)

As per table no. 20, EBL has increased its total deposit from Rs. 4574.50 million in f.y 057/58 to Rs. 18186.25 million in f.y 063/64. This represents the net growth of 297.56%. Similarly, the total loan and advances including bills purchased has been increased from Rs. 2999.39 million in f.y 057/58 to Rs. 14082.69 in f.y 063/64 which represents the increment of 369.52%. The banks income spread and its net profit has increased from Rs. Rs 148.31 million to Rs 627.24 million and 69.71 million to 296.41 million respectively during these seven review periods, thus , registering a net growth of net profit of 325..21pc (Source: Annexure – IX).

In case of NBBL, the total deposit has been increased from Rs. 2097.49 in f.y 2057/58 million to Rs 6024.60 million in f.y 2063/64 representing the net growth of 187.23. The total loan and advances including bills purchased has been decreased from Rs. 7358.84 in f.y 2057/58 to Rs. 5854.58 million in f.y 2063/64 showing net decrement of 20.454%(Source : Annexure-VII). Similarly, the bank's income spread has been increased from Rs 294.20 million to Rs 470.14 in f.y 060/61 million, gone down from Rs 470.14 million in FY 2060/061 to Rs 437.79 million in FY 2062/063 showing a negative growth of almost 6.88 pc But a solid improvement has been seen in f.y 063/64 when the interest spread further increased to Rs. 549.98 million. In comparison to the preceding year, it must be said that the recovery has been made. Despite the increment in deposit cost and decrement in loan and advances, the bank gained net profit of Rs. 392.70 million. This indicates the net growth of 97.58pc. (Source : Annexure – IX). It is a drastic improvement of the bank from the previous fiscal years when the bank even suffered from net loss of Rs. 749.54 million. The detail analysis of the loan category of the bank is done in the upcoming sections. Prior to that, the analysis of Loan classification and provisioning categorization of NRB is done.

LBL has increased its deposit from Rs. 2097.49 in f.y 057/58 to Rs. 6024.60 in f.y 063/64 which is an increment of 187.23 p.c. Its loan and advances including bills purchased has increased from Rs. 1786.13 in f.y 057/58 to Rs 4944.50in f.y 063/64 showing increment of 176.83%. (Source : Annexure-VII). Its interest spread has shown a two way trend. It is in increasing trend till f.y 061/62 but decreasing in the following period. However the recovery has been made in f.y 063/64. The net growth of interest spread during the seven study periods is 18.00 p.c. Lumbini bank, in case of net profit, is in fluctuating situation. It had been initially facing the net loss till f.y 058/59. It made the noticeable recovery in fiscal year 059/60 by converting the net loss into net profit of Rs. 89.14 which decreased the following year and the bank again went into loss in f.y 061/62 and 062/63. In f.y 063/64, the recovery has been once again made and the bank has earned net profit of Rs. 192.40. Hence, from the Net Profit's aspect, the bank has shown a net growth of 620.84pc. (Annexure – IX). Though the bank has gone through the worst condition, the bank is in recovery phase.

Comparatively, despite of highest deposits, loan and advances and income spread, EBL stood second to NBBL in case of Net Profit. LBL is the one with lowest deposits, loan and advances and income spread and so with the net profit. However as the study is related with the implementation of NRB Directives, appliance of such directives is more important to rank the banks rather than the figures of Net Profit made and Loans and Advances advanced. To study the abilities of the banks to follow directives of NRB, we shall further compare the banks on the basis of provisioning made by them for the loans advanced.

4.3.1 Loan Classification and Provisioning Categorization of NRB

NRB has instructed the licensed institution to classify the loan and advances in accordance with Clauses 1 to Section 7 under different category based on the risk associated with them. These levels of category are reviewed from time to time and amendments are done regarding the provisioning in concern with these classifications. The classified loans and advances under the existing arrangement are required to be classified as per the following time table in five phases;

Table – 4.12

Classification of Loan and Advances for Different Phases

Classification	**For FY 2058/59**	**For FY 2059/60**	**For FY 2060/61**	**For FY 2061/62 onwards.**
Pass	Loans not past due and past due upto 3 months.	Loans not past due and past due upto 3 months.	Loans not past due and past due upto 3 months.	Loans not past due and past due upto 3 months.
Sub-Standard	Loans and advances past due for a period of over 3 months to 1 year.	Loans and advances past due for a period of over 3 months to 1 year.	Loans and advances past due for a period of over 3 months to 9 months.	Loans and advances past due for a period of over 3 months to 6 months.
Doubtful	Loans and advances past due for a period of over 1 year to 3 years.	Loans and advances past due for a period of over 1 year to 3 years.	Loans and advances past due for a period of over 9 months to 2 years.	Loans and advances past due for a period of over 6 months to 1 years.
Loss/ Bad	Loans and advances past due for a period of over 3 years.	Loans and advances past due for a period of over 3 years.	Loans and advances past due for a period of over 2 years.	Loans and advances past due for a period of over 1 year.

The loan loss provisioning on the outstanding loans and advances and bills purchased shall be provided on the basis of classification made as per the Directives, as follows:

Table – 4.13

Loans Provisions to be Made for Loans under Different Category

Category	**Loan Loss Provision to be made**
Pass	1 pc
Sub-Standard	25 pc
Doubtful	50 pc
Loss	100 pc

4.3.2 Loan Classification and Provisioning of EBL w.r.t. NRB Provisions

In order to analyze whether EBL is following the loan loss provisioning as directed by NRB, it is necessary to calculate following details:

Provision to be made (Rs) = (Total loan of corresponding category)
X (%provision to be made)

Excess /Shortfall on Provision = Amount provision by the bank - Required provision

Net Loan of the bank = Total Loan and Advances – Total provision made by the bank.

The required data for analyzing the loan classification & provisioning of EBL has been taken out from the annual reports of EBL and the analytical calculation of the data collected has been done on the basis of the above formulas.

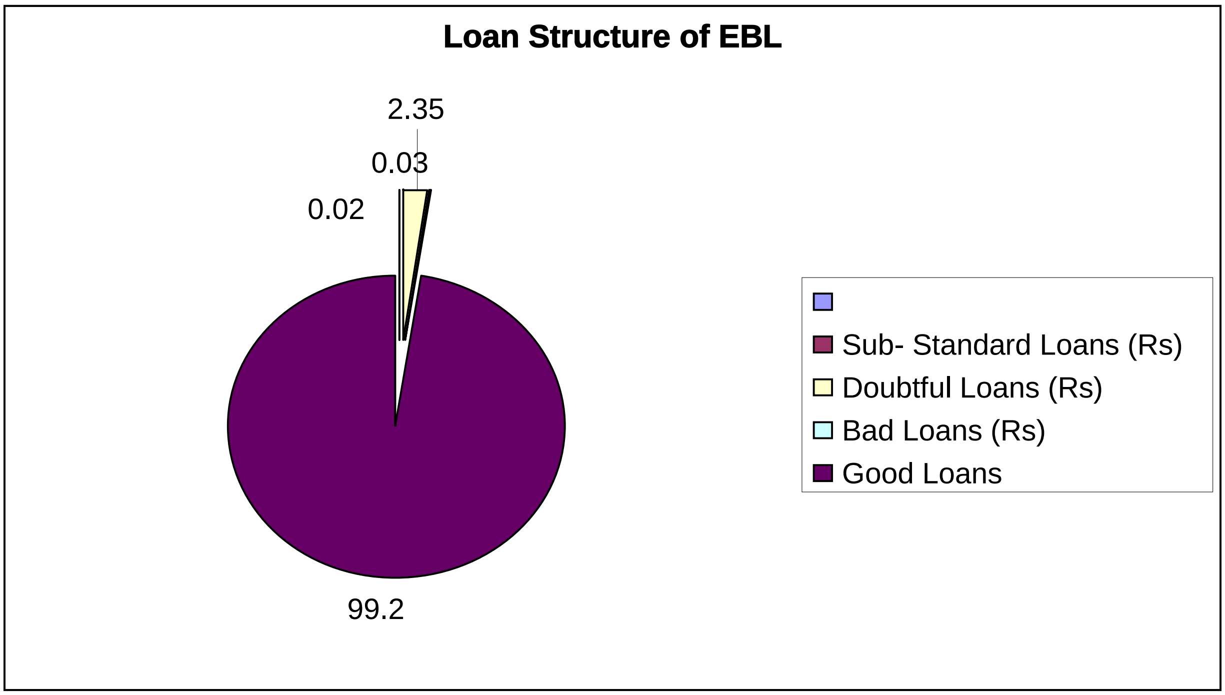
Table– 4.14

Loans Classification of EBL w.r.t NRB Provisions (Rs. In million)

Particulars	057/58	058/059	059/060	060/061	061/062	062/63	063/64
A) Total Loans and Advances (Rs)	2999.39	4044.23	5049.58	6095.84	7900.00	10136.25	14082.69
Good Loans (Rs)	2881.37	4001.84	4938.39	5991.09	7771.28	10007.02	13969.51
Provision to be made (%)	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Provision to be made (Rs)	28.81	40.02	49.38	59.91	77.71	100.07	139.70
Provisioned by the bank (Rs)	28.32	68.66	80.42	135.52	112.26	128.80	164.87
Provisioned by the bank (%)	0.98	1.72	1.63	2.26	1.44	1.29	1.18
Excess/ Shortfall on Provision (Rs)	0.49	28.64	31.04	75.61	34.55	28.73	25.17
Sub- Standard Loans (Rs)	92.65	15.73	41.95	1.11	4.41	10.67	4.22
Provision to be made (%)	25.00	25.00	25.00	25.00	25.00	25.00	25.00
Provision to be made (Rs)	23.16	3.93	10.49	0.28	1.10	2.67	1.06
Provisioned by the bank (Rs)	21.22	3.93	10.49	2.77	1.10	2.67	1.05
Provisioned by the bank (%)	22.90	24.98	25.01	249.55	24.94	25	24.88
Excess/ Shortfall on Provision (Rs)	0.94	0.00	0.00	2.49	0.00	0.00	(0.01)
Doubtful Loans (Rs)	22.18	13.33	38.06	40.49	1.98	0.69	2.35
Provision to be made (%)	50.00	50.00	50.00	50.00	50.00	50.00	50.00
Provision to be made (Rs)	11.09	6.67	19.03	20.25	0.99	0.35	1.18
Provisioned by the bank (Rs)	11.02	6.66	19.03	20.25	0.99	0.35	1.18
Provisioned by the bank (%)	49.68	49.96	50.00	50.01	50.00	50.00	50.00
Excess/ Shortfall on Provision (Rs)	0.07	0.00	0.00	0.00	0.00	0.00	0.00
Bad Loans (Rs)	3.19	13.33	31.18	53.18	122.42	117.88	106.61
Provision to be made (%)	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Provision to be made (Rs)	3.19	13.33	31.18	53.18	122.42	117.88	106.61
Provisioned by the bank (Rs)	2.24	16.50	31.18	53.18	122.42	117.88	106.61
Provisioned by the bank (%)	70.22	123.78	100.00	100.00	100.00	100.00	100.00
Excess/ Shortfall on Provision (Rs)	0.95	3.17	0.00	0.00	0.00	0.00	0.00
Additional Provision made by the bank						85.25	144.90
B) Total Provision to be made by the bank	66.25	63.95	110.08	133.61	202.23	220.97	248.55
C) Total Provision to be made by bank (% of total loan)	2.21	1.58	2.18	2.19	2.56	2.18	1.76
D) Total Provision made by the bank	62.80	95.75	141.12	211.72	281.41	334.95	418.60
E) Total Provision made by bank(% of total loan)	2.09	2.37	2.79	3.47	3.56	3.30	2.97
Shortfall/ Excess on Total Provision (Rs) (C-B)	(3.45)	31.80	31.04	78.11	79.18	113.98	170.05
Total Excess Provision made by the bank (%)	(0.12)	0.79	0.61	1.28	1.00	1.12	1.21
Net Loans (A - D)	2936.59	3948.48	4908.46	5884.12		9801.3	13723.73

As per the above table, the total loans and advances of EBL was Rs. 2999.39 million in f.y. 2057/58 and the figure reached Rs. 14082.69 million in FY 2063/64. Thus from the above consolidated table regarding loan classification and provisioning of Everest Bank Limited during seven years of review period, we can see that EBL has shown a average growth of almost cent percent in its' Loans and Advances.

Fig – 4.12



Out of the total loan and advances of Rs 14082.69 million of EBL, the good loans, sub-standard loans, doubtful loans and the bad loans are Rs 13969.51 million, Rs 4.22 million, Rs 2.35 million and Rs 106.61 million that represents about 99.20 pc, 0.03 pc, 0.02 pc and 0.78 pc respectively. The provisions made by EBL against these loans are exactly as per the standards prescribed by NRB, however the provision made for pass loan is excess by 170.05 million which represents 1.21% higher than that directed by NRB. Overall, EBL has maintained the idle Loan Loss Provision.

The provisions to be maintained have increased as the result of the increment in loan amount forwarded. As on the end of FY 2063/64, EBL has provisioned Rs 418.60 million for the total loans disbursed which is 2.97 pc of the total loans and advances of the bank. . This includes an additional provision of Rs 144.90 million despite the total provision fulfilled by the bank as per the NRB directives.

The increase in the bad loans of the bank was due to the change of NRB directives in the period of bad loans from over 3 years (f.y 057/58) to over 1 year (f.y. 062/63).

The Net Loan of the bank has gone up to Rs 13723.23.08 million in FY 2063/064 from Rs 2936.59 million in FY 2057/58 recording an average growth of almost 367.34 percent (Source: Annexure – VIII).

4.3.3 Loan Classification and Provisioning of NBBL w.r.t. NRB Provisions

In order to analyze whether NBBL is following the loan loss provisioning as directed by NRB, it is necessary to calculate following details:

Provision to be made (Rs) = (Total loan of corresponding category)
X (%provision to be made)

Excess /Shortfall on Provision = Amount provision by the bank - Required provision
Net Loan of the bank = Total Loan and Advances – Total provision made by the bank.

The required data for analyzing the loan classification & provisioning of NBBL has been taken out from the annual reports of NBBL and the analytical calculation of the data collected has been done on the basis of the above formulas.

Table – 4.15

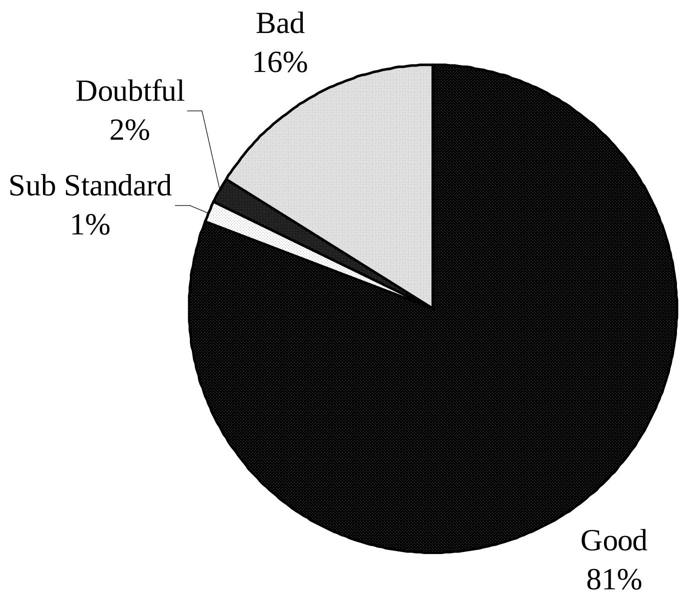
Loans Classification of NBBL w.r.t NRB Provisions (Fig in million)

Particulars	057/58	058/059	059/060	060/061	061/062	062/63	063/64
A) Total Loans and Advances (Rs)	7358.84	8083.99	7961.51	9644.70	9626.91	8478.808(	5854.58
Good Loans (Rs)	6745.07	6808.77	6948.24	8602.51	7793.97	NA	
Provision to be made (%)	1.00	1.00	1.00	1.00	1.00		
Provision to be made (Rs)	67.45	68.09	69.48	86.03	77.94		
Provisioned by the bank (Rs)	57.72	77.99	117.31	144.03	194.94		
Provisioned by the bank (%)	0.86	1.15	1.69	1.67	2.50		
Excess/ Shortfall on Provision (Rs)	(9.73)	9.90	47.83	58.00	117.00		
Sub- Standard Loans (Rs)	555.00	749.85	166.13	127.93	120.63	NA	
Provision to be made (%)	25.00	25.00	25.00	25.00	25.00		
Provision to be made (Rs)	138.75	187.46	41.53	31.98	30.16		
Provisioned by the bank (Rs)	81.12	165.53	42.01	31.98	30.16		
Provisioned by the bank (%)	14.62	22.08	25.29	25.00	25.00		
Excess/ Shortfall on Provision (Rs)	(57.63)	-21.93	0.48	0.00	0.00		
Doubtful Loans (Rs)	44.44	422.21	577.61	168.58	160.78	NA	
Provision to be made (%)	50.00	50.00	50.00	50.00	50.00		
Provision to be made (Rs)	22.22	211.11	288.81	84.29	80.39		
Provisioned by the bank (Rs)	92.65	148.10	288.81	84.28	80.39		
Provisioned by the bank (%)	208.48	35.08	50.00	49.99	50.00		
Excess/ Shortfall on Provision (Rs)	70.43	-63.01	0.00	-0.01	0.00		
Bad Loans (Rs)	14.32	103.15	269.54	745.67	1551.54	NA	
Provision to be made (%)	100.00	100.00	100.00	100.00	100.00		
Provision to be made (Rs)	14.32	103.15	269.54	745.67	1551.54		
Provisioned by the bank (Rs)	52.44	59.94	265.40	735.67	1533.74		
Provisioned by the bank (%)	366.20	58.11	98.46	98.66	98.85		
Excess/ Shortfall on Provision (Rs)	38.12	-43.21	-4.14	-10.00	-17.80		
B) Total Provision to be made by the bank	242.74	569.81	669.36	947.97	1740.03	NA	
C) Total Provision to be made (% of total Loan)	3.30	7.05	8.40	9.83	18.07		
D) Total Provision made by the bank	283.93	451.56	713.53	995.96	1839.23	1221.37	2112.44
E) Total Provision made by the bank (%)	3.86	5.59	8.96	10.33	19.11	14.40	36.08
Shortfall/ Excess on Total Provision (Rs) (C-B)	41.19	-118.25	44.17	47.99	99.20	NA	
Shortfall/Excess on Total Provision(%) (E-C)	0.56	(1.46)	0.56	0.50	1.04		
Net Loans (A – C)	7074.91	7632.43	7247.98	8648.74	7787.68	7257.43	3742.14

The above table of NBBL regarding loan classification and provisioning includes only five fiscal years because the audit reports for f.y 062/63 and 063/64 has not been published yet. The above consolidated table reveals that NBBL has recorded an average growth of just 19 percent in its' Loans and Advances. During FY 2057/058, the total loans and advances of NBBL was Rs 7358.84 million and the figure touched Rs 9626.91 million in FY 2061/062.

Fig – 4.13

Loan Structure of NBBL



Out of the total loan and advances of Rs 9626.91 million in f.y 2061/62 of NBBL, the good loans, sub-standard loans, doubtful loans and the bad loans are Rs 7793.97 million, Rs 120.63 million, Rs 160.78 million and Rs 1551.54 million that represents about 81 pc, 1 pc, 2 pc and 16 pc respectively.

The provision to be made against the loan has also increased significantly from Rs 242.74 million to Rs 1740.03 million during the review period. The increase in the bad loans of the bank from Rs 14.32 million to Rs 1551.54 million during the review period compelled the bank to increase the amount of the provisioning due to the change in NRB directives as in case of the EBL.

It can be clearly seen that NBBL has failed following the NRB directives consistently with respect to Loan Provisioning. In each fiscal year of the review period, the bank somehow failed to fulfill all the criteria of NRB. During FY 057/058 the bank met provisioned full amount on doubtful loans and bad loans. But it failed to meet the standard in case of good loan and substandard loan. However, in total the bank was excess by Rs 41.19 million in provisioning the amount as needed by NRB. During f.y 058/59, the bank was supposed to provision Rs 569.81 million whereas the bank provisioned only Rs 451.56 million thus falling short by Rs. 118.25 million. Similarly during FY 059/061 the bank did not provision the required amount in bad loans. In FY 2060/061 the bank failed to provision the needed amount in doubtful loans and the bad loans. Also as on FY 2061/062 the bank has not provisioned the required amount of loans falling under bad loans category. However, the bank has shown that it has done an excess provision of Rs 99.20 million than required during FY 2061/062. This was done by provisioning excess amount of Rs 117.00 million on good loans where the bank have to provision only 1 pc. The good loan during that year was Rs 7793.97 and the bank was supposed to provision only Rs 77.94 million. During same fiscal year, the bank was short by Rs 17.80 million in provisioning the bad loans where the bank need to provision 100 pc of the bad loans. The bad loans of NBBL during FY 2061/062 was 1551.54 million whereas the bank provisioned only Rs 1553.74 million, widening the gap by 17.80 million which was Rs 10.00 million during the previous year.

The Net Loan of the bank has decreased up to Rs 3742.14 million in FY 2063/064 from Rs 7074.91 million in FY 2057/058 recording an average decrease of only 47.11 percent during the seven years period (Source: Annexure – VI). As on the end of FY 2061/062, the bank provisioned Rs 1839.23 million which is 19.11 pc of the total loans and advances of the bank.

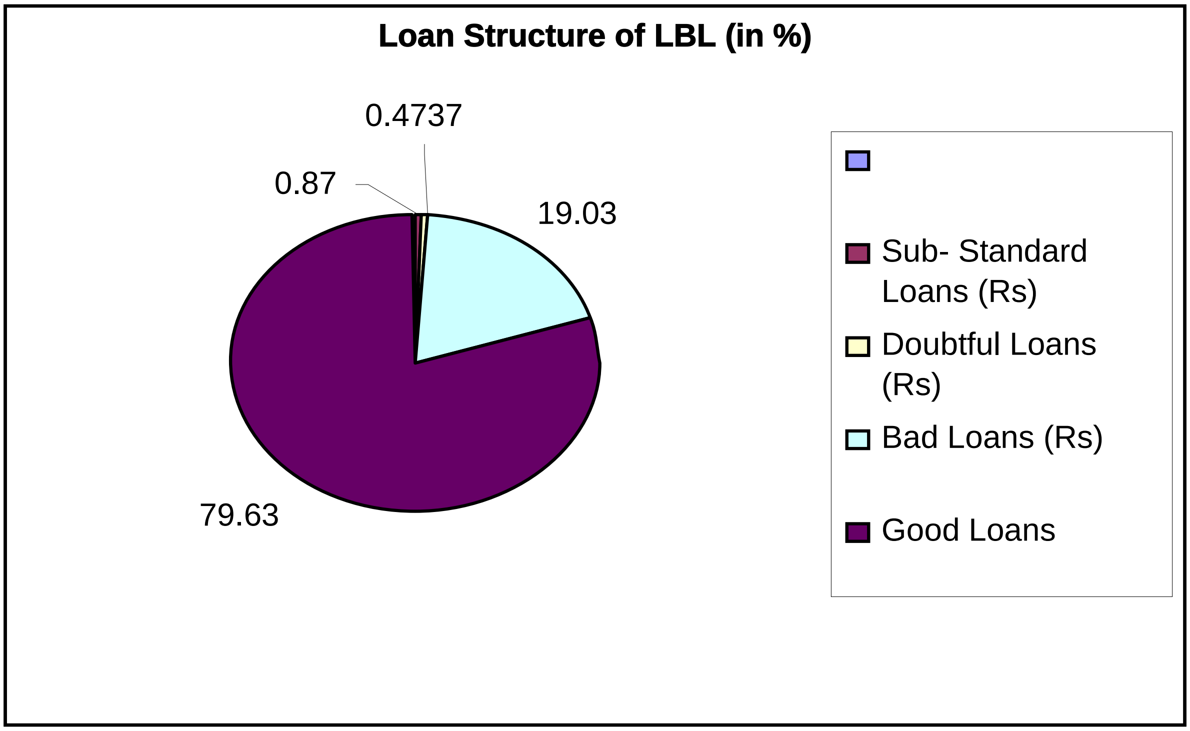
Table-4.16

Loan Structure of LBL (Fig in million)

Particulars	057/58	058/059	059/060	060/061	061/062	062/63	063/64
A) Total Loans and Advances (Rs)	1786.13	2285.49	2622.36	3222.75	3124.01	4321.593	4944.50
Good Loans (Rs)	1508.59	1843.50	2315.58	2985.45	3154.01	2982.34	3937.46
Provision to be made (%)	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Provision to be made (Rs)	15.08	18.43	23.16	29.85	31.54	29.82	39.37
Provisioned by the bank (Rs)	14.16	27.16	38.96	40.59	58.52	54.82	79.00
Provisioned by the bank (%)	0.94	1.47	1.68	1.36	1.87	1.84	2.00
Excess/ Shortfall on Provision (Rs)	(0.06)	0.47	0.68	0.36	0.87	0.84	1.00
Sub- Standard Loans (Rs)	266.55	286.65	158.67	16.64	59.58	52.43	42.85
Provision to be made (%)	25.00	25.00	25.00	25.00	25.00	25.00	25.00
Provision to be made (Rs)	66.63	71.66	39.67	4.16	14.90	13.11	10.71
Provisioned by the bank (Rs)	31.36	88.17	44.96	3.92	14.09	12.69	10.71
Provisioned by the bank (%)	11.76	30.76	28.33	23.56	23.65	24.20	25
Excess/ Shortfall on Provision (Rs)	35.27	(16.51)	5.29	(0.24)	(0.81)	0.42	0
Doubtful Loans (Rs)	10.99	140.51	108.39	43.88	100.91	26.56	23.42
Provision to be made (%)	50.00	50.00	50.00	50.00	50.00	50.00	50.00
Provision to be made (Rs)	5.50	70.26	54.20	21.94	50.46	13.28	11.71
Provisioned by the bank (Rs)	4.66	70.51	43.88	22.46	48.15	13.00	11.71
Provisioned by the bank (%)	42.40	50.29	52.67	51.19	47.72	48.94	50.00
Excess/ Shortfall on Provision (Rs)	(0.84)	0.25	(10.32)	0.52	(2.31)	(0.28)	0
Bad Loans (Rs)	0	14.79	39.71	176.78	400.65	1260.25	940.77
Provision to be made (%)	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Provision to be made (Rs)	0	14.79	39.71	176.78	400.65	1260.65	940.77
Provisioned by the bank (Rs)	0	14.33	39.71	175.38	396.65	1257.18	937.86
Provisioned by the bank (%)	0	96.89	100.00	99.21	99	99.76	99.69
Excess/ Shortfall on Provision (Rs)	0	3.11	0	0.79	1.00	0.24	0.31
B) Total Provision to be made by the bank	87.21	175.14	156.74	232.73	497.55	1316.86	1002.56
C) Total Provision to be made by bank(% of total loan)	4.88	7.66	5.98	7.22	15.93	30.47	20.28
D) Total Provision made by the bank	50.18	200.16	180.72	242.35	517.41	1337.69	1039.28
E) Total Provision made by bank(% of total loan)	2.81	8.76	6.89	7.52	16.56	30.95	21.02
Shortfall/ Excess on Total Provision (Rs) (C-B)	(37.03)	25.02	23.98	9.62	19.86	20.83	101.25
Total Provision made by the bank (%)	(2.07)	1.1	0.91	0.30	0.93	0.48	0.74
Net Loans (A – D)	1735.95	2085.33	2441.64	2980.40	2606.6	2983.9	3840.69

Thus from the above consolidated table regarding loan classification and provisioning of Lumbini Bank Limited during seven years of review period, we can see that LBL also has shown an average growth of more than cent percent in its' Loans and Advances. In FY 057/58, LBL had advanced total loan and advances of Rs. 1786.13 million. During FY 2058/059, the total loans and advances of LBL was Rs. 2285.49 million and the figure touched Rs 4944.50 million in FY 2063/64.

Figure – 4.14



Out of the total loan and advances of Rs 4944.50 million of LBL, the good loans, sub-standard loans, doubtful loans and the bad loans are Rs 3737.46 million, Rs 42.85 million, Rs 23.42 million and Rs 940.77 million that represents about 75.59 pc, 0.87 pc, 0.47 pc and 19.03 pc respectively.

However, the provision to be made against the loan has also increased significantly from Rs 87.21 million to Rs 1002.56 million during the review period. The increase in the bad loans of the bank from nil to Rs 940.77 million compelled the bank to increase the amount for the provision. The increase in the bad loans of the bank was due to the change of NRB directives in the period of bad loans from over 3 years

(057/58) to over 1 year(062/63). As per current provision, loans and advances past due for a period of more than 1 year has to be classified as bad loan whereas in FY 2057/058, only the loans and advances past due for a period of more than 3 years was to be categorized as bad loan. During that year, Loans and advances that remained past due for more than 1 year but less than 3 years were to be considered as doubtful loan. As on the end of FY 20163/64, LBL has provisioned Rs 1103.81 million for the total loans disbursed.

During F.Y 057/58, LBL failed to maintain the standard loan loss provision by 2.07 %. But it can be clearly seen from the above table that LBL has been consistently following the NRB directives with respect to Loan Provisioning then after. To view in aggregate, despite the frequent changes NRB has made in classification of loan, LBL has fulfilled all the criteria for loan classification and provisioning. During the entire review period of seven years, from FY 058/59 onwards, LBL has never been shortfall in provisioning the loan amount in aggregate as required by the NRB. The bank has further provisioned the loan amount in excess, like during FY 2063/64, the bank provisioned 79.00 million in good loans irrespective of Rs 39.37 millions to be provisioned. This is an excess provision in the good loans by 1p.c. Similarly, the bad loan has also been provisioned by excess of Rs. 101.25 million which indicates an excess of 0.74p.c.

The Net Loan of the bank has gone up to Rs 3840.69 million in FY 2063/64 from Rs 1735.95 million in FY 2057/58 recording an average growth of more than 121.24 percent. As on the end of FY 2063/64, the bank provisioned Rs 1039.28 million which is 21.02 pc of the total loans and advances of the bank.

4.3.4 Comparative Study of Loan Classification and Provisioning of EBL, LBBL and NBBL

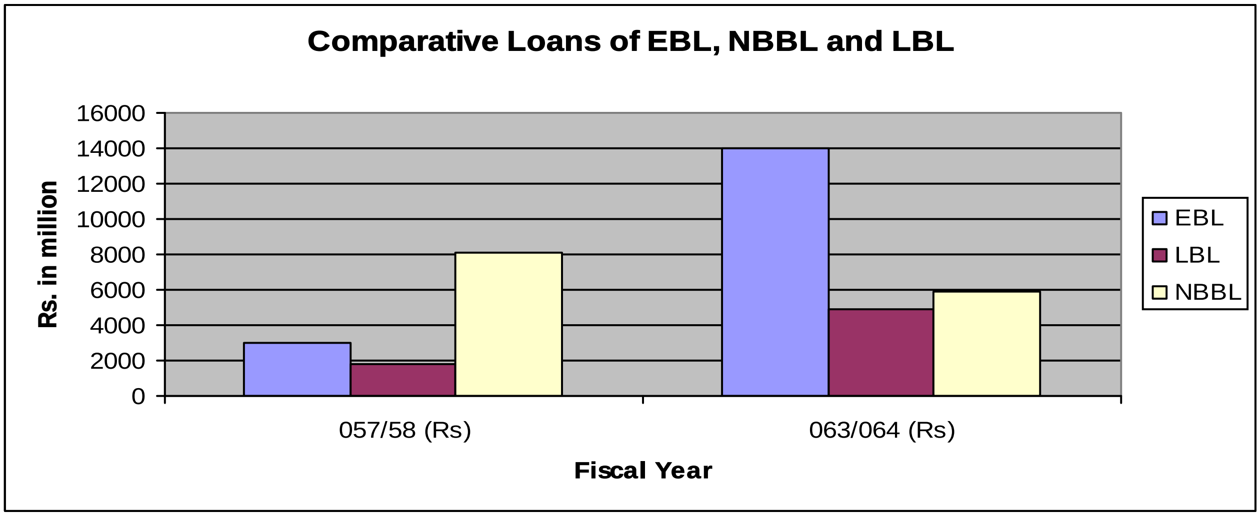
On the basis of above analysis we can conclude that during the review period of seven fiscal years, EBL has extended more loans and advances than that by LBL and NBBL. NBBL was leading the market till FY 057/58, but by FY 063/64, LBL has recovered its situation enough and has occupied the market more than that by NBBL.

Table – 4.17

Comparative Study of Loans of EBL and NBBL (Fig in million)

Total Loans and Advances of EBL and NBBL	057/58 (Rs)	063/064 (Rs)	Net Growth (%)
EBL	2959.44	14041.89	474.48
LBL	1786.13	4944.50	276.83
NBBL	8083.99	5854.58	(27.60)

Fig – 4.15



From above figure it becomes clear that initially the total loan extended by NBBL is higher in figure than that by EBL and LBL during the review periods. Till f.y 063/64, loan extended by NBBL is higher than that by LBL in figure. But in terms of the percentage growth, the percentage growth of loan extended by EBL is highest among the three banks and the growth of loan extended by LBL is higher than that by NBBL during the fiscal years. Total loan extended by NBBL in f.y 2057/58 is Rs. 8083.99 million whereas EBL has extended loan of only Rs. 2959.44 million in the same period. The loan extended by LBL is lowest i.e. 1786.13 million. But, in f.y 2063/64, NBBL decreased its loan amount to Rs. 5854.58 million whereas the loan provided by EBL is Rs. 14041.89 million and that of LBL is 4944.50 million . Hence, EBL exceeds both LBL and NBBL in loan amount and LBL exceeds NBBL. As far as growth percentage in Loan and advances is concerned with, EBL registered the growth of 150.64%, LBL has registered growth of 276.83% but NBBL registered negative growth rate of 27.60.%. The growth of NBBL in terms of loan and advances is very low in comparison to EBL's as both the banks have same target group and almost same market coverage. LBL, despite of being new in the history in comparison to NBBL with the small market coverage, has overtaken NBBL in terms of growth. This shows that EBL is most aggressive in extending its loans and advances and LBL is more aggressive in loan expansion than NBBL is. Hence more the loans disbursed, more will be the interest income and more will be the profit for the bank, So, EBL has been doing exceptionally well than of LBL and NBBL in increasing its' loans and advances. LBL has been improving and increasing its market rapidly. NBBL though, is ahead of LBL in figure of Loan Extended, is lying behind LBL in the growth rate of loan extended.

Increment in loan and advances is not the sole indicator of profitability. The proper monitoring of the loans is a must as the non-performing loans are more dangerous than no loans as it not only decrease the profit of the bank but the bank may suffer a huge loss and there are the chances of the bankruptcy. So it is essential to examine the loan categorization of the bank to see which bank is performing well.

Table – 4.18(a)

Loan Composition of EBL and LBL in Percentage

Loan	2057/058			2063/64			Change in Percentage		
	LBL	EBL	NBBL	LBL	EBL	NBBL	LBL	EBL	NBBL
Good %	84.46	96.07	91.365	79.63	97.80	NA	(4.83)	1.73	
Sub- Standard %	14.92	3.09	7.54	0.87	0.03	NA	(14.05)	(3.06)	
Doubtful %	0.61	0.74	0.61	0.47	0.02	NA	(0.14)	(0.72)	
Bad %	0	0.11	0.19	19.02	0.76	NA	19.02	0.65	
Total %	100.00	100.00 %	100.00 %	100.00 %	100.00 %	100.00 %			

Above table shows that the portion of good loan of EBL in its total loan composition has increased in f.y 2063/64 in comparision to that in f.y 2057/58 by 1.70%. But the portion of good loan of LBL has decreased by 4.83% for the same period.. Such a decrease in good loan is not a good indicator for banks' long term interest. Along with the good loan the percentage of sub-standard and doubtful loan has also decreased in case of both banks. The sub-standard loan of EBL in f.y 063/64 has decreased by 3.06% in comparison to that in f.y 2057/58, that of LBL has decreased by 14.05%. Doubtful loan of EBL has decreased by 0.72%, that of LBL has decreased by 0.14%. This decrease in sub-standard loan and doubtful loan is considered to be beneficial for the banks as they have higher chances to turn out as the bad loans. Bad loans have an extremely negative influence on the banks' progress because it not only decreases the profit of the bank but also threatens the security of the depositors' money. Increment in bad loans decreases the capacity of the bank to repay the depositor's money on demand, thus reducing its trustworthiness. Such a lack of trustworthiness stimulates the depositors to withdraw the money. This reduces the opportunity for the bank to borrow and invest which is the main source of income for the bank. Hence the banks shall attempt to keep their bad loans to a minimum level as far as possible. More the bad loans, more is the threat for the bank.

However as the audit report of NBBL has not been published yet, the break down of loan structure of NBBL could not be available. Hence, in order to compare the two banks i.e. EBL and LBL with NBBL, we have to make the comparison in terms of composition of performing and non-performing loan in total loan, which is as follows:

Table 4.18(b)

Loan Composition of LBL, EBL and NBBL

Loan	**2057/058**			**2063/64**			**Change in Percentage**		
	LBL	**EBL**	**NBBL**	**LBL**	**EBL**	**NBBL**	**LBL**	**EBL**	**NBBL**
Performing Loan%	84.46	96.07	91.365	79.63	99.20	61.81	(4.83)	3.14	(29.56)
Non-performing Loan %	15.54	3.94	8.34	20.37	0.80	38.19	4.83	(3.14)	29.85
Total %	100.00	100.00 %	100.00 %	100.00%	100.00 %	100.00 %			

As per above table, an increase has been noticed in the portion of performing loan of EBL in its total loan composition during the period of f.y 2063/64 to f.y 2057/58 by 3.14%. But the portion of good loan of LBL has decreased by 4.83% for the same period and that of NBBL has decreased by 29.56.. Along with the change in performing loan the inverse change in the percentage of non-performing loan such as sub-standard, doubtful loan and bad loan has also changed inversely in case of all banks.

The non-performing loan of EBL in f.y 063/64 has decreased by 3.14% in comparison to that in f.y 2057/58, but non-performing loan of LBL has increased by 4.83% and that of NBBL by 29.85%. Increment in non-performing loan is considered to be risky for the banks.

In case of non-performing loans, NBBL has to pay special attention in reducing it because its non-performing loan has increased by 29.85% in f.y 2063/64 in comparison to that in f.y 057/58. This means among every loan of Rs. 100.00 extended by NBBL, loan of Rs.29.85 turns to be or may soon turn to be bad loan.

This concept can be more clarified through the sole concept of Non-Performing Loan (NPL) or Non-Performing Assets (NPA).

Table – 14.19

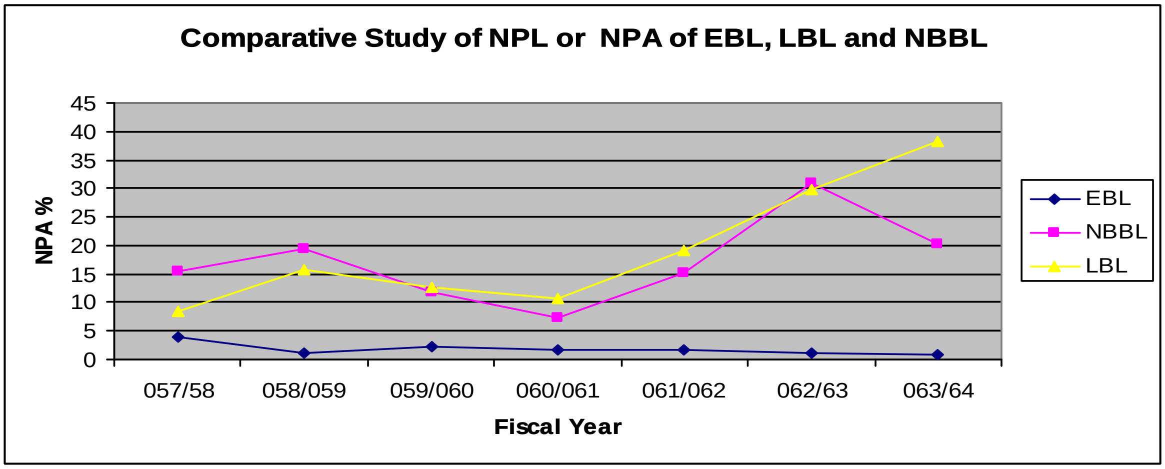
Comparative Study of NPL or NPA of EBL, LBL and NBBL (Fig in million)

Total Loans and Advances of EBL, LBL and NBBL	**057/58**	**058/059**	**059/060**	**060/061**	**061/062**	**062/63**	**063/64**
EBL							
NPL (Rs in million)	**118.02**	42.39	111.19	94.78	128.81	121.86	112.66
Non- Performing Assets (%)	3.93	1.05	2.20	1.55	1.63	1.20%	0.80
LBL							
NPL (Rs in million)	277.56	441.56	308.13	238.16	475.79	**1339.26**	1007.19
Non- Performing Assets (%)	15.54	19.32	11.75	7.39	15.23	**30.99**	20.37
NBBL							
NPL (Rs in million)	613.78	1275.21	1013.28	1042.18	1832.95	2927.10	2235.86
Non- Performing Assets (%)	8.34	15.77	12.73	10.81	19.04	29.88%	38.19

(The required data for the above analysis has been extracted from the annual reports of EBL and NBBL and unaudited report of NBBL for f.y 062/63)

As per the above table, the non-performing loan of EBL which was only Rs. 118.02 million in f.y 057/58 reached Rs. 128.81 million in f.y 2061/62 but again decreased to Rs. 112.66 million thus representing the net growth of 66.40% . The non-performing loan of NBBL was Rs. 613.78 in f.y 057/58 but reached Rs. 2235.86 in f.y 063/64 showing the increment rate of 264.28%. Similarly, non-performing loan of LBL has increased from Rs. 277.56 million in f.y 057/58 to Rs. 1007.19 million in f.y 063/64 showing the growth rate of 262.87% which is an extremely high increment rate. Generally, NPL of the bank increases with the increase in the Loan amount advanced. The rate of growth of NPLs of NBBL is highest among the three during the review period though EBL extended its' Loans and advances by more than 297.56 pc whereas the NBBL decreased its' Loans and advances by 27.60pc. It's not because it has increased its Loans and advances figure but because of its failure and lack of efficiency in its Loan extending policies. In figure, Loan advanced by LBL is less than that by EBL and NBBL. Despite of providing such lesser loan, NPL of LBL is extremely high in comparison to that of EBL which is providing a threat to the bank. . Hence both LBL and NBBL have not been able to implement efficient Loan and Advances extending policies.

Fig - 14.16



NPA percentage is the actual parameter for measuring the actual loaning position of a bank. Above graph shows that the NPA% of NBBL and LBL has always remain extremely higher than that of EBL throughout the review period. In case of the comparison between LBL and NBBL, the NPA % of LBL has remained higher most of the time.

The NPA % of EBL is only 1.20% in f.y 2063/64 whereas the NPA% of LBL is 20.37% and that of NBBL is 38.19% for the same period. The maximum NPA % of EBL during the review period is 3.93% i.e in f.y 2057/58 but the maximum NPA % of NBBL is 38.19% i.e in f.y 063/64. The maximum NPA % of LBL is 30.99% in the same fiscal year. This represents that EBL is in a much better loan maintaining and positioning than of LBL and NBBL and NBBL is in worst condition among the three. It was also observed during the analysis period that the NPA percentage of EBL is one of the lowest among the commercial banks and NPA percentage of NBBL is one of the highest among the private commercial banks of Nepal.

Hence, after going through all above analysis, we can conclude that EBL is in a far better position in extension and maintenance of Loan and Advances than LBL and NBBL is and NBBL is in the worst condition.

4.4 Finding of the Study

From the above analysis, it has become clear that EBL has been following the NRB directives consistently almost in every aspect whether it is in Capital Adequacy Maintenance, Loan and Advances Provisioning or Banking Supervision and Monitoring. But in contrast to it, NBBL has always failed to maintain consistency with the directives of NRB. LBL has been successful to follow NRB Directives in Loan and Advances Provisioning but failed in Capital Adequacy Maintenance.

4.4.1 Major Findings of the Study

Capital Adequacy Ratio

EBL has maintained the required Capital Adequacy Ratio as per directed by NRB. As on f.y 2063/64, the standard rate of Capital Adequacy Ratio was 11% of its total weighted assets and the bank maintained a capital adequacy ratio of 11.2%. Though NRB has defined core capital to be maintained at 5.50 pc for FY 2061/062, the bank has maintained core capital of 7.8 pc to compensate the shortfall in the supplementary capital. According to the directives, a shortfall in supplementary capital can be fulfilled by the surplus in core capital. EBL has maintained an excess capital of Rs. 28.67 million in f.y 063/64.

On the contrary, NBBL has failed to maintain Capital Adequacy Ratio as well as the Core Capital Ratio as per the prescription of NRB. The actual capital maintained shows negative balance of Rs. 1038.20 million after adjustment of previous year's cumulative net loss and this year's gross loss which is -19.68% of the total risk weighted assets thus resulting the shortfall of Rs. 2353.89 million i.e. 22.02% of total risk weighted assets. Similarly, the shortfall of core capital is Rs. 1696.05 million, which is 14.18% less in comparison to NRB's benchmark. This shortfall in maintaining the required capital is not a good symptom for the bank's future.

LBL has continuously failed to maintain Capital Adequacy Ratio from f.y 060/61 onwards and the Core Capital Ratio from f.y 061/62 onwards. The CAR on f.y 063/64 is -7.80% and Core Capital Ratio on the same period is -7.8% too. The main reason behind the negative balances of Core Capital Ratio and Capital Adequacy Ratio is the adjustment of previous year's cumulative net loss of Rs. 1091.45 million. Thus LBL has failed to maintain standard Capital Adequacy Ratio by 18.8% and Core Capital Ratio by 13.3%.

Loan Classification and Provisioning

It has been observed that in f.y 2063/64, EBL has extended loan and advances of Rs. 13364.08 million and provisioned Rs. 358.96 million against it. Under every loan head, it has maintained almost exactly as prescribed by NRB but in case of good loan it maintained an excess of 1.18%. Hence EBL has followed the NRB directives for provisioning the required amount under each category of the loans.

In the same f.y of 2063/64, LBL also has been found to follow the directives in Loan and Advances provisioning. It has extended loan and advances of Rs. 4944.50 million and has to provision 1002.56 million against Loan Losses. But it has provisioned Rs. 1039.28 million. Though the loan advanced by LBL is lesser than that of EBL, the provisioned amount is higher because the figure of bad loan in higher in case of LBL than that of EBL. LBL too has maintained the provision almost exactly as prescribed by NRB under each loan head but in case of good loan it has provisioned an excess of 1% and in case of bad loan it has maintained an excess of 0.31%. Hence LBL has also followed the NRB directives for provisioning the required amount under each category of the loans.

The data of NBBL for fiscal years 062/63 and 063/647 couldn't not be available as no audit has been conducted for these years. But while going through the study till f.y 061/62, we can conclude that NBBL has failed to provision the loan and advances as directed by NRB. Under loan category of Bad Loan, it has failed short in maintaining the adequate amount of provision by 1.15%. In case of Substandard Loan and Doubtful Loan, it has maintained exact provision. But it has provisioned an excess amount of Rs. 117.00 million for good loan where it had to provision only 1%. There is more than 100 p.c increment in bad loan in comparison to the previous year.

The growth rate of NBBL is much less than that of EBL and LBL during the review period. Hence, we can say that NBBL's position is much lower in comparison to that of EBL and LBL and is worsening year by year.

Non-Performing Loan

The NPA % of EBL is only 1.20% in f.y 2063/64 whereas the NPA% of LBL is 20.37% and that of NBBL is 38.19% for the same period. The maximum NPA % of EBL during the review period is 3.93% i.e in f.y 2057/58 but the maximum NPA % of NBBL is 38.19% i.e in f.y 063/64. The maximum NPA % of LBL is 30.99% in the same fiscal year. This represents that EBL is in a much better loan maintaining and positioning than of LBL and NBBL and NBBL is in worst condition among the three. It was also observed during the analysis period that the NPA percentage of EBL is one of the lowest among the commercial banks and NPA percentage of NBBL is one of the highest among the private commercial banks of Nepal.

4.4.2 Other Findings of the Study

Capital Adequacy Ratio

It has been observed during the course of study that NRB is consistently increasing the capital adequacy ratio bank should maintain. The main purpose of such increment is to make the commercial banks financially strong, safeguard the depositors' money and to prevent higher capital flight prevailing in the country. The capital adequacy was 8.0% on f.y 057/58. It was fixed at 9.0% in f.y 058/59 and increased to 10.00% in f.y 059/60 and again increased to 11.00% in f.y 2060/61. The rate remained stable thenafter.

Licensed institutions shall at the end of Asoj, Paush, Chaitra and Ashad of each fiscal year, prepare the Statements of Capital Fund on the basis of the financial statements as per the enclosed /directives Form No. 1.1 and 1.2 and submit to the Bank and Financial Institution Regulation Department and related Supervision Department of Nepal Rastra Bank within 1 month from the end of each quarter.

In the event of non-fulfillment of Capital Fund Ratio as prescribed, the Board of Directors of the licensed institution shall prepare and submit within 35 days the reason for non-fulfillment of the capital fund and plan or program for making good the shortfall in the capital. On the submission of such capital plan or program, Nepal Rastra Bank may direct the concerned licensed institution to maintain required capital fund within prescribed time period. During the period of inadequate capital fun, distribution of dividend and bonus share is prohibited.

Loan Classification and Provisioning

The respective overdue periods of Pass, Sub-Standard and Doubtful loans have been changed and the provision to be maintained for each loan category has also been changed accordingly by NRB. For instance, in previous periods, any loans and advances which are past due for a period of more than two years were included in ‘Loss Loan’ category. But now all those loans that are past due for a year or more are included in this category and the provision of 100% has to be made for such loan.

Directives regarding Loan Loss and Provisioning have been directed in order to safeguard the depositors’ money and to safeguard the banks from financial crisis. It has become clear from the analysis of questionnaire that most of the commercial banks follow the directives strictly and those who don’t follow are taken action against by NRB for example; take over of NBBL and LBL by NRB.

Chapter Five
Summary, Conclusions and Recommendations

5.1 Summary

The banking system in Nepal started lately with the establishment of NBL in 1994 B.S. But after the establishment of Nepal Rastra Bank as the central bank of Nepal was established in 2012 B.S under a special act, financial system of Nepal gained a significant growth both in number of financial institutions, volume of the business and the quality of the assets of the financial institutions. By mid July 2006, 18 commercial banks, 29 development banks, 70 finance companies, 30 Saving and Cooperatives, 17 NGOs performing banking activities and 11 micro-credit development banks had come into operation extending their services in Nepal. They have been playing the pivoted role in mobilization of funds and also providing their services on commerce, trade and industry along with general public. As the result of the significant growth in the financial sector of Nepal, the necessity had emerged to control the activities of the financial institutions to generate healthy competition and to uplift the economy of the country. NRB for this purpose has introduced a defined set of rules which all the financial institutions of Nepal must abide with and such a set of rules is known as NRB Directives. NRB has altogether introduced 16 directives related with different sector.

In the current worsening economic scenario of the country , the mushrooming growth of commercial banks in private sector as well as in joint venture and increasing higher profits of the banks has arose the chances of offering of uneconomic rate of interest, indulging in risky enterprises, unhealthy competition etc. In order to scrutinize the performance of these commercial banks, safeguard the public deposits and ensure the economic stability in the country, NRB issues Directives time to time. The commercial banks are compulsory to follow these directives. In another hand, the directives thus issued by NRB, if not addressed properly, have potential to wreck the financial system of the country, as they are only the tools of NRB to supervise and monitor the activities of the financial institutions.

This research has been conducted with the main objective to conclude the impact of NRB Directives on safety of general public's deposit and on enhancement of the situation of commercial bank's situation. Other objectives of the study are to examine the implementation of NRB Directives by the selected Commercial Bank related to Capital Adequacy, Loan Classification and Provisioning in their activities, to find out the role of NRB on monitoring and inspection of commercial banks regarding the implementation of its directives and to make a comparative study between Everest Bank Ltd., Lumbini Bank and Nepal Bangladesh Bank Ltd. with respective to Capital Adequacy, Loan Classification and Provisioning as given in the directives of NRB.

To organize systematic research, this study has used a research methodology. This study is descriptive and explanatory in nature.

For this study, out of the 23 commercial banks, 3 commercial banks-Everest Bank Ltd., Lumbini Bank Ltd., and Nepal Bangladesh Bank Ltd. have been selected which represents almost 13% of the total population.

The study is based both on primary and secondary data. Secondary data have been collected from annual reports and websites of the concerned companies and published NRB Directives. For primary data, questionnaires were designed to look into the various issues that are related to capital adequacy ratio, loan classification and provisioning of the studied banks.

To analyze the data, this study has used various data analytical methods like charts, tables, graph etc.

5.2 Conclusions

- The total capital fund, core capital and supplementary capital of EBL are in increasing trend indicating the increasing trend of liquidity of the bank to repay the depositors' demand. However the capital fund and core capital fund of LBL and NBBL is decreasing and even negative indicating the inability of the bank to repay the depositors' demand.

- EBL has increased its capital fund by increasing its core capital than its supplementary capital. Such increased portion of Core Capital in total capital fund increases the extent of safeguard of both the survival of the bank and stability of the financial system. However, the core capital of LBL and NBBL is negative. Hence, the healthy survival of EBL is guaranteed and the survival of LBL and NBBL is in threat.

- On the basis of risk weighted assets, we may rank EBL in the first position with the highest risk weighted asset due to highest growth in Loan and Advances. LBL comes in the second position with higher risk weighted asset than that of NBBL due to higher growth in Loan and Advances than that of NBBL. NBBL stands in last position with lowest risk weighted asset due to negative growth in Loan and Advances' growth.

- Throughout the review period, EBL has maintained the capital adequacy ratio as prescribed by NRB. This means that EBL has maintained its financial strength and ability to repay the deposits on the demand of the depositors. LBL has failed to maintain the capital adequacy ratio as directed by NRB. In fact its capital adequacy ratio has gone negative. Similarly, NBBL has also always failed to maintain the Capital Adequacy Ratios. Such shortfall in capital fund means that both LBL and NBBL are financially weak, unable to meet the depositors' requirements, and carries the threat of bankruptcy.

- In terms of capital adequacy EBL is in a much better position than of NBBL and LBL. The bank is heading forward with a healthy growth. However, LBL is in a recovering stage but the position of NBBL in terms of capital adequacy is deteriorating.
- Comparatively, despite of highest deposits, loan and advances and income spread, EBL stood second to NBBL in case of Net Profit. LBL is the one with lowest deposits, loan and advances and income spread and so with the net profit.

- EBL has been doing exceptionally well than by LBL and NBBL in increasing its' loans and advances. LBL has been improving and increasing its market rapidly. NBBL though, is ahead of LBL in figure of Loan Extended, is lying behind LBL in the growth rate of loan extended.

- EBL and LBL have maintained the idle Loan Loss Provision. This means though the loan advanced by them converts into bad loan, they have sufficient fund to compensate the loss. Hence deposits of the depositors are safe and the bank is safe from financial crisis that may arise due to non-recovery of loan. NBBL also has met the standard of loan loss provision in aggregate, but it continuously failed to maintain the provision for bad loan as directed by NRB. The main reason behind such failure is the increase in the bad loans of the bank due to the change of NRB directives in the period of bad loans from over 3 years (f.y 057/58) to over 1 year (f.y. 062/63).

- It was also observed during the analysis period that the NPA percentage of EBL is one of the lowest among the commercial banks and NPA percentage of NBBL is one of the highest among the private commercial banks of Nepal. Hence, NBBL is in a highly risky position than EBL and LBL as among every loan of Rs. 100.00 extended by NBBL, loan of Rs.39.19 turns to be or may soon turn to be bad loan.

- It has been observed during the research that EBL has been continuously following the directives issued by NRB in every sector.

- Hence, after going through all above analysis, we can conclude that EBL is in a far better position in maintenance of capital fund, extension and maintenance of Loan and Advances and NPA position than LBL and NBBL is and NBBL is in the worst condition however LBL is in a recovery stage as its negative balances are decreasing.

- The change in the capital adequacy affects the shareholders. It also affects loan clients as more capital adequacy to be kept, lesser will be the borrowing capacity of the bank and the loan clients will be affected.

- The commercial banks are regularly following the directives. Though some norms are disobeyed sometimes but there are only few areas where these directives are disobeyed.

- The frequent changes made by NRB in NRB standards have a significant impact on the various aspects of the commercial banks. NBBL failed to meet the standards regarding capital adequacy in the early changes in the rates. In later years, LBL also failed to maintain the standard.

5.3 Recommendations

After analyzing the necessary data of the three banks, this research has recommended EBL to use its remaining fund in loans & advances and investment but NBBL and LBL first of all must meet the criteria of capital adequacy before investment. The recommendations for Nepal Rastra Bank, Everest Bank Ltd., Lumbini Bank Ltd. and Nepal Bangladesh Bank are followings:

Recommendations for Nepal Rastra Bank

- Though NRB is the one who formulates the directives but commercial banks are the one who bring them into action. No matter how effective the formulated directives are but they become irrelevant if their implementation is not effective. Hence NRB should consult the commercial banks before setting standards on different aspects of commercial banks. It has been observed that commercial banks are raising questions on timing of the directives and NRB believes that they are making excuses out of this. It shows there is lack of co-ordination between Nepal Rastra Bank and commercial banks of Nepal. Hence the complaints and criticisms of bank officials should be considered accordingly. Consequently, an optimal standard will ensue which will satisfy almost every complaints of commercial banks.

- As we know, directives are only tools of NRB to supervise monitor and control the financial institution; it must be formulated, taking into consideration, the positive as well as negative impact on the commercial banks. Issue of wrong or unsuitable directives, may ruin the conditions of commercial banks instead of enhancing its situation. Also, NRB should take necessary actions to ensure that its recent directives have been compelled to be followed by all commercial banks.

- NRB also has to strengthen the functioning of its Credit Information Bureau so that the commercial banks receive the details of the blacklisted borrower in quick time. This will reduce chances of creating bad quality assets in the bank balance sheet.

- It was observed that NRB is playing reactive role instead of being proactive. Sometimes the inspection of the bank shall be done without prior notice to the bank so that the concern bank may not have the chance to hide their irregularities. Any deviations during the inspection shall be informed to the branch immediately and the ratification period shall be defined, the failure of which shall be penalized. Unlike the case of NBBL bank where NRB delayed in taking action against the bank during which the position of the bank was almost non-recoverable, NRB should also have the policy to take the proactive measures.

Recommendations for Everest Bank Ltd.

- Everest Bank Ltd. is doing best by reducing its NPL account but if we see the portfolio of NPL, then it is noticeable that bad loan is increasing dramatically every year, which is not good for the bank. Though it has reduced in f.y 063/64, the noticeable decrement has not been found. Although EBL is doing best, it must be very careful and take necessary steps to recover the NPL account and reduce it to zero so that it can stop other loans from becoming bad loans.

- In the name of increasing capital base, Everest Bank Ltd. is cutting down the earning of its shareholders. Since shareholders are the actual owners of the bank and are investing their money with a hope of handsome returns, management should be very careful and must provide adequate return for their investment.

- It has been observed that EBL has maintained an excess core capital of Rs. 347.41 million and Rs. 28.07 million of excess capital fund. EBL shall try to increase its' supplementary capital fund also to meet the total capital fund requirement and not to maintain excess capital fund in the core capital only. In stead of keeping this excess capital ideal, bank should invest them further to increase the income opportunities as ideal capital only increases opportunity cost.

- EBL has not just provisioned the required amounts for all categories of loans but has provisioned additional amount of Rs 25.16 million to meet the possible future default loans. The excess is not much higher but yet the excess provisioned amount should be brought into investment in stead of keeping it idle.

Recommendations for Lumbini Bank Ltd.

- Though LBL has been doing lots of improvements, it still has failed to maintain sufficient capital fund to set the capital adequacy ratio as directed by NRB. Due to the adjustments of previous cumulative losses, its Capital Adequacy Ratio has gone negative. Hence the bank is recommended to increase its Capital fund sufficiently so as to recover its cumulative losses of previous years and to meet the standards set by NRB.

- Various ways may be recommended to LBL to increase the capital fund. One of the easy ways to do so is the issuance of the additional shares in the market either in the form of ordinary shares or in the form of right shares. In case of paying the cash dividend, the bank may pay stock dividends. If the existing share holders do not want to share their positions, the bank may issue preference shares too but for this purpose it should be confident that the sufficient amount of profits will be earned per year.

- LBL has maintained Loan Loss provisions excess by Rs. 0.31 million. Though the excess is not many high but such extra provisions can be further invested in the productive sectors in stead of being kept idle.

- Maximum part of the LBL's loan falls under Pass Loan category but it is also true that a huge amount of loan still falls under the bad loan category. The bank needs to pay special attention in decreasing the total bad loan amount. A strict follow up is required to recover such bad loans. However as maximum portion of loan falls under Pass Loan and as the provisions made by the bank is as per NRB directives, the loan monitoring of LBL is very good.

- NPA of LBL was in increasing trend till f.y 062/63 but in f.y 063/64, a slight decrease has been found in NPA. Still the decrease is not noticeable in amount. NPA of 20.37% is still a matter of threat for the bank. The bank should try to decrease NPA to zero percent.

Recommendations for Nepal Bangladesh Bank Ltd.

- As the core capital of NBBL is highly negative in balance, the risk bearing capacity of bank has been minimized. In such situation, in order to minimize the influence of bank's promoters over the bank and to increase capital reserve, it is must to issue the share to individuals and companies other than promoters using NRB act 2058, section 86(e).

- Large portion of NBBL's loan amount is related to Non-Performing Loan. The reasons behind inability of the bank to collect its loan amount may be centralization of the huge loan amount within few huge and powerful debtors which disables single borrower loan limit and the recovery capacity of the bank. Hence bank is advised to diversify its loan and advances as far as possible. However, lots of improvement has taken place in recovery situation of loan after the bank has been taken over by NRB.

- NBBL has failed to follow the NRB directives in different sectors which is challenging the safeguard of the deposits of the depositors and decreasing the faith of depositors over the bank. Hence the bank has to follow the directives issued by NRB in different sectors which in turn will increase the depositors' trust.

- NBBL, the bank that is in operation from 2002 A.D, should adjust its procedural guidelines of its Loan and Advances as per the need of changing time.

- NBBL rather than extending the loans further shall attempt to recover the loans it has disbursed already. The main focus of the bank now shall be converting the bad loans to the good loans and bring the NPA percentage to a minimum level.

- Generally the core capital act as the main base to decide the limits of i) the sector wise loan bank can advance, ii) net position of its foreign exchange and iii) the investment in organized institutions' shares and debentures. But as the core capital of NBBL is highly negative, the bank should take necessary actions to get fixed such limits from NRB.

- NBBL has to make its monitoring and follow up department stronger. Bank needs to give priority in human resource development through training its staff and make them efficient enough to monitor and collect already disbursed loans. Also, the bank has to come up with a stronger internal audit department to make sure that the directives are properly implemented.

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Annexure – I

Growth of Capital Fund of Everest Bank Ltd.

$$\text{a) Growth in Total Capital Fund in 7 yrs(\%)} = \frac{\text{Total Capital Fund (063/064)} - \text{Total Capital Fund (057/058)}}{\text{Total Capital Fund (057/058)}} \times 100\ \%$$

$$= \frac{1676.12 - 382.19}{382.19} \times 100\ \%$$

$$= \frac{1293.33}{382.19} \times 100\ \%$$

$$= 338.56\ \%$$

$$\text{b) Growth in Core Capital in 7 yrs (\%)} = \frac{\text{Core Capital (063/064)} - \text{Core Capital(057/058)}}{\text{Core Capital (057/058)}} \times 100\ \%$$

$$= \frac{1171.13 - 310.67}{310.67} \times 100\ \%$$

$$= \frac{860.46}{310.67} \times 100\ \%$$

$$= 276.97\%$$

$$\text{c) Growth in Supp. Capital in 7 yrs(\%)} = \frac{\text{Supp. Capital (063/064)} - \text{Supp. Capital(057/058)}}{\text{Supp. Capital (057/058)}} \times 100\ \%$$

$$= \frac{504.98 - 71.52}{71.52} \times 100\ \%$$

$$= \frac{433.46}{71.52} \times 100\ \%$$

$$= 606.07\ \%$$

Annexure - II

Growth of Capital Fund of Nepal Bangladesh Bank Ltd.

$$\text{A) Growth in Total Capital in 7 yrs (\%)} = \frac{\text{Capital Fund (063/064)} - \text{Capital Fund (057/058)}}{\text{Capital Fund (057/058)}} \times 100\ \%$$

$$= \frac{-1038.20 - 879.05}{879.05} \times 100\ \%$$

$$= \frac{-1917.25}{879.05} \times 100\ \%$$

$$= -218.11\ \%$$

$$\text{b) Growth in Core Capital in 7 yrs(\%)} = \frac{\text{Core Capital (063/064)} - \text{Core Capital (057/058)}}{\text{Core Capital (057/058)}} \times 100\ \%$$

$$= \frac{-1038.20 - 151.64}{151.64} \times 100\ \%$$

$$= \frac{-\ 1599.54}{151.64} \times 100\ \%$$

$$= -784.65\%$$

$$\text{c) Growth in Supp. Capital in 7 yrs(\%)} = \frac{\text{Supp. Capital (063/064)} - \text{Supp. Capital (057/058)}}{\text{Supp. Capital (057/058)}} \times 100\ \%$$

$$= \frac{0 - 317.41}{317.41} \times 100\ \%$$

$$= \frac{-\ 317.41}{317.41} \times 100\ \%$$

$$= -\ 100\ \%$$

Annexure - III

Growth of Capital Fund of Lumbini Bank Ltd.

$$\text{A) Growth in Total Capital in 7 yrs (\%)} = \frac{\text{Total Capital (063/064)} - \text{Total Capital (057/058)}}{\text{Total Capital (057/058)}} \times 100\ \%$$

$$= \frac{-435.81 - 336.86}{336.86} \times 100\ \%$$

$$= \frac{-772.67}{336.86} \times 100\ \%$$

$$= -229.37\ \%$$

$$\text{B) Growth in Core Capital in 7 yrs (\%)} = \frac{\text{Core Capital (063/064)} - \text{Core Capital (057/058)}}{\text{Core Capital (057/058)}} \times 100\ \%$$

$$= \frac{-435.81 - 285.64}{285.64} \times 100\ \%$$

$$= \frac{-721.45}{285.64} \times 100\ \%$$

$$= -252.57\%$$

$$\text{c) Growth in Supp. Capital in 7 yrs (\%)} = \frac{\text{Supp. Capital(063/064)} - \text{Supp. Capital(057/058)}}{\text{Supp. Capital (057/058)}} \times 100\ \%$$

$$= \frac{0 - 51.22}{51.22} \times 100\ \%$$

$$= \frac{-\ 51.22}{51.22} \times 100\ \%$$

$$= -\ 100\ \%$$

Annexure – IV

Total Risk Weighted Assets (TRWA) of EBL

(Fig in million)

	2057/058	2063/64
Risk Weighted Assets of EBL	3580.50	14976.74
Loan & Advances including Bills Purchased	2999.39	14082.69

Loan, Adv & BP percentage in TWRA (As on FY 2063/064) $= \dfrac{\text{Loan, Adv. \& BP of 2063/64}}{\text{TRWA (2063/064)}}$

$$= \frac{14082.69}{14976.74} \times 100\ \%$$

$$= 94.03\ \%$$

Avg growth of TWRA (During FY 2057/058 – 2063/064) $= \dfrac{\text{TWRA (2064)} - \text{TWRA (2058)}}{\text{TRWA (2058)}} \times 100$

$$= \frac{14976.74 - 3580.50}{3580.50} \times 100\ \%$$

$$= \frac{11396.24}{3580.50} \times 100\ \%$$

$$=318.29\ \%$$

Annexure –V

Total Risk Weighted Assets (TRWA) of NBBL

	2057/058	2063/64
		(Fig in million)
Risk Weighted Assets of NBBL	9452.00	11960.83
Loan & Advances including Bills Purchased	7358.84	5854.58

Loan, Adv & BP percentage in TWRA (As on FY 2061/062)

$$= \frac{\text{Loan, Adv. \& BP of 2063/64}}{\text{TRWA (2063/064)}} \times 100\%$$

$$= \frac{5854.58}{11960.83} \times 100\ \%$$

$$= 48.95\ \%$$

Avg growth of TWRA (During FY 2057/058 – 2063/064)

$$= \frac{\text{TWRA (2064)} - \text{TWRA (2058)}}{\text{TRWA (2058)}} \times 100\%$$

$$= \frac{11960.83 - 9452.00}{9452.00} \times 100\ \%$$

$$= \frac{2508.83}{9452.00} \times 100\ \%$$

$$=26.54\ \%$$

Annexure – VI

Total Risk Weighted Assets (TRWA) of LBL

(Fig in million)

	2057/058	2063/64
Risk Weighted Assets of LBL	2120.15	5586.35
Loan & Advances including Bills Purchased	1786.13	4944.50

Loan, Adv & BP percentage in TWRA (As on FY 2063/064)

$$= \frac{\text{Loan, Adv. \& BP of 2063/64}}{\text{TRWA (2063/064)}} \times 100\%$$

$$= \frac{4944.50}{5586.35} \times 100\,\%$$

$$= 88.51\%$$

Avg growth of TWRA (During FY 2057/058 – 2063/064)

$$= \frac{\text{TWRA (2064)} - \text{TWRA (2058)}}{\text{TRWA (2058)}} \times 100\%$$

$$= \frac{5586.35 - 2120.15}{2120.15} \times 100\,\%$$

$$= \frac{3446.1}{2120.15} \times 100\,\%$$

$$=163.48\%$$

Annexure – VII

Growth of Loan, Advances & Bills Purchased

(Fig in million)

	2057/058	2063/64
Loan & Advances including Bills Purchased (EBL)	2999.39	14082.69
Loan & Advances including Bills Purchased (NBBL)	7358.84	5854.58
Loan & Advances including Bills Purchased (LBL)	1786.13	4944.50

EBL

Avg growth of Loan, Adv & BP (During FY 2057/058 – 2063/064)

$$= \frac{\text{Loan, Adv \& BP(2064)} - \text{Loan, Adv \& BP(2058)}}{\text{Loan, Adv \& BP(2058)}} \times 100\%$$

$$= \frac{14082.69-2999.39}{2999.39} \times 100\ \%$$

$$= \frac{11083.3}{2999.39} \times 100\ \%$$

$$= 369.51\%$$

NBBL

Avg growth of Loan, Adv & BP (During FY 2058/059 – 2061/062)

$$= \frac{\text{Loan, Adv \& BP(2064)} - \text{Loan, Adv \& BP(2058)}}{\text{Loan \& Adv (2058)}} \times 100\%$$

$$= \frac{5854.58 - 7358.84}{7358.84} \times 100\ \%$$

$$= \frac{-1504.26}{7358.84} \times 100\ \%$$

$$=-20.44\%$$

LBL

$$\text{Avg growth of Loan, Adv \& BP} = \frac{\text{Loan, Adv \& BP(2064)} - \text{Loan, Adv \& BP(2058)}}{\text{Loan \& Adv (2058)}} \times 100\%$$

(During FY 2058/059 – 2061/062)

$$= \frac{4944.50 - 1786.13}{1786.13} \times 100\ \%$$

$$= \frac{2858.37}{1786.13} \times 100\ \%$$

$$=176.83\%$$

Annexure – VIII

Growth of Net Loan& Advances

(Fig in million)

	2057/058	2063/64
Net Loan of EBL	2936.59	13723.73
Net Loan of NBBL	3742.14	7074.91
Net Loan of LBL	1735.95	3840.69

EBL

$$\text{Avg growth of Net Loan \& Adv (During FY 2057/058 – 2063/064)} = \frac{\text{Net Loan \& Adv (2064)} - \text{Net Loan \& Adv(2058)}}{\text{Net Loan \& Adv (2058)}} \times 100\%$$

$$= \frac{13723.73 - 2936.59}{2936.59} \times 100\ \%$$

$$= \frac{10787.37}{2936.59} \times 100\ \%$$

$$= 367.34\ \%$$

NBBL

$$\text{Avg growth of Net Loan \& Adv (During FY 2057/058 – 2063/064)} = \frac{\text{Net Loan \& Adv (2064)} - \text{Net Loan \& Adv(2058)}}{\text{Net Loan \& Adv (2058)}} \times 100\%$$

$$= \frac{7074.91 - 3742.14}{3742.14} \times 100\ \%$$

$$= \frac{3332.77}{3742.14} \times 100\ \%$$

$$= 89.06\ \%$$

LBL

$$\text{Avg growth of Net Profit} = \frac{\text{Net Profit (2064)} - \text{Net Profit (2058)}}{\text{Net Profit (2058)}} \times 100\%$$

(During FY 2057/058 – 2063/064)

$$= \frac{192.40 - (-36.94)}{36.94} \times 100\ \%$$

$$= \frac{229.34}{36.94} \times 100\ \%$$

$$= 620.84\%$$

Annexure – IX

Growth of Net Profit

(Fig in million)

	2057/058	2063/64
Net Profit of EBL	69.71	296.41
Net Profit of NBBL	198.75	392.70
Net Profit of LBL	38.63	193.88

EBL

Avg growth of Net Profit (During FY 2057/058 – 2063/064) $= \dfrac{\text{Net Profit (2064) – Net Profit (2058)}}{\text{Net Profit (2058)}} \times 100\%$

$$= \frac{296.41 - 69.71}{69.71} \times 100\ \%$$

$$= \frac{226.7}{69.71} \times 100\ \%$$

$$= 325.21\ \%$$

NBBL

Avg growth of Net Profit (During FY 2057/058 – 2063/064) $= \dfrac{\text{Net Profit (2064) – Net Profit (2058)}}{\text{Net Profit (2058)}} \times 100\%$

$$= \frac{392.70 - 198.75}{198.75} \times 100\ \%$$

$$= \frac{193.95}{198.75} \times 100\ \%$$

$$=97.58\%$$

LBL

$$\text{Avg growth of Net Profit} = \frac{\text{Net Profit (2064)} - \text{Net Profit (2058)}}{\text{Net Profit (2058)}} \times 100\%$$

(During FY 2057/058 – 2063/064)

$$= \frac{193.88 - 38.63}{38.63} \times 100\ \%$$

$$= \frac{155.25}{38.63} \times 100\ \%$$

$$= 401.89\%$$