CHAPTER - I
INTRODUCTION

1.1 Background of the Study

To start with, performance in terms of profitability is a benchmark for any business enterprise including the banking industry. Extension of credit is one of the major activities of banks and financial institution. Credit represents the bulk of the bank and financial institution’s asset portfolio. However, increasing NPAs have a direct impact on banks profitability as legally banks are not allowed to book income on such accounts and at the same time banks are forced to make provision on such assets as per the central Bank guidelines. Also, with increasing deposits made by the public in the banking system, the banking industry cannot afford defaults by borrower since NPAs affects the repayment capacity of banks. Further, central Bank successfully creates excess liquidity in the system through various rate cuts and banks fail to utilize this benefit to its advantage due to the fear of burgeoning non-performing assets.

Economic development is the foundation development of any country. Economic development is supported by the financial infrastructure of that country. Financial institution constitutes an important part of the financial infrastructure. The main function of the bank is the collection of idle funds and mobilizes them to productive sector causing overall economic development, which finally leads to national development of the country. Bank pools the fund through deposit and mobilize them to productive sector in the form of loans and advances. Bank is the financial institution which deals with money by accepting by accepting various types of deposits, disbursing loan and rendering various types of financial services. It is the intermediary between the deficit and surplus of financial sources.

It cannot be denied that the issue of development rest upon the mobilization of resources and the bank deals in process of channelizing the available resources in the needed sectors. Commercial bank collects deposits from the public and the largest portion of deposited funds is utilized by disbursing loan and advances. The balance sheet of a commercial bank reflects deposit constitutes a major portion of the liabilities and the loan and advances constitutes a major portion of the asset side. Similarly the profit of the bank depends upon the spreads that it enjoys between the interest it receive from the borrowers and that to be paid to the depositors. An average bank generates about 70% of its revenue through its lending. The return that the bank enjoys of deposit mobilization through loan and advances is very attractive but they do not come free of cost and free of risk. There is risk in lending. The bank faces number of risk like interest rate risk, liquidity risk, credit risk, borrower risk etc. Such risk in excessive form had led many banks to go bankrupt in number of countries.

Amongst many risk that bank faces one of the most critical is borrower risk – the risk of non payment of the disbursed loans. Failure to collect fund disbursed may sometimes result in the bank’s inability to make repayment of the money to depositors and return to the shareholders. The bankers have the responsibility of safeguarding the interest of the depositors, shareholder and society they are serving. If bank behaves unresponsively the cost born by the economy is enormous. Banking sector is volatile and sensitive sectors of national economy, which require effective monitoring and efficient supervision. Smooth and effective operation of banking activities is most for sustainable economic growth of a country. The regulatory agency should always be watchful of banking activities carried out by government and non governmental banking and financial institution.

In the distant past, banks had to deal with only few cases of bad-loans. So, they used to take legal actions against chronic defaulters of bank-loans. For the last ten/twelve years, banks are suffering from a large chunk of non-performing loans (assets) as a consequence of economic as well as non-economic factors in the country. By international parameter, non-performing assets of a bank should not exceed ten percent while such an indicator is estimated to have been crossed 26 percent, (Rs. 31 billion in aggregate) mainly due to the increase in willful defaulters in the government, semi-government and private sector banks.

Recovery of bad loans by banks and financial institutions has turned into a big issue in the financial sector of Nepal. This has greatly caused negative impact upon Banks' profit, government revenue and the overall financial sector of the country. This calls for an effective system and mechanisms that case the early recovery of debts of Banks and also of bank-like institutions as specified by Nepal Rastra Bank-the Monetary Authority.

Due to their control role in the economy, government and central bank try their best to rescue banks from such situations. Hence to protect the banks from such situation and protect depositors and shareholders interest, central bank issues various directives and guidelines from time to time with modification and amendments for the sound regulation of the banking system. All the banks have to abide by the rules and regulation issued by central bank of the country.

1.2 Focus of the Study

Bank disbursed loan and advances for certain predetermined periods or every loans and advances has its maturity period or expiry date and borrower must repay the loan by the maturity period but there is no certainty that all the loans are recovered by the maturity date. Some loans are recovered with in maturity period but some loans are not recovered even after its maturity period and remains as non-performing asset of the bank. Bank in Nepal are in poor health. Increasing non-performing asset of Nepalese banking sector is estimated to be 30%. Bank is facing problems in recovering the granted loans that had turned to non-performing asset. The nationalized two commercial bank named Nepal Bank Limited and Rastriya Banijya Bank have non-performing asset to the extent of 60% and 50% respectively. Nowadays, in most of national newspaper, it can be seen that government owned commercial bank are publishing names of borrower who defaulted in making payment of bank loans. Even the private and joint venture banks are facing the problem of increasing non-performing asset. This problem may lead to bankruptcy bank and failure of banking system adversely affecting the depositors and other parties of the society.

The origin of the problem of burgeoning NPAs lies in the quality of managing credit risk by the banks concerned. What is needed is having adequate preventive measures in place namely, fixing pre-sanctioning appraisal responsibility and having an effective post-disbursement supervision. Banks concerned should continuously monitor loans to identify accounts that have potential to become non-performing.

In order to rescue bank from the financial distress, to safeguard depositors interest to ensure stability in the economy, NRB issues directives from time to time related to various aspects of the banks. NRB directives number 2 (2001) is related to loan classification and provisioning of commercial banks. As per this directive commercial bank supposed to categorize the loan disbursed into four different categories on the basis of ageing of its past dues and each categories of loan require certain percentage of it to be provisioned for the probable loss. Going through the old directives regarding the loan loss provision, banks had classified loans into six categories and as per those directives, for a loan to be bad the time period of past due was 5 year. But with new directives, that period has also been reduced. This means the previously categorized substandard loan will now be a doubtful loan and a doubtful loan is bad loan. The provisioning amount is taken from by deducting from the profit of the bank. Hence there is great impact of loan loss provision in the profitability of the banks. The provision of the loan means the net profit of the bank will come down by that amount. Increase in loan loss provision decrease then profit of the bank leading to decrease in dividends to shareholders. However adequate loan loss provision strengthen the financial health of the banks by controlling credit rill and safeguards the depositors money leading to overall economic development of the country.

1.3 Statement of the Problem

After the liberalization policy in 1980s, the financial made some progress and prudent regulatory measure have been introduced by central bank of the country. However actual performance of the financial institution couldn’t improve. Financial institution in Nepal have been facing several problems like lack of smooth functioning of economy, different policies and guidelines on Nepal Rastra Bank , political instability, security problems, poor information system, over liquidity caused by lack of good lending opportunity, increasing NPAs. etc. in the present context where Nepalese commercial banks are facing the problem of increasing NPAs, more amount has to be allocated for loan loss provision. As earlier mentioned, the provision amount is taken out by deducting from the profit of the bank; the profit of the bank might come down. This research has been conducted to find out the solution of following problem:-

- What is the proportion of non performing asset in the selected commercial banks?
- What are the factors leading to accumulate of non performing asset?
- What are the guidelines and provision pertaining to loan classification and loan loss provision?
- What is the relationship between loan and loan loss provision in the selected commercial bank?
- What is the impact of loan loss provision on the profitability of the commercial banks?

1.4 Objectives of the Study

The main objective of this research was to examine and study of non performing assets of commercial banks, especially of Nepal Arab Bank Limited and Nepal Investment Bank Limited. The specific objectives are:

a. To find out the level of non-performing assets in selected commercial bank.
b. To study and find the impact of non-performing assets on the profitability of the commercial bank.
c. To find out the portion of risky assets in the total assets of the commercial banks.
d. To measure the relationship between NPA with total deposit and net profit.
e. To find out the factors leading to accumulation of non performing assets in commercial bank.

1.5 Significance of the Study

It is well known fact that the financial institution and bank in Nepal has been facing the problem of increasing non- performing assets and issue becomes more and more critical. Unfortunately nowadays banks have been becoming victims of high level of non- performing assets. Non- performing assets are those loans, which neither pay interest nor repay the principal. So non- performing assets have been becoming subject of headache to the banking sector. Likewise Nepalese banking sectors cannot escape from such truth.

Concerning to the central library of Tribhuvan University, it has been found that there are a few research regarding non- performing assets and loan loss provision. This research will be able to deliver some of the present issues, latest information and data regarding non- performing assets and loan loss provision. Hence this study will be significant to bankers, shareholders, depositors and further researcher, students etc.

1.6 Limitation of the Study

The research is conducted to fulfill the academic requirement of Master of Business degreee. It is focused on the study of non performing asset of NABIL & NIBL based of theaudited financial annual reports of condition of each bank during the period 2003/04 to 2007/08. This research is tried to cover all the aspects of the non-performing assets. However the present research has the following limitation:

a. This research is concerned only with the non- performing assets of commercial bank. It doesn't consider other aspects of banks.
b. This research is focused on the Nepalese commercial bank and only two commercial bank, namely NABIL and NIBL, have been selected as sample for the study.
c. The period of the study is limited for fiscal year 2003/04 to 2007/08.
d. The accuracy of secondary data mainly relies on the annual reports of the banks and the accuracy of the primary data totally relies on the responses of the respondents. Any mispresentation, mistakes, omission etc may affect the outcome of the study. Thus, the reality of the study depends on secondary sources of the data and questionnaire filled and responses given by the respondents.

1.7 Organization of the Study

This research work has been divided into five chapters:

Chapter – I: Introduction

This chapter deals with the subject matter of the study consisting background of the study, statement of the problems, objective of the study, significance of the study, limitation of the study and organization of the study.

Chapter – II: Review of the Literature

The second chapter incorporates review of theoretical and related literature regarding the subject matter.

Chapter – III: Research Methodology

The third chapter deals with the research methodology which consist of research design, sources of dada, population and sample along with different statistical and financial tools used in this research.

Chapter – IV: Data Presentation and Analysis

This chapter deals with the main part of the research. In this chapter effort have been made to present and analyze the data in required form.

Chapter – V: Summary, Conclusion and Recommendations

This chapter deals with summary and conclusion of the research and recommendation given to the concerned organization.

Besides these chapters, Bibliography and Appendix are also presented at the end of the research.

CHAPTER - II
REVIEW OF LITERATURE

This chapter is related to examine and review some related to books, articles, published and unpublished economic journals, bulletins, magazines, newspapers, and websites.

2.1 Conceptual frame work

2.1.1 Loan and Advances

The main function of the commercial banks is to generate the resources or funds and make loan and advance. It is the most profitable assets of bank. Loan and advances dominate the assets side of balance sheet of any bank.

Similarly, earning from such loan and advances occupy a major space in income statement of the bank. It is the assets that fetches income for the bank. "The profitability of the banks depends upon the extent to which it grants loan and advances to customers. Loan granted in the form of overdraft, cash credit and direct loan. Loan are granted against adequate security. The banks should have to take in consideration safeties of loan and advances at the time of lending but not only on profitability. At the time of lending the loan, the banks carefully study the lending sectors and make a sound policy for rendering loan. The policy should contain the credit deposit ratio. (CDR), the bank wishes to maintain. CD ratio is very much influenced by the behaviors of bank's liabilities. The higher the volatile deposit's and volatile borrowing lower the volume of loan and vice versa." (Shekher & Shekher, 1998: 27)

2.1.2 Performing loan

"Performing loans are those loans that repay principle and interest timely to the bank from the cash flow it generates. In other word, performing loan are the productive assets that generate the some profits. Loans have the certain time period to return its principle with its interest. If anyone repays loan with its interest on time, is known as the performing loan. It is the most profitable assets of banks. Its helps to rapid growth of banking sector in this fast pace competitive age. Better performing loan are the symbol of success of banks. But many banks are suffering from the non repayment of loan amount.” (Timilsina, 1997: 67)

2.1.3 Non-Performing Assets/Loan (NPAs/NPL)

“One of the most emerging problems of the commercial banks is to the management of non-performing assets/loan. Due to the effects of non-analysis of Non-performing Assets of Nepalese Commercial Banks performing assets/loan, many banks have already closed down. In this fast pace competitive age, the bank should have to operate taking in consideration that thing.

Non Performing Asset means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by NRB.” (Dahal & Dahal, 2002: 15)

“If any advances or credit facilities granted by bank to a borrower becomes non-performing, then the bank will have to treat all the advance/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may be still exist certain advance/credit facilities having performing status.” (Pandey, 1999: 167)

“NPAs have a different meaning that varies from country to country. In some countries, it means that the loan is impaired. In some countries, it means that the payment are due but there are significant different among countries how many days a payment should be in arrears before past due status is triggered.” (Shrestha, 2004: 14) “According to current banking Act, the banks have to make provision for bad and doubtful debts. After deducting the band and doubtful debts from the non-performing assets, net non-performing assets can be achieved.” (Regmi, 2063:75)

NPA = (NPL+NBA+RNPL+SI+UA)

Where;

NPA = Non-Performing Assets

NPL = Non-Performing Loan

NBA = Non- Banking Assets

RNPL = Remaining non performing loan

SI = Suspend Interest

UA = Unutilized Assets

“Non-Performing loan (NPL) can be defined as the non-productive assets of the banks. In other words, it is the loan or bad and doubtful debts that doesn't repay timely. Generally the loan, which doesn't repay with in three months, is known as non-performing loan. The loan amount that doesn't covered by the collateral after selling is known as non-banking assets (NBA). Non – performing assets also includes the suspend interest. It is the interest, which become receivable unutilized assets and those investments which don't generate any cash or incomes to the bank are also non- performing assets (NPAS). The proper management of those assets to generate income is known as management of non-performing assets.” (Rahdaswami & Vasudevan, 1984: 49)

Increasing NPAs is the emerging problem of the banks. We know that the some banks are closed sown due to the uncontrollable NPAs. In USA, 1016 commercial banks were declared as unsuccessful (bankruptcy) from 1985 to 1990 and 27 banks from 1995 to 2001. However, Nepalese commercial banks face this type of problem till now but they have to take step towards it. For this, appropriate amount of bad and doubtful debts is made provision from their incomes/profits.

2.1.3.1 International Definition of Non Performing Assets

“According to Finnish and Norwegian definitions, an asset is to be classified as nonperforming if interest or principal payments are in arrears for at least three months. In Sweden a payment disruption is allowed for only two months. In Japan an asset is nonperforming if the interest has been in arrears for at least six months. In the United Kingdom nonperforming assets are only mentioned in accounting instructions; there is no precise definition.” (Pensala & Soltilla, 1993: 7)

In the Nordic countries an off-balance-sheet bank guarantee becomes a nonperforming asset immediately the bank effects payment on the basis of the guarantee.

Accounting regulations in Sweden and Norway recognize the concept of a "soft loan". This is a loan on which a bank has agreed to set the interest payable at a rate substantially below the market rate because of the customer's inability to pay. The concept of other zero-interest assets is not recognized outside of Finland. These can, however, be considered as soft loans. (Pensala & Soltilla, 1993: 8)

In Sweden problem assets are reported as the sum of nonperforming assets and soft loans. In Norway soft loans are not included in nonperforming assets. In Finland other zero-interest assets (soft loans) are included in the concept of non performing assets. The Swedish concept of problem assets is thus the broadest concept applied in the Nordic countries. (Pensala & Soltilla, 1993: 8)

The Japanese Ministry of Finance defines narrow and broad concepts of banks' nonperforming assets. The narrow concept includes only assets on which the interest has been in arrears for a specified period. The broad concept also includes soft loans. (Pensala & Soltilla, 1993: 8)

2.1.3.2 Causes of occurring NPA

“There are various causes to increase the NPAs. NPAs can be increased due to;” (Wild, Subramanyam & Haskey, 2003: 118)

- Lack of transparent and clear policy to mobilize the assets productively.
- Lack of effective fore casting or deviation between expectation and actual outcomes of the business.
- Wrong choose of project and business to lend the fund.
- Lack of supervision, monitoring and control.
- Lack of information and communication between bank and customer.
- Lack of closed relationship between banker and customer.
- Lack of proper information about the situation and transaction of the

customer at the time of rendering loan.

- Wrong valuation of accepted collateral by the bank to the loan.
- Lack of step towards the decrease or sell the NPAs, which don't useful to the bank.
- Lack of training and seminars to build the smart human resources.
- Get loss from the operation of the business/project by the customer of the bank.
- Depression of the economy of the country due to the in security and instability of the business environment.
- Lack of proper policy and act to return the expired loan.

2.1.3.3 Effect of NPAs

NPAs has affected the profitability liquidity and competitive functioning of public and private sector banks and finally the psychology of the bankers in respect of their disposition towards, credit delivery and credit expansion.

"Increasing Non-Performing Assets (NPAs) has the direct effects to banks, investors and customers. It has also negative impact to the economic health and business of country. It has two types of effects." (Johnson & Johnson, 2003:6)

a) Internal Effect

"In the one hand, the bank for increasing the profitability can't mobilize the non-performing assets. In the other hand, the banks have to make provision doubtful debts from their profits and other sources. That's why the profit of the banks decreases or may occur losses. As a result, share capital also becomes capital erosion and capital inadequacy." (Johnson & Johnson, 2003: 10) In the present context, capital adequacy ratio in Nepal, India, UAE, and Indonesia are 11%, 12.6%, 12.7% and 21.4% respectively. The central bank of the country can take action to their banking activities, which banks have lower capital or capital adequacy ratio. For example, Nepal Development Bank Ltd. is suffering the same problem that can't take deposit due to the action of Nepal Rastra Bank.

"When the non-performing assets increase, the banks have to increase the amount of provision for doubtful debts and when the loan is repaid, the profit treated as profit. If the provision for doubtful debts crosses 5% of the total loan amount, the bank have to pay income tax as profit. So, it has direct effect to the cash flow of bank. As a result, the employment of human resources and profit of the bank has also affected." (Vaidya, 1998: 25)

i) Impact on Profitability

"The NPAs has negative impacts on the profitability of the banks. Non- Performing assets are the idle assets of the banks, which do not generate any return for the banks. Thus, we can say that the NPAs reduce the profitability of the banks due to the becoming the idle resources. Not only it reduces the profitability of the banks, but also it may the causes for losing the customer's faiths and supports." (Johnson & Johnson, 2003:12)

ii) Impact on The Outlook of Banker Towards Credit Delivery

"The psychology of the banks today is to insulate them selves with zero percent risk and turn lukewarm to fresh credit. This has affected adversely credit growth compared to growth of deposits, resulting a low C/D Ratio around 50% to 54% for the industry. It is evident that the existence of collateral security at best may convert the credit extended to productive sectors into an investment against real estate, but will not prevent the account turning into NPA. Further blocked assets and real estate represent the most illiquid security and NPA in such advances has the tendency to persist for a long duration. Nationalized banks have reached a dead-end of the tunnel and their future prosperity depends on an urgent solution of this hovering threat." (Johnson & Johnson, 2003:15)

iii) Excessive Focus on Credit Risk Management

"The most important business implication of the NPAs is that it leads to the credit risk management assuming priority over other aspects of bank's functioning. The bank's whole machinery would thus be pre-occupied with recovery procedures rather than concentrating on expanding business. A bank with high level of NPAs would be forced to incur carrying costs on a non-income yielding assets. Other consequences would be reduction in interest income, high level of provisioning, stress on profitability and capital adequacy, gradual decline in ability to meet steady increase in cost, increased pressure on net interest margin (NIM) thereby reducing competitiveness, steady erosion of capital resources and increased difficulty in augmenting capital resources. The lesser-appreciated implications are reputation risks arising out of greater disclosures on quantum and movement of NPAs, provisions etc. the non-quantifiable implications can be psychological like 'play safe" attitude and risk aversion, lower morale and disinclination to take decisions at all levels of staff in bank." (Johnson & Johnson, 2003:22)

Two decades of regimented and directed baking to credit delivery has deprived bank managers of the instinct skill and knowledge. Nationalized banking did not produce a spring of talent resources. Directive inputs and course direction came externally from NRB and Finance Ministry which were/are external to the day-to-day affairs and problems of the Nepalese banking industry. The system did not promote initiative and talent, but bred corruption and nepotism. This is the scene of Nepalese Banking struggling hard to transition from old primitive systems and values to modern professional business ethics and corporate good governance.

iv) High Cost of Fund Due To NPAs

"Quite often genuine borrowers face the difficulties in raising funds form banks due to mounting NPAs. Either the bank is reluctant in providing the requisite funds to the genuine borrowers or if the funds are provided, come at a very high cost to compensate the lender's losses caused due to high level of NPAs. Therefore, quite often corporate prefer to raise funds through commercial papers (CPs) where the interest rate on working capital charged by banks is higher." (Johnson & Johnson, 2003:24)

iv) Impact on Banks Scrip on Stock Exchange

"In further of a report, the NRB has said informational asymmetries arising from less onsite/off site inspection, declining performance and shooting NPAs weighed heavily on bank stocks. The NRB has for the first time included stock market behavior of bank scrip in its annual review of the banking sector. As per a NRB Report, despite the various reforms being carried out in Nepalese Stock exchange, much bank scrip remains illiquid and thinly traded. The NRB report says, "Private sector bank stocks whose market performance was affected and attributed the battering the scrip got in the secondary market to their poor performance in general and the concern of the market over their NPAs." (Johnson & Johnson, 2003:27)

b) External Effect

"The banks accept deposits from the public and provide loan to the operation of business and other purposes. When the loan does not return with its interest, it becomes non-performing assets and banks will not able to return the deposited amount to their customer. If the banks unable to return the deposited amount the banks are loosed public supports and faiths. Not only that much but also, the banks have to take loan at a higher rate to pay deposit, which directly affects the profitability of banks and which leads the bank bankruptcy and dissolved. It also affects the monetary system and economy of the country." (Johnson & Johnson, 2003:30)

There are various other pressing factors that are relevant from the point of view of Nepalese banking operations with a view to focusing on NPAs and its related effects;

i) Excess liquidity lending default

The banks in Nepal are faced with the problem of increasing liquidity in the system. Further, the Rastriya Banijya Bank (RBB) is increasing the liquidity in the system through various rate cuts. Banks can get rid of its excess liquidity by increasing its lending but, often shy away from such an option due to the high risk of default. In order to promote certain prudential norms for healthy banking practices, most of the developed economics require all banks to maintain minimum liquid and cash reserves broadly classified into Cash Reserve Ratio (CCR) and the statutory liquidity ratio (SLR). A rate cut (for instance, decrease in CRR) results into lesser funds to be locked up in

NRB's vaults and further infuses greater funds into a system. However, almost all the banks are facing the problem of bad loans, non-performing assets, thinning margins, etc. as a result of which, banks are little reluctant in granting loans to corporate. As such, though in its monetary policy NRB announces the bankers no longer warmly greet rate cut but such news.

ii) Importance of credit rating in assessing the risk of default for lenders

Credit rating has been explained by Moody's, a credit rating agency, as forming an opinion of the future ability, legal obligation and willingness of a bond issuer or obligor to make full and timely payments on principal and interest due to the investors. Banks do rely on credit rating agencies to measure credit risk and assign a probability of default. It depends on the information available to the credit rating agency. Besides, there may be conflict of interest, which a credit rating agency may not be able to resolve in the interest of investors and lenders. Stock prices are an important (but not the sole) indicator of the credit risk involved. Stock prices are much more forward looking in assessing the creditworthiness of a business enterprise.

iii) NRB guidelines on NPAs and ICAI Accounting Standard on revenue recognition

In view of the guidelines issued by the Nepal Rastra Bank (NRB), income on NPAs should be recognized only when it is actually realized. As such, a doubt may arise as to whether the aforesaid guidelines with respect to recognition of interest income on NPAs on realization basis are consistent with Accounting Standard 9, 'Revenue Recognition'. For this purpose, the guidelines issued by the NRB for treating certain assets as NPAs seem to be based on an assumption that the collection of interest on such assets is uncertain. Therefore complying with AS 9, interest income is not recognized based uncertainty involved but is recognized at a subsequent stage when actually realized thereby complying with NRB guidelines as well.

iv) Usage of financial statements in assessing the risk of default for lenders

For banks and financial institutions, both the balance sheet and income statement have a key role to play by providing valuable information on a borrower's viability. However, the approach of scrutinizing financial statements is a backward looking approach. This is because the focus of accounting is on past performance and current positions. The key accounting ratios generally used for the purpose of ascertaining the creditworthiness of a business entity is that of debt-equity ratio and interest coverage ratio. Highly rated companies generally have low leverage. This is because high leverage is followed by high fixed interest charges, non-payment of which results into a default.

2.1.4 Loan Loss Provision

There is associated risk in every loan. To minimize the risk from possible losses of them loans bank has to allocate some funds as loan loss provision. Loan loss provision is the accumulated funds that are provided as a safeguard to cover possible losses upon classification of risk inherited by individual loans. The level of provisioning in depended upon the level of NPAs and their quality. Increased portion of NPAs generate additional liability of resources to the financial institutions. In other words higher the NPA, higher the provision as down graded loans need more provision. 1% provision of total credit is minimum requirement as every pass/good loan has to provision by 1%. However, the ratio of provision may differ from nation to nation. In Nepal, NRB has prescribed:

Pass	1%
Substandard	25%
Doubtful	50%
Loss loan	100%

2.1.5 Principles of lending loan and advances

“The precautions to be taken by a banker, and the principles to be taken care of, while granting advances. By way of introduction, an attempt is being made in the following paragraphs to discuss the general principle to be borne in mind by a banker while granting advances.” (Shekher and Shekher, 1998: 551)

i) Liquidity

“The term 'Liquidity' implies the ability to produce cash on demand. A bank mainly utilizes its deposits for the purpose of granting advances. These deposits are repayable on demand or on the expiry of a specified period. In either case, the banker must be ready to meet these liabilities whenever necessary. The advances granted by the banker are as liquid as possible." (Shekher and Shekher, 1998: 551)

ii) Profitability

"Banks are essentially commercial venture. It is true that excessive and unjustifiable profits can only be at the cost of the customer, in so far as higher lending rates push up production costs, and in the ultimate analysis, adversely affects society in general. At the same time, the facts remains that while strong operating profits allow for full prudential provisioning high net profits allow for allocation to capital and reserves, which is essential for any bank to maintain its competitive viability and expand its lending operations. Also, the shareholders of a bank are entitled to reasonable dividend. All this indicated that it is that their lending operations are sufficiently profitable." (Shekher and Shekher, 1998: 553)

iii) Safety and Security

"The banker should ensure that the borrower has the ability and will to repay the advances as per agreement. The banker should carefully consider the margin of safety. If it is as unsecured advance, its repayment depends on the credit-worthiness of the borrower, and that of guarantor. The banker should consider the Charter, Capacity, and Capital (popularly known as 3 Cs) or Reliability, Responsibility, and Analysis of Non-performing Assets of Nepalese Commercial Banks Resources (popularly known as 3 Rs) of the borrower and the guarantor." (Shekher and Shekher, 1998: 554)

iv) Purposes

"The bankers has to carefully examine the purpose for which the advance has been applied. Of course the exact purpose for which the advance is actually utilized. There is always the possibility that the advance, once granted, may be diverted for purposes other than that indicated by the borrower at the time of application. Thus, there should be proper analysis of purpose." (Shekher and Shekher, 1998: 556)

v) Social Responsibility

"While admitting that banker are essentially commercial ventures, a bank should not forget the fact that it is not enough that only people of means are given bank finance. The identification of priority sectors for the purpose of extending bank credit should be considered as a positive development in the banking system, aimed at effectively discharging its responsibility should not deter the banks from paying adequate attention to the qualitative aspects of lending. Social responsibility is, no doubt, highly exacting." (Shekher and Shekher, 1998: 557)

2.2 Review of NRB Directives

The world has witnessed many financial crises and devastating consequences due to huge financial and economic losses that resulted from each episode. Every crisis was sudden in onset and their, magnitude of losses was much larger than expected. If we go back to the history, then on 3rd march 1997; the Asian crisis began in the form of liquidity problem of two finance companies. Later this spread over to other financial intuition within the Thai financial system. Simultaneously, crisis began to cover Malaysian, Indonesian and South Korean financial statement and loomed in the form of Asian crisis. So this Asian crisis appealed the whole world for regular and timely supervision and assessment of financial system, its soundness and vulnerabilities. This event forced the regulatory authorities for the enforcement of prudential measures in order to avoid further crisis review and revision in prudential regulations such as capital adequacy ratio, asset classification. Provisioning for impaired assets, exposures limit and enforcement of international accounting standard etc have now become common issue all over the world since the late 1990s.

Similarly, in our country too, 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. In addition to these expected happenings new challenger were added to the Nepalese banking sector due to the adverse development in the domestic economy resulting from deteriorating peace and security situation and continuous persistence of natural calamities inside the country on one hand and the global recession primarily caused by international terrorism on the other. Viewing the need of structural reform amidst these adverse implications, NRB issued directives to run commercial banks in a healthy competitive manner to ensure the sustainable development of the overall banking system. At present the number of guidelines issued by NRB to commercial bank reaches sixteen, which are as follows.

1) The provision of minimum capital fund to be maintained by the commercial bank.
2) The provision of loan classifications and loan loss provisioning on the credit.
3) The provision relating to limit on credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy.
4) The provision relating to accounting policy and the structure of financial statements to be followed by the commercial banks.
5) Regulation relating to minimization of risk inherent in the activities of commercial banks.
6) The provision of institutional good governance to be followed by commercial banks.
7) Time frame for implementation of regulatory directives issued in connection with inspection and supervision and supervision of commercial banks.
8) Regulation relating to investment in shares and securities by commercial banks.
9) The provision of submission of statistical data to the NRB. Banking management division and inspection and supervision division.
10) Regulation relating to sale and ownership transfer of promoters shares.
11) Regulation relating to, stringent blacklisting procedure for loan defaulters.
12) The provision relating to compulsory deposited amount of NRB.
13) Regulation relating to developing the branch office of commercial banks.
14) Provision relating to interest rates.
15) Provision relating to collection of financial sources.
16) Provision relating to consortium financing.

2.2.1 NRB Directives Relating to Loan Classification and Loan Loss Provision *(www.nrb.org.np)*

1. Classifications of Loan and Advances: Effective from FY 2058/59 (2001/02) banks shall classify outstanding principal amount of loan and advances on the basis of aging. As per the directives issued by NRB, all loans and advances shall be classified into the following four categories:

- **a. Pass Loan: -** Loans and advances whose principal amount are not past due and past due for a period up to 3 months shall be included in this category. These are classified and defined as performing loans.
- **b. Sub-Standard Loan: -** All loans and advances that are past due for a period of 3 months to 6 months shall be included in this category.
- **c. Doubtful Loan: -** All loans and advances which are past due for a period of 6 months to 1 year shall be included in this category.
- **d. Loss: -** All loans and advances which are past due for a period of more than 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.

Historical Provisions Relating to Loan Classification is depicted in the following table:

For fiscal year 2001/2002 A.D. (2058/2059 B.S.)

Pass loan	Loans and advances not past due and past due up to 3 months.
Sub-standard loan	Loans and advances past due for a period of over 3 months to 1 year.
Doubtful loan	Loans and advances past due for a period over 1 year to 3 year.
Loss	Loans and advances past due for a period of over 3 Year.

For fiscal year 2002/2003 A.D. (2059/2060 B.S.)

Pass loan	Loans and advances not past due and past due up to 3 months.
Sub-standard loan	Loans and advances past due for a period of over 3 months to 1 year.
Doubtful loan	Loans and advances past due for a period over 1 year to 3 year.

Loss	Loans and advances past due for a period of over 3 Year.

For fiscal year 2003/ 2004A.D. (2060/2061 B.S.)

Pass loan	Loans and advances not past due and past due up to 3 months.
Sub-standard loan	Loans and advances past due for a period of over 3 months to 9 months.
Doubtful loan	Loans and advances past due for a period over 9 months to 2 years.
Loss	Loans and advances past due for a period of over 2 Years.

For fiscal year 2004/2005A.D. (2061/2062 B.S.)

Pass loan	Loans and advances not past due and past due up to 3 months.
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 over 6 months to 1 year.
Loss	Loans and advances past due for a period of over 1 Year.

2. Additional Arrangement in Respect of Pass Loan: Loan and advances fully secured by gold, silver, fixed deposit receipts, credit cards and government securities shall be include under "pass" category. Loans against fixed deposit receipts of other banks shall also qualify for inclusion under pass loan. However, where collateral of fixed deposit receipt or government securities or NRB bonds is placed as extra security, such loan has to be classified on the basis of clause 1 to clause 7. While renewing working capital loan having maturity period up to one year can be classified as pass loan. If the interest of working capital nature loans and advance is not regular, such loan and advances should be classified on the basis of interest outstanding period.

3. Additional Arrangement in Respect of loss Loan: Even if the loan is not past due, loans having any or all of the following discrepancies shall be classified as "loss".

a. Security is not sufficient,
b. The borrower has been declared bankrupt,

c. The borrower is absconding or cannot be found,
d. Purchased or discounted bills are not realized within 90 days from the due date and non fund based letter of credit and guarantees etc are not realized with in 90 days from the date of conversion into fund based are not realized within 90 days,
e. The credit has not been used for the purpose originally intended,
f. Owing to non-recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation,
g. Loan provided to the borrowers included in the blacklist of credit information center (CIC),
h. Project or business is not in operative conditions, project or business is not in operation,
i. Credit Card Loan is not written off within 90 days from past due date.

4. Additional Arrangements in Respects of Term Loan: In respect of term loans, the classification shall be made against the entire outstanding loan on the basis of the past due period of overdue installment.

5. Prohibition to Recover Principal and Interest by Overdrawing the Current Account and Exceeding the Overdraft Limit: Principal and interest on loans and advance shall not be recovered by overdrawing the borrower's current account or where overdraft facility has been extended, by overdrawing such limit. However, this arrangement shall not be constructed as prohibitive for recovering the principal and interest by debiting the customers' account. Where a system in the bank exists as to recovery of principal and interest by debiting the customers' account, and recovery is made as such resulting in overdraft, which is not settled within one month, such overdrawn principal amount shall also be liable to be include under the outstanding loan and such loan shall be downgraded by one step from its current classification. In respects if recognition of interest, the same shall be as per the clause relating to income recognition mentioned in directives no 4.

6. Letter of Credit and Guarantees: If letter of credit and guarantees and other contingent liabilities converted into fund based liabilities and have to be paid, in such condition such loan shall be classified as pass loan within 90 days from the date of conversion into fund based. After 90 days such loan shall be classified as loss loan.

7. Rescheduling and Restructuring of the Loan: If the bank is confident on the following bases of written plan of action submitted by borrower, it may reschedule or restructure the loans and advances. Clear bases of rescheduling or restructuring should be attached with loan files.

a. If there is proof of adequate documents and collateral security relating to loan.
b. If the bank is confident in recovery of restructured or rescheduled loans and advances.

In addition to written plan of action for rescheduling or restructuring of loan, payment of at least 25 percent of total accrued interest up to the date of rescheduling of restructuring should have been collected.

8. Loan Loss Provisioning: The loan loss provisioning, on the basis of the outstanding loans and advances and bills purchases classified as per this directives, shall be provided as follows:

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

2.3 Review of Journals and Articles

GE Rejda (1998) said in his articles "Bankers' Insights and Issues- what should done about lost interest from troubled loans?" that non-performing loans and interest brings the very bad and crucial situations in the banks and it leads to the bank in the liquidation.

"The market- value accounting controversy is not the only contentious issue surrounding how bankers keep their books. Another controversy has centered on how banks, until recently, dealt with the interest income they were losing when customers stopped paying on their loans. Realizing that the industry was for the most part ignoring this issue, the US Financial Accounting Standard Board recently issued yet another important bank accounting rule, known as FASB 144.

Under this new rule banks and other financial institutions must account for the expected loss of interest income on non-performing loans when calculating their loan-loss provisions. Many banks still base their loan- loss reserve only upon their projected loss of principal from a troubled loan, not including the expected loss or delay in receiving interest payments. A similar problem arises when the term of the loan must be renegotiated to a longer payout schedule or the bank agrees to reduce or delay interest payments because the borrower can't successfully handle the originally negotiated term of the loan. Currently, many banks don't report lost interest of they expect eventual repayment of the entire principal of a troubled loan. Statement 144 requires banks to reduce the value of a loan on their books in order to reflect any reduction in expected interest payment as well as any loss of principal. While both secured and unsecured loans are covered, certain loans (such as credit cards and home mortgages) are exempt.

When the adjustment for loss of interest is made, the result is likely to be an increase in loan-loss provisions at those banks not already recognizing interest losses on their non-performing loans. In figuring the value of impaired loans, banks are required by the new FASB rules to measure the value of the bank loans by the present value of their expected future cash flows discounted at the loans' effective interest rate (which is the contractual loan rate adjusted fee any deferred loan fee, costs, premiums, or discounts that prevailed when the loan was extended or acquired). Each quarter bankers must estimate when their troubled loans are likely to be repaid, if ever."(Rejda, 1998:215)

Deependra Bahadur Chhetri (2057) stated in his article titled "Non-Performing

Assets: A Need for Rationalization" that to provide connation of the NPA and its potential sources, implication of NPA in financial sector in the South East Asian Resign. He has also given possible measure to contain NPA. "Loan and Advances of financial institution are mean to be serviced either part of principle of the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan settlement. Since the date becomes past dues, the loans becomes non-performing assets. The book of the account with lending institution should be effectively operative by means of real transaction effected on the part of the debtor in order to remain loan performing." (Chhetri, 2057:17)

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

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

He said that there is serious implication of NPAs, on financial institution. He further added that the liability of credit institution dose not limit to the amount declared as NPA but extend to extra amount that requires by regulation of supervisory authority in the form of provisioning as the amount required for provisioning depends upon the level of NPAs create a psyche of worse environment especially in the financial institution like waiving interest, rescheduling the loan, writing off the loan, appointing private recovery agent, taking help of tribunals and law of land etc NPAs can be reduced.

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

Bishwambher Pyakuryal (2001) has stated in his articles entitled 'Our Economy is in a Volatile Stage' that the banks have not able to collect their overdue due to the increasing cumulative NPAs in Nepalese commercial banks. There is no additional demand of the investment due to the higher risk and present uncertainty.

He said, Revenue collection is negative and regular expenditure is higher than the revenue. This indicates volatility of the economy. Even before the declaration of emergency, the government didn't have surplus revenue to pay for the remuneration and benefits of retired civil servants. The year 2002 is going to be difficult as major loans are going to mature. Debt servicing will also demand a significant share of the budget. Up to 65% of our development expenditure is being financed by foreign aid. But if we can't meet the regular expenditure (through our revenue), it will be very difficult for us to convince the donor community. This could push our society toward what is called a 'mass unrest society.'

He also adds, "The government is about to establish an Assets Management Company to take over the non-performing assets (NPAs) of the government-owned banks. On the other hand, it looks like the government's entire concentration has been on two commercial banks only (Nepal Bank Ltd. and Rastriya Banijya Bank). Due to cumulative growth of the NPAs, the banks haven't been able to collect their overdue. Due to the present uncertainty and higher risks, there is virtually no demand for new investments. That's why many banks are concentrating on conventional areas. We haven't been able to explore potential areas of competitive advantage in the regional context." (Pyakuryal, 2001:3)

Bishwambhar Neupane (2058) said in his article titled 'NPAs at Nepalese Financial Institutions' that thinking rationally no one shall be surprised to note two of the giant commercial banks of this country such as Nepal Bank Ltd. and Rastriya Banijya Bank accounting for the highest number and amount of non-performing assets (NPA) among players in the industry. In general and more specifically, in least developed countries like ours, the larger the size of the credit portfolio the larger the amount of NPAs.

As per his view, "the concept and realization of NPAs in the Nepalese financial sector evolved round about a decade ago along with the notion of prudential accounting norms. I reckon that ten years time frame should have been more that enough to formulate and implement strategy for identifying and canalizing the ever accumulating NPAs at Nepalese financial institutions (FIs). However, the Nepal Rastra Bank (NRB) seems to have realized the panic only a year ago. As a result, the NRB came up with a nineteen-point strategy, primarily pertaining to ways to tackle NPAs. Some of the measures the NRB has envisaged are formation of an assets reconstruction company, credit rating agencies, legal reforms, strengthening administrative/monitoring/supervising mechanisms etc, and above all, the recent NRB directive (number 1 to 7). Although the NRB, the FIs would have been much better off had it come up with all these philosophies some five years ago, better late than never."(Neupane, 2058:1)

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

There is no denying that no capital market around the world can be termed perfect. However, the capital markets are primarily driven by certain norms, which make lots of sense, and every single movement including stock price fluctuation is guided by prudential norms. By contrast, share prices at the Nepal Stock Exchange (NEPSE) move very surprisingly. Share prices at NEPSE are bound to move upward if a bank registers say Rs.800 million in profit, an accounting profit, even if it does not contribute anything towards shareholders' wealth maximization. The bank, even while accumulating a sizable NPA, can manage to fool the general public in terms of the accounting profit it registers.

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

At last, even if the banks endeavor to recoup NPAs through the auction of mortgaged property, the legal system and the regulations are so shabby and defaulter friendly that they have to struggle for many years to realize the auction process. Just imagine this process; a borrower, initially, default payment, the bank calls back the loan, six months thereon the concerned authority blacklists the borrower, a 35 days notice goes to the papers for auction and after that a 7 days ultimatum and so on and so forth. Hundreds of cases have been lingering in the courts for many years. Inefficient legal provisions, from the point of view of the bankers, have encouraged borrowers to default and contributed more towards enhancing the quantum of NPA in Nepalese FIs.

Bhisma Raj Dungana (2058) in his article titled "Why Assets Management Co. is considered the best to solve the non-performing loan problem?" as above has tried to highlight one of the approach mainly Assets Management Company (AMC) for resolving the problem of NPL. As per him, AMC is the specialize financial intermediary to manage the non- performing and distress loans of banks and financial instructions who buy the NPL from financial institution and take necessary steps to recover the maximum value from the acquired assets. As per his view, if NPLs are not resolved in time there would be inherent direct of indirect costs to the economy. As stated by him NPL may arise due to the external factors like decrease in market value of collateral deterioration borrower's repayment capacity, economic slowdown, borrower's misconduct, improper credit appraisal system, lack o frisk management practice, ineffective credit monitoring and supervision system. Hence he suggested that, NPL should be kept at minimum level and the specialized institution such as AMCs should manage the distressed loans.

He says that both traditional approach and AMC are available to deal with NPL problem. Under traditional approach, bank handles the NPLs in its own way especially through recovery unit who focus on continuing negotiation with the borrower and give top priority to the loan recovery. As opined by the writer, this approach is useful in dealing with small business loans where personal touch is adopted but for big loan this approach does not work. "AMCs seem as the only realistic option when the financial sector recovery is the underlying objective in financial system where the institution fails to resolve the NPL problem through their own efforts." (Dungana, 2058:125). He stated that the main advantage of establishing AMC is that AMC is able to move in an expeditious manner removing the distraction of managing NPLs from the banking system and frees up resources within the financial institution allowing them to concentrate on their core activities.

He concludes, "As in most of the countries, Nepalese Financial System is largely dominated by the banking sector. The banking sector is severely affected by the NPL problem, it is estimated that the NPL of the Nepalese Banking system is around 16%. Therefore there is no doubt that is has serious implication on the economic performance of the country. It will be the eclipse in the development of financial soundless in the economy, if not controlled in time. However, traditional or AMC root can be practiced to get recovery from this sickness of the financial system, the AMC root may be more effective approach to be quick recovery as it has been experience around the world.

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

Even most of the privately owned banks has NPA within international standard, some privately owned bank's NPA is higher that international standard. As per international standard 5% NPA is acceptable. He also states that, Nepal's total NPA of banking sector is 30% which is very high. (Shaplota, 2004:5)

Rawal, T. (2003) in his article entitled, “Measures adopted to overcome the problem of financial sector and the NPLs” addressed that financial sector reform measures can be broadly grouped under three heads: (1) restructuring of large two state-owned banks (ii) reengineering of the central banks and (iii) capacity building in the financial sector. In this connection, management of two state-owned bank has been handed over to the expert groups comprising the people within and outside of Nepal, the reengineering and restructuring process of the central bank (Nepal Rastra Bank) is in progress. Side by side, the capacity building in the financial sector is smoothly approaching ahead. Enactment of new NRB Act 2002 which, gives greater autonomy in its operation, enforcement of inspection and supervision directives based on international standard, withdrawal of government/ NRB involvement from the financial institutions, adoption of accommodative monetary measures are the efforts made to build up sound financial environment. Moreover, it should view to strengthening legal arrangements, Debt Recovery Act has been approved and the Debt consolidate financial sector through an umbrella act Banks and Financial Institutions Act has recently been approved and for the purpose to resolve the problem of non-performing assets- Asset Management Company Act is in the process of being approved. In addition, establishment of Credit Rating Company, strengthening of Credit Bureau and Bankers' Training Center are some of the tasks progressing ahead.

With the arrangement of such a legislative, regulatory, supervisory and institutional framework, the financial sector would, hopefully, take a pace for reviving which, in turn, would help NPLs to be reduced.

2.4 Review of Master Thesis

Pandey, Santosh (2002) has carried out study on 'Nepal Rastra Bank- Directives Their Implementation and Impact on the commercial Banks- A Case Study of Himalayan Bank Limited' with the objectives to find out the impact of change in NRB directives on the performance of the commercial banks and find out whether the directives were implemented or not.

The directives if not properly addressed have potential to wreck the financial system of the country as they are the only tool of the NRB to supervise and monitor the financial institution. The directives in themselves aren't that important unless properly implemented, the implementation part depends upon the commercial banks. In case commercial banks are making such huge profit with full compliance of NRB directives, then the commercial banks would deserve votes of praise because they would be instrumental in the economic development of the country. All the changes in NRB directive made impacts on the bank and the result are the followings:

- Increase in operational procedure of the bank, which increase the operational cost of the bank.
- A short term decreases in profitability, which result to lesser dividends to shareholder and lesser bonus to the employees.
- Reduction in the loan exposure of the bank, which decreases the interest income but increase the protection of the depositors' money.
- Increase protection to the money of the depositors' through increased capital adequacy ratios and more stringent loan related documents.
- Increase demand for shareholders' contribution in the banks by forgoing dividends for loan loss provisions and various other reserves to increase the core capital.

All the aforesaid results lead to one direction: the bank will be financially healthy and stronger in the future. HBL will be able to withstand tougher economic situation in the future with adequate capital and provision for losses. The tough time through which the bank is undergoing at present will prevail only for a couple of years but in the long run, it will be strong enough to attract more deposits and expose itself to more risk with capital cushion behind it. The quality of the asses of the banks will become better as banks will be careful creating credit. Ultimately, the changes in the directives will bring prosperity not only to the shareholders but also to the depositors, the employees and economy of the country as a whole." (Pandey, 2002:101)

Ojha, Lila Prasad (2002) has stated on his study "Lending Practise: A Study on Nabil Bank Limited, Standard Chartered Bank Nepal Ltd. and Himalayan

Bank Ltd.," over liquidity caused due to lack of good lending opportunities, risk arising due to the mismanagement of lending of portfolio, increasing non-performing assets etc are some of the problem that is facing by Nepalese banking sector. His main objective is to analyze the various aspects of banks lending quantity and quality.

He concludes "the highest growth rate, proportionately high volume of loans and advances, the best contribution in priority and agriculture sector and the high level of deposits mobilization of HBL has put this back in the top position in the lending function, however the better activity ratio of SCBNL has proved this bank the best in managing the lending portfolio according to the demand of profit oriented business. The high volume of lending activities and high volume of productive sector loan of NABIL has put the bank in the top position in absolute term. The increasing provision on loan loss and high volume of non-performing assets in NABIL and HBL certainly attracts the high attention of any person interested with these banks. The high volume of NPA of HBL may have caused due to failure of industrial and agricultural sector. Nabil's increased NPA may have caused due to the accumulated bad debts that is kept behind the certain to show the high efficiency of management.(Ojha, 2002:88)

Khadka, Anju (2003) has stated in her study "A Comparative Study on Investment Policy of Commercial Bank" with an objective to find out the relationship between deposits, investment, loans and advances and net profit.

She has made the following conclusion while comparing the performance of NBL with Nabil, SCBNL and NIBL. She expresses "NBL is comparatively less successful in on balance sheet as well as off-balance sheet operations than that of other CBs. It predicts that in the coming days if it could not mobilize and utilize its resources as efficiently as other CBs to maximize the returns, it would lag behind in the comparative market if banking-profitability positions of NBL is comparatively of shareholders, depositors and its all customers if it can't increase its volume even in future."(Khadka, 2003:88)

As the banks experience many difficulties in recovering the loans and advances and their large amount is being blocked as non-performing assets. She suggested that there is an urgent needs to workout a suitable mechanism through which the overdue loan can be realized.

Shilpakar, Anjana (2004) in her study "A Study on Lending Practices of Finance Companies of Nepal" aimed to analyze performance of finance company regarding lending quality and quantity and its contribution in profitability. As per her view, loan and advances is one of the main sources of income of finance companies. "Loan loss provision is like a by product of loans and advances, thus, with loans and advances, loan loss provision does increase in synchronize."(Shilpakar, 2004:89)

She recommended that loan and advances of finance companies are increasing and the non-performing loans and loan loss provision. Hence extra efforts should be enforced to control over NPL.

Shrestha, Niva (2005) in her study "A Study on Non-Performing Loan and Loan Loss Provisioning of Commercial Banks" with reference to Nepal Bank Ltd, NABIL Bank ltd. and Standard Chartered Bank Nepal ltd., has mace an attempt to analyze the various aspects of non-performing loan in the commercial banks. Her main objectives of the study is to find out the proportion of non-performing loan, factors lending to accumulation of non- performing loan, relationship between loan and loan loss provision and impact of loan loss provision on profitability of the commercial bank.

She concludes, "Increasing non-performing loan is the serious problem of the banking sector in Nepal. Non-performing assets directly affects the income flow of the bank. It has been found that NBL has very high portion of non-performing loan resulting to higher portion. Hence, even the bank has the highest investment in the most income generating assets i.e. loan and advances, it is in loss. Even the private sector bank like NABIL has higher non-performing loan and according higher provision. NABIL's average proportion on non-performing loan during the study period is higher than the acceptable. However in recent two year NABIL's non-performing loan has shown significant decrement and according provision has also decreased. Among the three banks SCBNL has the least non-performing loan and thus the least loan loss provision. From these indicators it can be said that SCBNL is the best among the three banks. However SCBNL seems less oriented towards lending. Hence, the lower percentage of NPL and provisioning of SCBNL in not only due to proper lending function but also due to relatively lower investment in loans and advances."(Shrestha, 2005:99)

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

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

Bhattarai, Shama (2006) has stated in her research "Implementation of Directives Issued by Nepal Rastra Bank: A Comparative Study of Nepal SBI Bank ltd. and

Nepal Bangladesh Ltd." to analyze the various aspects of NRB directives such as capital adequacy and loan classification and loan provisioning. In her view, the loan classification helps to the banks to monitor the quality of their loan and advances and to take step towards the remedial action in the credit quality of their loan and advances.

She concludes that the new provision of the banks will have its provision amount increasing in coming years and subsequently profitability of the banks will also come down. However, the true picture of the quality of the assets will be painted in the coming year.

She recommends, "The banks should be very careful while analyzing the paying capacity of its credit clients. With longer period of past due, the bank will end up increasing its provisions which will keep the bottom line low if the bank is not careful."

Khadka, Denesh Kumar (2007) in his thesis "Non-Performing Assets of Nepalese Commercial Banks" with an objective to examine the level of NPAs in total assets, total deposit and total landing of Nepalese commercial banks. He also showed that the effects of non-performing assets on Return on Assets and Return on Equity of Nepalese commercial banks.

He said that 'despite of being loan and advances more profitable those other assets, it creates risk of non-payment for the bank. Such risk is known as credit risk or default risk. Therefore, like other assets on the basis of overdue schedule. Escalating level of NPAs has been becoming great problem in banking business in the world. In this context, Nepal can't be run off from such situation. The level of NPAs in Nepalese banking business is very alarming. It is well known fact the problem of swelling non-performing assets (NPAs) and the issue is becoming more and more unmanageable day by day. We are well known from different financial reports, newspaper and news that the total NPA in Nepalese banking system is about 35 billion, while it is very worse in case of two largest commercial banks Rastriya Banijya Bank (RBB) and Nepal Bank Ltd. (NBL). (Khadka, 2007:79-82)

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

In other level of NPA of Nepal Investment Bank and NABIL bank has been gradually decreasing every year. The NPA of NIBL is least (minimum) than all of other banks at the end of 2059/60. The high degree of negative correlation of different commercial banks between NPA and ROA, and NPA and ROE indicates towards the inverse relation between NPA and ROA, and NPA and ROE. It means the level of NPA effect the return on assets and return on shareholder's equity. Therefore, banks should reduce their level of NPA to increase the ROE and ROA.

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

Pradhan, Kumar (2008) has conducted a research on "A study on Non-Performing Assets of commercial bank with references to SCBNL, RBB, Everest bank, NB bank and NBBL. Main objective of his study are to find out the proportion of non-performing loan and the level of NPA in total assets, total deposit and total lending in the selected commercial bank relationship between loan loss provision in the commercial bank impact of non-performing assets in the performance of commercial bank.

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

He has concluded "high level of non-performing assets not only decrease the profitability of the banks but also affect the entire financial as well as operational health of the organisation. If the NPA doesn't control immediately, it will be main causes for shutdown of the banks in future.

He suggest that reduce the NPA problem immediate remedial action for taking enough collateral, so that the bank at least can able to recover its principle and interest amount in case of being unable to repay by the borrower, proper financial analysis should be done before lending to the borrowers bank should provide appropriate training regarding loan management, risk management, credit appraisal etc to the employee. Bank should apply precautions before granting any loan and advances to decrease the bad loans.

CHAPTER – III

RESEARCH METHODOLOGY

3.1 Research Design

Research design is the plan, structure and strategy of investigation conceived so as to obtain answer to research question and control variance. The plan mean now researcher investigator collect the data structure in term controlling the data in term of money and time. The plan mean now researcher investigators collect the data structure in term controlling the data in term of money and time.

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

3.2 Sources of Data

Making study more reliable and justifiable, both primary and secondary data have been used in this study. Published articles, books, newspaper, websites and annual reports of concerned banks are the secondary sources of data. Similarly, the responses obtained from the questionnaire form the primary data.

3.3 Population and Sample

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

A total number of 26 commercial banks are operation throughout the nation in the present context. Out of the total population, only two banks, namely, NABIL Bank Ltd and NIBL Bank Ltd., were selected as sample of the total population, to fulfill the objective of research. The sample represented 7.70% of the total populated commercial banks.

Table 3.1

Sample Bank

S.N.	Banks
1.	Nepal Arab Bank Limited
2.	Nepal Investment Bank Limited

3.4 Data Processing Procedures & Analysis

Data collected from various sources were in raw form. They were classified and tabulated as per the nature of the study and in accordance of the data. Applying different financial and statistical tools are used for data analysis. Further to represent the data in simple form bar diagrams and graphs have also been used.

3.4.1 Financial Tools

To achieve the objectives of the study, the following financial tools have been effectively used:

A) Composition of Loans and Advances

The loans and advances of bank is composed of performing loan and non-performing loan. The composition of loans and advances depicts the amount of performing loan and non-performing loan along with their respective coverage in the total loans and advances.

$$\text{Composition of Loan and Advances} = \text{Performing Loan} + \text{Non} - \text{Performing Loan}$$

B) Composition of Non-Performing Assets

Non-Performing Assets of bank is composed of sub-standard loan, doubtful loan and loss loan. This composition demonstrates the actual credit risk of the bank by clearly depicting the coverage and amount of sub-standard loan, doubtful loan and loss loan on non-performing assets.

$$\text{Composition of Non Performing Assets} = \text{Sub} - \text{Standard Loan} + \text{Doubtful Loan} + \text{Loss Loan}$$

C) Non Performing Assets to Performing Loan

The non-performing assets to performing loan also measures the credit risk of financial institutions. Lower ratio is considered better, while ratio is unhealthy to the institutions. It measures how much of the performing loan is represented by the non-performing loan. It is calculated as follows:

$$\text{NPA to Performing Loan} = \frac{\text{Non} - \text{Performing Loan x 100}}{\text{Performing Loan}}$$

D) Non Performing Assets to Total Assets

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

$$\text{NPA to Total Assets} = \frac{\text{Non} - \text{Performing Loan x 100}}{\text{Total Assets}}$$

E) Non Performing Assets to Total Deposits

The main objective of the commercial banks is to collect deposit and lend it to secure sector. The non performing assets to total deposits measures the portion of total deposit that is having credit risk. Higher the ratio is unfavorable and thus lower ratio is preferable. This ration is calculated as:

$$\text{NPA to Total Deposits} = \frac{\text{Non} - \text{Performing Loan x 100}}{\text{Total Deposits}}$$

F) Loan Loss Provision to Total Loans and Advances

Each bank has to keep the loan loss provision for loan and advances as per the direction of Nepal Rastra Bank. The loan loss provision to total loans and advances measures the aggregate percentage of loan loss provision kept by bank on loans and advances and thus eventually measures the security position. It is calculated as follows:

$$\text{LLP to Loans and Advances} = \frac{\text{Loan Loss Provision x 100}}{\text{Total Loans and Advances}}$$

G) Loan Loss Provision to Non Performing Assets

This ratio describes the proportion of provision held to non-performing assets of the bank. This ratio measures up to what extent of risk inherent in NPA is covered by the total loan provision. Higher ratio signifies that the banks are safeguarded against future contingencies that may create due to non-performing assets. So, higher the ratio better is the financial strength of the bank. This ratio is calculated as follows:

$$\text{LLP to NPA} = \frac{\text{Loan Loss Provision x 100}}{\text{Non Performing Assets}}$$

H) Net Profit to Non Performing Assets

This ratio indicates the proportion of the return over the non-performing loan. It describes how efficiently the bank has employed its resources in recovering its non-performing loan along with the interest. Higher the ratio indicates better performance of bank and lower non-performing assets. It is calculated as follows:

$$\text{Net Profit to NPA} = \frac{\text{Net Profit x 100}}{\text{Non Performing Assets}}$$

3.4.2 Statistical Tools

The analysis could not have been done without using the statistical tools. The following statistical tools have been effectively utilized for data analysis.

A) Mean

Arithmetic mean or simply a mean of a set observations is the sum of all the observations divided by the number of observations Srithmetic mean is also know as the arithmetic average.

Let x_1, x_2, x_3, …………………., x_n be the n values of the variable then their arithmetic mean be denoted by x is defined by,

$$x = \frac{x_1 + x_2 + x_3 + \dots\dots\dots\dots\dots\dots . + x_n}{n}$$

Where, n is the number of observations.

B) Standard Deviation

The standard deviation is the absolute measure of dispersion in which the drawbacks present in other measures of dispersion are removed. It is said to be the best measure of dispersion as it satisfies most of the requisites of a good measure of dispersion.

$$\text{s.d.} = \sqrt{\frac{\sum (x-\bar{x})^2}{N}}$$

C) Coefficient of Variation

The coefficient of dipersion based on standard deviation multiplied by 100 is known as the coefficient of variation (C.V.). Less the C.V., more will be the uniformity and more the C.V., less will be uniformity. If x be the arithmetic mean and s.d the standard deviation of the distribution, then the C.V. is defined by,

$$C.V. = \frac{S.D. \text{ x } 100}{\text{Mean}}$$

D) Karl Pearson's Correlation Coefficient

Two values are said to have 'correlation', when they are so related that the change in the value of one variable is accompanied by the change in the value of the other. One of the widely used mathematical methods of calculating the correlation coefficient between two variables is Karl Pearson's correlation coefficient 'r'. It is calculated as;

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

E) Probable Error

The probable error denoted by P.E. is used to measure the reliability and test of significance of correlation coefficient. Significance of relationship has been tested by using the probable error (P.E.) and it is denoted by the following model:

$$\text{Probable Error (P.E.)} = 0.6745X \frac{1-r^2}{\sqrt{n}}$$

Where, r = the value of correlation coefficient

n = number of pairs of observations

if r < P.E., it is insignificant, i.e. there is no evidence of correlation

if r > 6 P.E., it is significant

if P.E. < r < 6 P.E., nothing can be concluded

F) Regression Lines

The regression line is the line, which gives the best estimate of one variable for any given value of the other variable. In case of two variables X and Y, we will have two regression lines i.e. lines is called the regression equation and also estimating equations. Since there are two regression lines, there are two regression equations.

<u>Regression equation of Y on X</u>

The regression equation is expressed as;

$$y = a + bx$$

We shall get the normal equation for estimating "a" and "b" as.

$$\sum X = Na + b \sum Y$$

$$\sum XY = a\sum Y + b \sum Y^2$$

Where,

X = the value of independent variable

Y = the value of dependent variable

a = Y-intercept

b = slope of the trend line/coefficient of regression

N = number of pairs of observations.

a = Y- b X

Similarly, to predict the value of one variable, dependent, on the changes of two other variables, independent, the regression line of dependent variable X1 on independent variables X_2 and X_3 is;

$$X_1 = a_1 + b_1 X_2 + b_2 X_3 \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots . \text{(i)}$$

The values of constant a_1, b_1 and b_2 can be determined by solving following three normal equations simultaneously.

$$\sum X_1 = na_1 + b_1 \sum X_2 + b_2 \sum X_3 \ldots\ldots\ldots\ldots\ldots\ldots .... \text{(ii)}$$

$$\sum X_1X_2 = a_1 \sum X_2 + b_1 \sum X_2^2 + b_2 \sum X_2X_3 \ldots\ldots\ldots\ldots\ldots \text{(iii)}$$

$$\sum X_1X_3 = a_1 \sum X_3 + b_1 \sum X_2X_3 + b_2 \sum X_3^2 \ldots\ldots\ldots\ldots\ldots . \text{(iv)}$$

G) Trend Analysis

A widely and most commonly used method to describe the trend is the method of least square. Let ther trend line between the dependent variable y and the independent variable x (i.e. time) be represented by;

$$Yc = a + bx \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(i)}$$

Where,

a = y intercept or value of y when x = 0

b = slope of the trend line or amount of change that comes in y of a unit change in x.

To find the value of x and y, the following equations should be solved;

$$\sum y = na + b\sum x \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots.. \text{(ii)}$$

$$\sum xy = a\sum x + b\sum x^2 \ldots\ldots\ldots\ldots\ldots\ldots\ldots\text{(iii)}$$

CHAPTER – IV

DATA PRESENTATION AND ANALYSIS

This section of research includes the conversion of collected raw data from various resources into an understandable presentation using financial as well as statistical tools supported by diagrams and graphs as mentioned in the previous chapter. This chapter of the thesis is main chapter as all the findings, conclusions and recommendations are going to be derived from the calculations and analysis done in this section.

4.1 Secondary Data Analysis

4.1.1 Composition of Loan and Advances

The loan and advances of bank should be categorized into performing loan and non-performing loan/assets as per the direction of NRB. Thus, the composition of loan and advances demonstrates the segregation of loan and advances into performing loan and non-performing loan/asset and thus finally delineates the credit risk of the bank.

Table 4.1

Composition of Loan and Advances

FY	NABIL					NIBL				
	LA	PL		NPL		LA	PL		NPL	
	Rs.	Rs.	%	Rs.	%	Rs.	Rs.	%	Rs.	%
2003/04	8548.66	8261.98	96.65	286.68	3.35	7124.09	6942.66	97.45	181.44	2.55
2004/05	10946.74	10802.23	98.68	144.51	1.32	10453.16	10172.29	97.31	280.87	2.69

2005/06	13278.78	13096.16	98.62	182.62	1.38	13178.15	12905.66	97.93	272.49	2.07
2006/07	15903.02	15724.73	98.88	178.29	1.12	17769.10	17347.13	97.63	421.97	2.37
2007/08	21759.46	21598.37	99.26	161.09	0.74	27529.30	27219.83	98.88	309.47	1.12
Mean			**98.42**		**1.58**			**97.84**		**2.16**
S.D.			**0.91**		**0.91**			**0.56**		**0.56**
C.V.%			**0.93**		**57.64**			**0.57**		**25.92**

(Source: Annual Reports of NABIL & NIBL)

The Table 4.1 showed the composition of loans and advances of NABIL and NIBL. The table showed that in NABIL, Performing loan (PL) covered 96.65%, 98.68%, 98.62%, 98.88% and 99.26% of the total loans and advances in the fiscal year 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 respectively. In contrast, Non-performing Loan (NPL) covered 3.35%, 1.32%, 1.38%, 1.12% and 0.74% of the total loans and advances in the fiscal year 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 respectively. The ratios of both performing and non-performing loan to total loans and advances fluctuated during the five years period. The table showed that in average, the performing and non-performing loan covered 98.42% and 1.58% respectively in the five years period taken for research. However, the fluctuation in non-performing loan was greater than that in performing loan, as the coefficient of variation in non-performing loan (57.64%) was comparatively higher than that in performing loan (0.93%).

Likewise, the ratio of performing loan to total loans and advances of NIBL in the fiscal year 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 were 97.45%, 97.31%, 97.93%, 97.63% and 98.88% respectively. And the ratio of performing loan to total loans and advances were 2.55%, 2.69%, 2.07%, 2.37% and 1.12% in the same fiscal years. In average, the performing loan covered 97.84% and non-performing loan covered 2.16% of the total loans and advances. Eventually, the fluctuation in non-performing loan (25.92%) is higher than the fluctuation in performing loan (0.57%).

Comparing two banks, it can be concluded that NABIL bank is slightly better than NIBL, as the coverage of performing loan (98.42%) in total loans and advances of NABIL is greater than the coverage of non-performing loan (97.84%) in total loans and advances of NIBL.

Figure 4.1

Composition of Loan and Advances of NABIL Bank

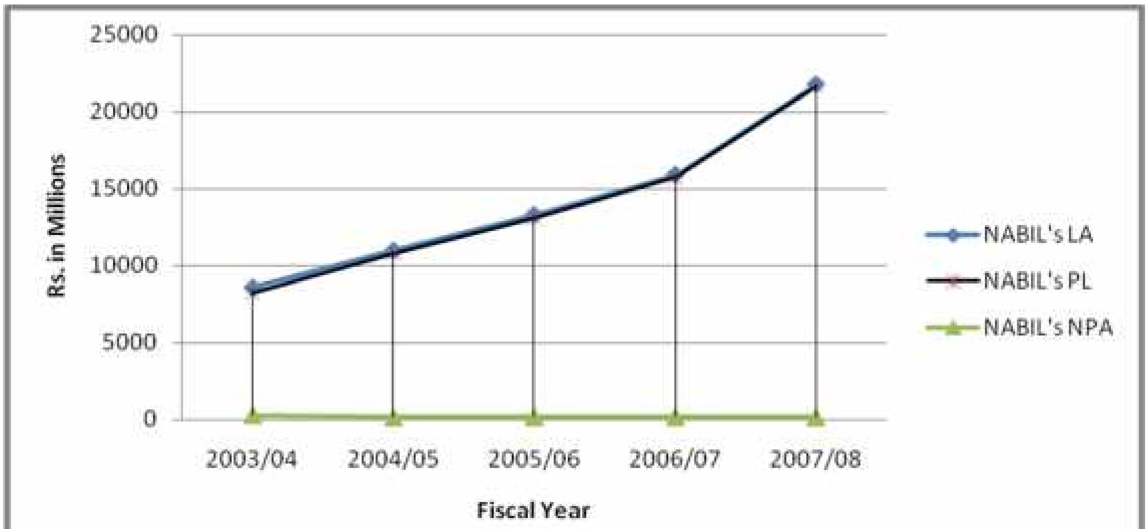
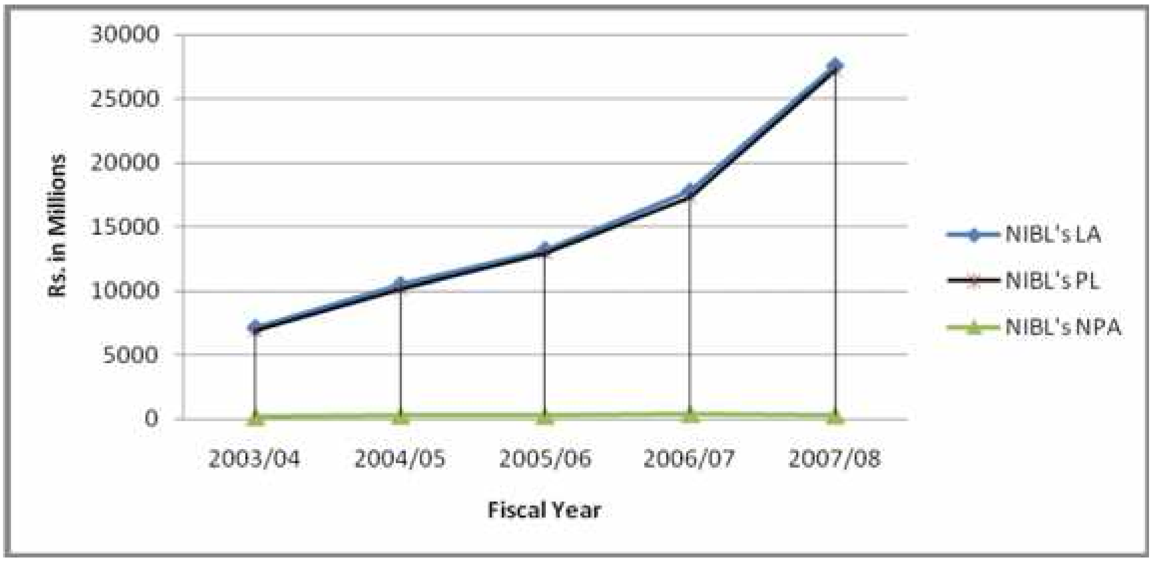


Figure 4.2

Composition of Loan and Advances of NIBL Bank



4.1.2 Composition of Non-Performing Assets

As per the direction of NRB, the non-performing assets/loans should be further categorized into sub-standard loan, doubtful loan and loss loan. The lower the loss loan and doubtful loan the higher the chances of lower credit risk. The composition of non-performing assets of NABIL and NIBL for the five consecutive years are presented in the table 4.2.

Table 4.2

Composition of Non-Performing Assets

FY	Sub-standard		Doubtful		Loss	
	NABIL	NIBL	NABIL	NIBL	NABIL	NIBL
2003/04	22.14	10.84	65.55	63.88	198.99	106.72
2004/05	22.07	0.82	19.34	74.94	120.50	205.11

2005/06	62.67	44.24	29.57	0.49	90.39	227.76
2006/07	119.70	96.89	14.47	86.05	44.12	239.03
2007/08	66.22	61.74	42.58	20.72	52.29	227.01
Mean	**58.56**	**42.91**	**34.30**	**49.22**	**101.26**	**201.13**
S.D.	**35.98**	**34.84**	**18.35**	**32.92**	**56.04**	**48.47**
C.V.%	**61.44**	**81.21**	**53.51**	**66.90**	**55.34**	**24.10**

(Source: Annual Reports of NABIL & NIBL)

The table 4.2 showed the composition of non-performing assets of NABIL and NIBL. The table showed that the sub-standard loan of NABIL followed fluctuating trend. The sub-standard loan of NABIL was 22.14 millions, doubtful loan was 65.55 millions and loss loan was 198.99 millions in the fiscal year 2003/04. In fiscal year 2004/05, NABIL decreased its loss loan to 120.50 millions, doubtful loan to 19.34 millions and sub-standard loan to 22.14 millions. In overall, NABIL bank made more emphasis on converting its loss loan to sub-standard loan and thus the sub-standard loan increased to 66.22 millions, doubtful loan decreased to 42.58 millions and loss loan decreased to 52.29 millions in the fiscal year 2007/08.

Likewise, the sub-standard loan and doubtful loan of NIBL followed fluctuating trend, while the loss loan followed increasing trend. The sub-standard loan, doubtful loan and loss loan of NIBL in the fiscal year 2003/04 were Rs. 10.84 millions, Rs. 63.88 millions and Rs. 106.72 millions respectively. At the end of fiscal year 2007/08, the sub-standard loan was Rs. 61.74 millions, doubtful loan was Rs. 20.72 millions and loss loan was Rs. 227.01 millions. The table shows that NIBL was success to convert the doubtful loan to sub-standard loan, but remained inefficient to decrease the loss loan, which has increased over the entire period. Thus, the composition of non-performing loan of NIBL indicates higher credit risk.

Comparing two banks, it can be concluded that NABIL efficiently converted its doubtful loan and loss loan in sub-standard loan and thus decreased the credit risk, while NIBL was only able to reduce the doubtful loan but remained failure to decrease the loss loan and thus has higher credit risk.

Figure 4.3

Composition of Non-Performing Assets of NABIL

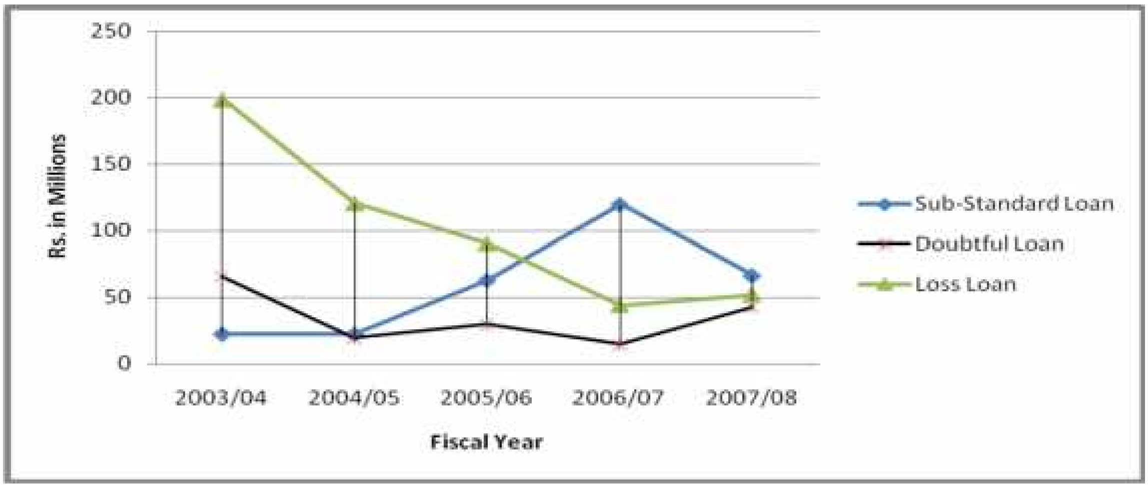
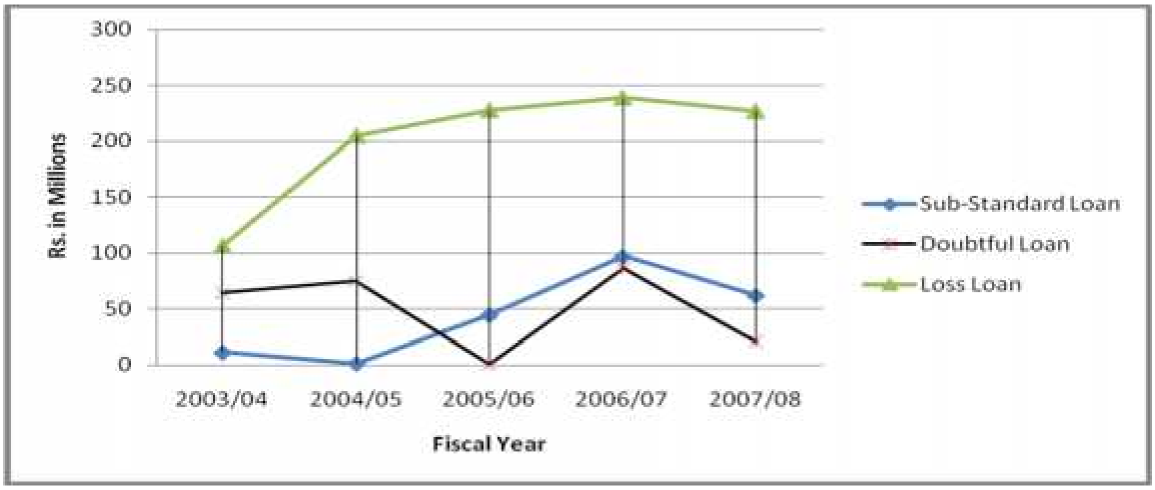


Figure 4.4

Composition of Non-Performing Assets of NIBL



4.1.3 Non-Performing Assets/Loan to Performing Loan

This ratio measures the representation of non-performing assets on the performing loan of the bank. The lower the ratio of non-performing assets to performing loan, the better will be the loan management. The ratio of non-performing assets to performing loan of NABIL and NIBL from the fiscal year 2003/04 to 2007/08 is presented in the table 4.3.

Table 4.3

Non-Performing Assets to Performing Loan

FY	NABIL			NIBL		
	NPA	**PL**	**Ratio**	**NPA**	**PL**	**Ratio**
2003/04	286.68	8261.98	3.47	181.44	6942.66	2.61
2004/05	144.51	10802.23	1.34	280.87	10172.29	2.76
2005/06	182.62	13096.16	1.39	272.49	12905.66	2.11
2006/07	178.29	15724.73	1.13	421.97	17347.13	2.43
2007/08	161.09	21598.37	0.75	309.47	27219.83	1.14
Mean			**1.62**			**2.21**
S.D.			**0.95**			**0.58**
C.V.%			**59.04**			**26.12**

(Source: Annual Reports of NABIL & NIBL)

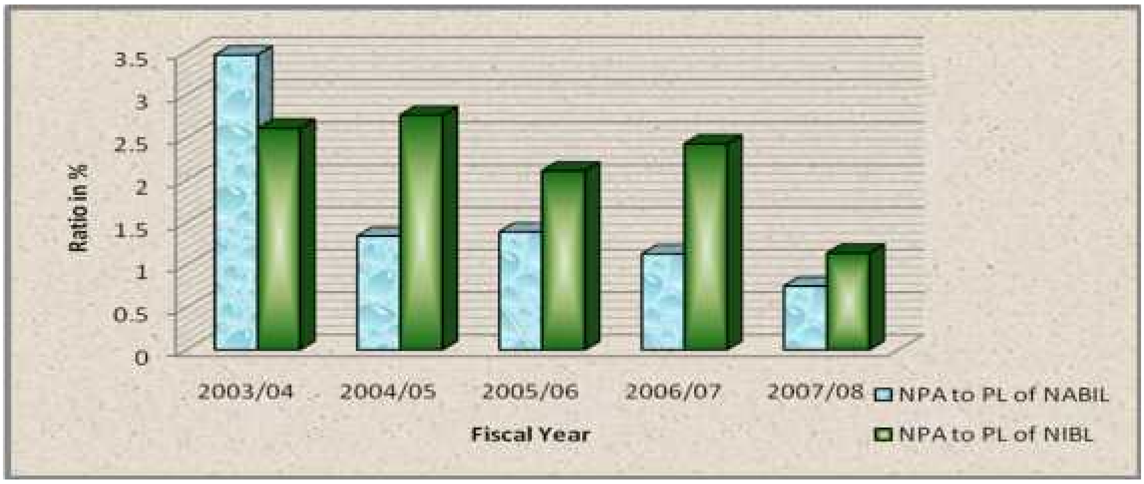
The Table 4.3 depicted the ratio of non-performing loan to performing loan of sampled banks. The table showed that the ratio of non-performing loan to performing loan fluctuated during the period. The ratio showed that the ratio ranged from 0.75% in the fiscal year 2007/08 to 3.47% in the fiscal year 2003/04. Similarly, in average the non-performing loan represented only 1.62% of the performing loan and the variance in the ratio was 59.04%, which delineated higher inconsistency.

Likewise, the ratio in NIBL for the fiscal year 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 were 2.61%, 2.76%, 2.11%, 2.43% and 1.14% respectively. In average, the non-performing loan represented 2.21% of the performing loan and the variation in the ratio was 26.12%.

Comparing two banks on the basis of average non-performing loan to performing loan, it can be concluded that the chances of turning total loans and advances in non-performing loan is lower in NABIL than in NIBL, as the ratio of non-performing loan to performing loan of NABIL (1.62%) is lower than that of NIBL (2.21%).

Figure 4.5

Non-Performing Assets to Performing Loan



4.1.4 Non-Performing Assets to Total Assets

This ratio measures the coverage of non-performing assets on total assets of the organization. The higher the ratio indicates higher maintenance of risky assets, as the recovery of non-performing assets is uncertain. The non-performing assets to total assets of NABIL and NIBL for the five fiscal year periods taken for study are presented in the Table 4.4.

Table 4.4

Non-Performing Assets to Total Assets

FY	NABIL			NIBL		
	NPA	**TA**	**Ratio**	**NPA**	**TA**	**Ratio**
2003/04	286.68	16745.49	1.71	181.44	13255.50	1.37
2004/05	144.51	17064.08	0.85	280.87	16063.54	1.75
2005/06	182.62	22329.97	0.82	272.49	21330.14	1.28
2006/07	178.29	27253.39	0.65	421.97	27590.84	1.53
2007/08	161.09	37132.76	0.43	309.47	38873.31	0.80
Mean			**0.89**			**1.35**
S.D.			**0.44**			**0.32**
C.V.%			**48.82**			**23.50**

(Source: Annual Reports of NABIL & NIBL)

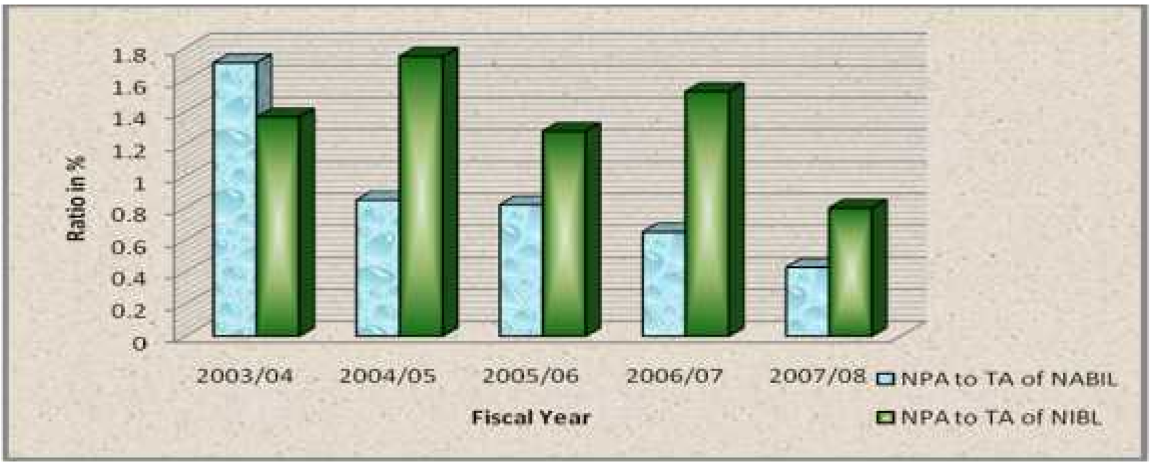
The Table 4.4 showed the ratio of non-performing loans to total assets. The table depicted that the ratio of NPA to Total Assets of NABIL followed declination in each period, which was a good indicator of loan management, especially loan recovery. The ratio was 1.71% in the fiscal year 2003/04 and eventually decreased to 0.43% in the fiscal year 2007/08. In average, NABIL maintained the ratio of 0.89% in the five year periods. However, the coefficient of variation in such ratio was 48.82%, which delineated higher degree of inconsistency.

In contrast, the ratio of non-performing assets to total assets of NIBL fluctuated in the periods taken for research. The ratio was 1.37%, 1.75%, 1.28%, 1.53% and 0.80% in the fiscal year 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 respectively. In average, 1.35% of the total assets of NIBL was covered by non-performing assets.

Comparing two banks on the basis of non-performing loan to total assets, it can be considered that NABIL is better than NIBL since the average ratio of NABIL (0.89%) is lower than that of NIBL (1.35%). Also, NABIL has good control over the non-performing assets than NIBL, as the ratio gradually declined in each year. Thus, NABIL has lower chance of turning its loan in non-recovery than NIBL.

Figure 4.6

Non-Performing Assets to Total Assets



4.1.5 Non-Performing Assets to Total Deposit

The non-performing assets to total deposit measures the mobility of total deposit in non-performing assets. The higher ratio indicates higher misuse of total deposits. The ratio of NABIL and NIBL for the five fiscal year periods is presented in table 4.5.

Table 4.5

Non-Performing Assets to Total Deposits

FY	NABIL			NIBL		
	NPA	TD	Ratio	NPA	TD	Ratio
2003/04	286.68	14119.03	2.03	181.44	11524.68	1.57
2004/05	144.51	14586.61	0.99	280.87	14254.57	1.97
2005/06	182.62	19347.40	0.94	272.49	18927.31	1.44
2006/07	178.29	23342.29	0.76	421.97	24488.86	1.72
2007/08	161.09	31915.05	0.50	309.47	34451.73	0.90
Mean			**1.04**			**1.52**
S.D.			**0.52**			**0.36**
C.V.%			**50.00**			**23.46**

(Source: Annual Reports of NABIL & NIBL)

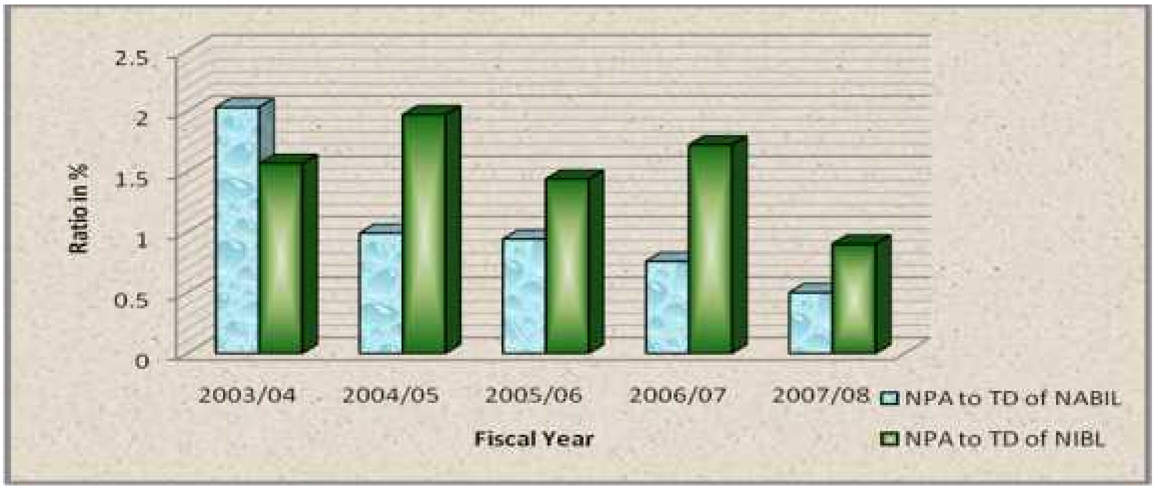
The table 4.5 delineated the coverage of non-performing assets on total deposit. The table showed that ratio declined in each year in case of NABIL. The ratio was 2.03%, 0.99%, 0.94%, 0.76% and 0.50% in the fiscal year 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 respectively. The ratio depicted that NABIL made a good attempt of decreasing its total deposit mobilization in non-performing assets. In average, NABIL mobilized 1.04% of its total deposits in non-performing assets. However, the coefficient of variation of 50.00% indicated high inconsistency in such ratio.

Likewise, the ratio of non-performing assets to total deposit of NIBL fluctuated during the entire period taken for study. The ratio was 1.57% in the fiscal year 2003/04, increased to 1.97% in the fiscal year 2004/05 and then decreased to 1.44% in the fiscal year 2005/06, again increased to 1.72% in the fiscal year 2006/07 and then finally decreased to 0.90% in the fiscal year 2007/08. This showed that NIBL didn’t have good control over non-performing assets and the non-performing assets coverage on total deposit was irregular. In average, the ratio of total deposit mobilization in non-performing assets was 1.52% and the coefficient of variation was 23.46%. It would be better if NIBL makes an effective policy of loan recovery and thus reduces the chances of credit risk by lowering non-performing assets.

Comparing NABIL and NIBL on the basis of non-performing assets to total deposit, it can be concluded that the total deposit of NABIL has been effectively utilized in higher secured sector than that of NIBL, as the ratio of non-performing assets to total deposit of NABIL (1.04%) is lower than that of NIBL (1.52%).

Figure 4.7

Non-Performing Assets to Total Deposits



4.1.6 Loan Loss Provision to Total Loans and Advances

As per the direction of NRB, each bank has to keep 1% of the pass loan, 25% of the sub-standard loan, 50% of the doubtful loan and 100% of the loss loan as provision. The loan loss provision to total loan and advances measures the aggregate provision kept by the bank. The loan loss to total loans and advances of NABIL and NIBL for the five consecutive years is presented in Table 4.6.

Table 4.6

Loan Loss Provision to Total Loans and Advances

FY	NABIL			NIBL		
	LLP	**LA**	**Ratio**	**LLP**	**LA**	**Ratio**
2003/04	358.66	8548.66	4.20	206.30	7124.09	2.90
2004/05	360.57	10946.74	3.29	327.11	10453.16	3.13
2005/06	356.24	13278.78	2.68	401.94	13178.15	3.05
2006/07	357.25	15903.02	2.25	482.67	17769.10	2.72
2007/08	394.41	21759.46	1.81	532.65	27529.30	1.93
Mean			**2.85**			**2.75**
S.D.			**0.84**			**0.43**
C.V.%			**29.34**			**15.71**

(Source: Annual Reports of NABIL & NIBL)

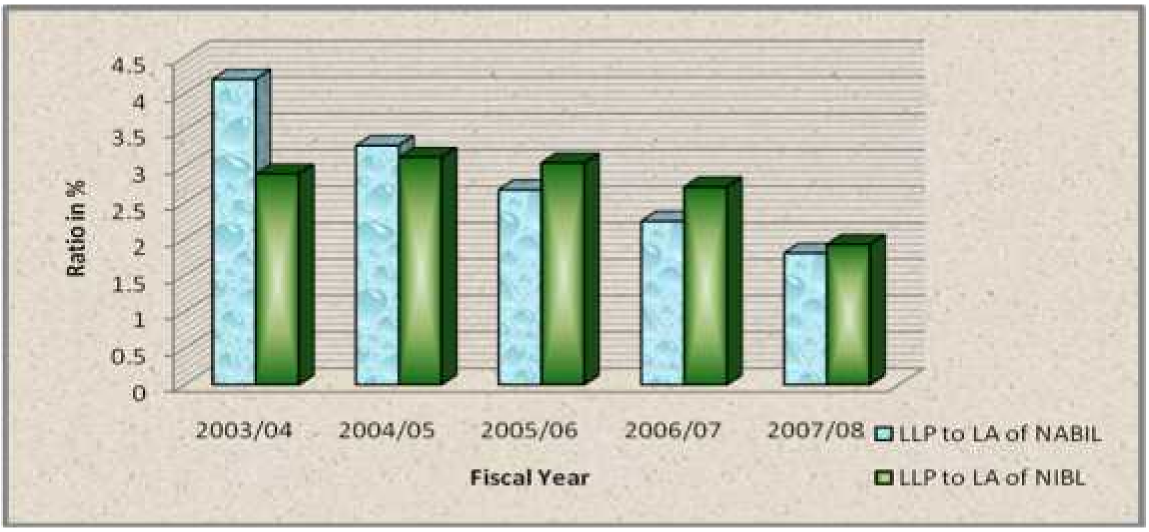
The table 4.6 showed the ratio of loan loss provision kept on total loan. The table showed that the loan loss provision of NABIL followed decreasing trend in each year compared to the previous year. This might be due to good loan management policy adopted by the bank. The ratio was 4.20% in the fiscal year 2003/04, decreased to 3.29% in the fiscal year 2004/05, decreased to 2.68% in the fiscal year 2005/06, again decreased to 2.25% in the fiscal year 2006/07 and finally reached to 1.81% in the fiscal year 2007/08. The decreasing trend of loan loss provision indicates that the amount of pass loan is comparatively higher than sub-standard, doubtful and loss loan in NABIL. In average, NABIL kept 2.85% of its total loan as loan loss provision.

However, the ratio of loan loss provision to total loan in NIBL increased for the first two years and decreased in last three years. The ratio was 2.90% in the fiscal year 2003/04, increased to 3.13% in the fiscal year 2004/05 and then decreased to 3.05% in the fiscal year 2005/06, 2.72% in the fiscal year 2006/07 and 1.93% in the fiscal year 2007/08. In average, NIBL maintained 2.75% of the total loan as loan loss provision. And the coefficient of variation of 15.71% indicated uniformity in the ratio.

Comparing two banks on the basis of loan loss provision to total loan disbursed, it can be concluded that NIBL has better coverage of pass loans on total loan as the average ratio of loan loss provision of NIBL (2.75%) is lower than that of NABIL (2.85%). Also NIBL has more stable loan loss provision than NABIL, as the coefficient of variation in the ratio of NIBL (15.71%) is lower than that of NABIL (29.34%).

Figure 4.8

Loan Loss Provision to Total Loans and Advances



4.1.7 Loan Loss Provision to Non-performing Assets

The non-performing assets is considered much risky than the performing loan and finally affects the financial performance of the company. Thus, to remain secure each bank has to keep more portion of the non performing assets, 25% of sub-standard loan, 50% of doubtful loan and 100% of loss loan as provision. The loan loss provision to non-performing assets measures the aggregate representation of loan provision on non-performing assets. The ratio of NABIL and NIBL for the five year periods is presented in the Table 4.7.

Table 4.7

Loan Loss Provision to Non-performing Assets

FY	NABIL			NIBL		
	LLP	NPA	Ratio	LLP	NPA	Ratio
2003/04	358.66	286.68	125.11	206.30	181.44	113.70
2004/05	360.57	144.51	249.51	327.11	280.87	116.46
2005/06	356.24	182.62	195.07	401.94	272.49	147.51
2006/07	357.25	178.29	200.38	482.67	421.97	114.38
2007/08	394.41	161.09	244.84	532.65	309.47	172.12

Mean		**202.98**		**132.83**
S.D.		**44.83**		**23.38**
C.V.%		**22.09**		**17.60**

(Source: Annual Reports of NABIL & NIBL)

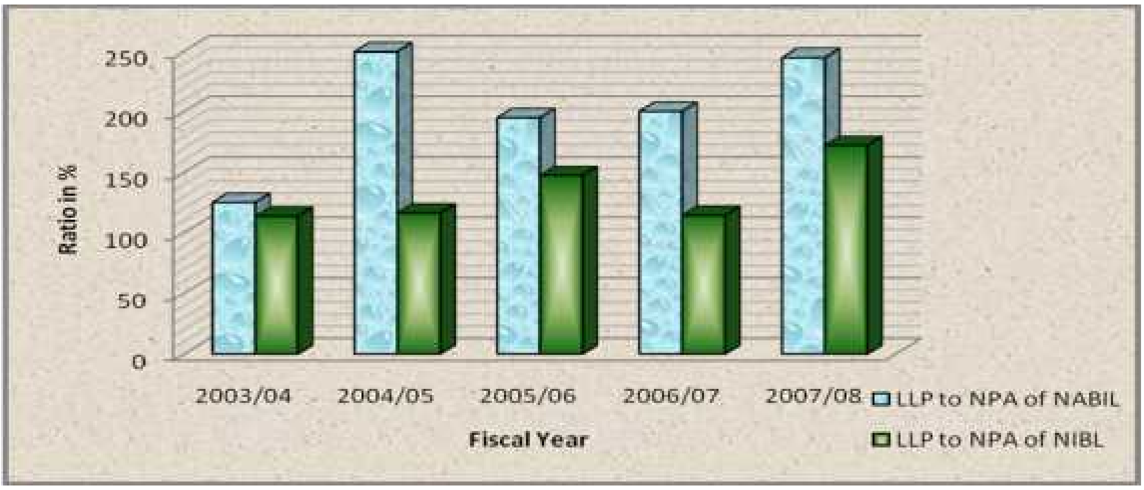
The table 4.7 depicted the ratio of loan loss provision on non-performing assets. The table delineated that the ratio loan loss provision on non-performing assets of NABIL fluctuated during the five year periods taken for study. The loan loss provision kept was 12.511%, 249.51%, 195.07%, 200.38% and 244.84% of the total non-performing assets in the fiscal year 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 respectively. In average, NABIL provisioned 202.98% of the non-performing assets as loan loss provision and the coefficient of variation of 22.09% further implied satisfactory uniformity in such ratio.

Similarly, the loan loss provision kept by NIBL was 113.70% in the fiscal year 2003/04, 116.46% in the fiscal year 2004/05, 147.51% in the fiscal year 2005/06, 114.38% in the fiscal year 2006/07 and 172.12% in the fiscal year 2007/08 of the total non-performing assets. In average, NIBL kept 132.83% of the non-performing assets as loan loss provision. Eventually, the coefficient of variation in such ratio was 17.60%, indicating satisfactory consistency.

Comparing two banks, it can be concluded that NABIL converted higher portion of its total loan disbursement in pass loans and restructured loans than NIBL as the total loan loss provision kept on non-performing loan of NABIL (202.98%) is greater than that of NIBL (132.83%). Thus, NABIL has good recovery policy and lower credit risk than NIBL.

Figure 4.9

Loan Loss Provision to Non-performing Assets



4.1.8 Net profit to Non-Performing Assets

This ratio shows the relationship of non-performing assets with the net profit of the company. The higher the non-performing assets, the lower will be the net profit. The net profit to non-performing assets of NABIL and NIBL for the five year periods are presented in the Table 4.8.

Table 4.8

Net profit to Non-Performing Assets

FY	NABIL			NIBL		
	NP	NPL	Ratio	NP	NPL	Ratio
2003/04	455.31	286.68	158.82	152.67	181.44	84.14
2004/05	520.11	144.51	359.91	232.15	280.87	82.65
2005/06	635.26	182.62	347.86	350.54	272.49	128.64
2006/07	673.96	178.29	378.01	501.40	421.97	118.82
2007/08	746.47	161.09	463.39	696.73	309.47	225.14

Mean		**341.60**		**127.88**
S.D.		**99.94**		**51.96**
C.V.%		**29.26**		**40.64**

(Source: Annual Reports of NABIL & NIBL)

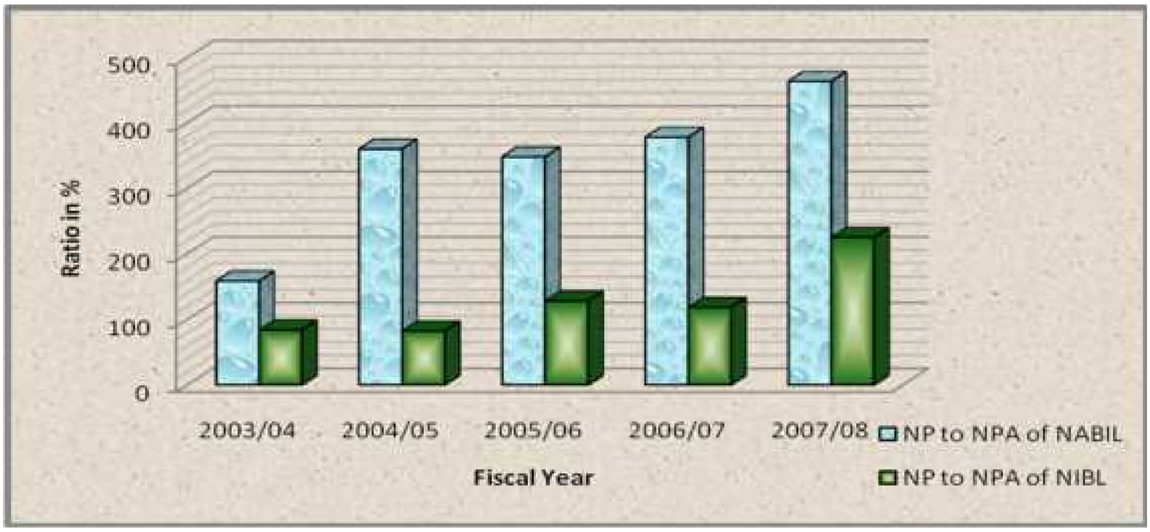
The table 4.8 represents the ratio of net profit to non-performing assets. The table showed that in NABIL the ratio was 158.82% in the fiscal year 2003/04. The ratio fluctuated during the periods taken for research and eventually reached to 463.39% in the fiscal year 2007/08. In average, the net profit represented 341.60% of the non-performing assets and the coefficient of variation on the ratio was 29.26%.

Likewise, the ratio in NIBL also fluctuated during the five consecutive years and ranged from 82.65% in the fiscal year 2004/05 to 225.14% in the fiscal year 2007/08. In average, the net profit of NIBL represented 127.88% of the non-performing assets and the coefficient of variation in the ratio was 40.64%, indicating higher inconsistency.

Comparing two banks, it can be concluded that NABIL made more profit in each year than NIBL and also the representation of net profit on total non-performing assets of NABIL is greater than NIBL, which indicated better loan management in NABIL than in NIBL.

Figure 4.10

Net profit to Non-Performing Assets



4.1.9 Simple Correlation and Regression Analysis

4.1.9.1 Correlation between Non-Performing Assets and Total Deposits

The correlation coefficient measures the relationship between two variables, viz, Non-Performing Assets (NPA) and Total Deposits (TD). To know the role of Total Deposit in moving the Non-Performing Assets (NPA), the Karl Pearson's correlation coefficient 'r' has been calculated and the significance of the value of 'r' is tested through probable error.

Table 4.9

Correlation Coefficient between NPA and TD

Bank	r	r^2	P.E.	6 P.E.	Remarks
NABIL	-0.4297	0.1846	0.2459	1.4757	Insignificant
NIBL	0.5877	0.3454	0.1974	1.1847	Insignificant

(Source: Appendix- III)

The table 4.9 shows that the relationship between NPA and TD of NABIL is negative, which indicates that the dependent variable, NPA decreases with the increase in independent variable, Total Deposits. The correlation coefficient between NPA and

TD is -0.4297, indicating Rs. 100 increase in TD leads to Rs. Rs. 42.97 decrease in NPA. Similarly, the coefficient of determination is 0.1846, which explicates that 18.46% variation in NPA is explained by change in total Deposits. Also, the calculated probable error and the 6 P.E. are 0.2459 and 1.4757 respectively. The higher value of 6 P.E. than the correlation coefficient (r < 6 P.E.) implies that the relationship between NPA and Total Deposit of NABIL is statistically insignificant and hence it can be concluded that it is not necessary that NPA should decrease with the increase in total deposits.

Likewise, the relationship between NPA and Total Deposit of NIBL is moderately positive, indicating that the dependent variable, NPA increases along with the increase in independent variable, TD. The correlation coefficient between these two variables is 0.5877, which depicts that Rs. 100 increase in Total Deposits causes Rs. 58.77 increase in NPA. Also, the coefficient of determination, 0.3454, explicates that 34.54% variation in NPA is explained by change in TD. The calculated probable error and 6 P.E. on these variables are 0.1974 and 1.1847 respectively. The higher the value of 6 P.E. than the correlation coefficient (6 P.E. = 1.1874 > r = 0.5877) implies that the relationship between NPA and TD of NIBL is statistically insignificant and hence it is not necessary that NPA should increase with the increase in Total Deposit and vice versa.

4.1.9.2 Regression Line of NPA on TD

Let NPA be the dependent variable, Y and TD be the independent variable, X then the regression lines of NPA on TD calculated in the *Appendix-III* are;

$$Y_c = a + bX$$

$$NPA_{NABIL} = 258.14 - 0.0033\ TD_{NABIL}$$

$$NPA_{NIBL} = 177.65 + 0.0056\ TD_{NIBL}$$

Table 4.10

Regression Analysis of NPA on TD

Bank	a-value	b-value	t-cal	t-tab	Remarks
NABIL	258.14	-0.0033	0.82	2.776	Insignificant
NIBL	177.65	0.0056	1.26	2.776	Insignificant

(Source: Appendix- III)

The table 4.10 shows the regression line of NPA on TD. The regression line of NPA on TD of NABIL shows that NPA has negative relationship with Total Deposits. Similarly, the constant of 258.14 indicates that if Total Deposit remains zero, NPA will be Rs. 258.14. Also, the beta coefficient of TD, -0.0033, indicates that per rupee increase in Total Deposits leads to Rs. 0.0033 decrease in NPA. The calculated t-value at 5% level of significance and 4 degree of freedom is 0.82, which is comparatively lower than the tabulated t-value (2.776), implies that the relationship between NPA and Total Deposit is statistically insignificant and hence NPA does not decrease with the increase in total deposits.

Likewise, the regression line of non-performing assets on total deposit of NIBL depicts that NPA has positive relationship with TD and hence NPA increases by Rs. 0.0056 with per rupee increase in TD, if the other variable, 177.65, remains constant. However, the calculated t-value (1.26) is lower than the tabulated t-value (2.776), which directly implies that the relationship between NPA and TD is statistically insignificant and hence it is not mandatory that NPA should increase by Rs. 0.0056 with per rupee increase in TD.

4.1.9.3 Correlation between Net Profit (NP) and Non-performing Assets (NPA)

The correlation coefficient between Net Profit and NPA calculated in the Appendix-

III and the test of significance through 6 P.E. has been presented in the Table 4.11.

Table 4.11

Correlation Coefficient between NP and NPA

Bank	r	r^2	P.E.	6 P.E.	Remarks
NABIL	-0.5999	0.3599	0.1931	1.1585	Insignificant
NIBL	0.6462	0.4176	0.1757	1.0541	Insignificant

(Source: Appendix- III)

The table 4.11 depicts the relationship of NP and NPA on the basis of correlation coefficient. The table shows that the relationship between NPA and NP of NABIL is negative, -0.5999, indicating that Net Profit decreases along with the increase in Non-performing assets. Also, the coefficient of determination, r^2, implies that 35.99% variation in Net Profit is explained by change in NPA. The calculated P.E. and 6 P.E. between the relationship of these two variables, NP and NPA, are 0.1931 and 1.1585 respectively. As the ‘r’ value is lower than the 6 P.E. ($r = -0.5999 < 6$ P.E. $= 1.1585$), it can be considered that the relationship between Net Profit and Non-Performing Assets is statistically insignificant, and hence it is not mandatory that NP should decrease with the increase in NPA.

Likewise, the relationship between NP and NPA of NIBL is moderately positive, i.e. $r = 0.6462$. Also, the coefficient of determination r^2, 0.4176, implies that NP changes by 41.76% with the change in value of NPA. The P.E. and 6 P.E. on the relationship between these two variables, NP and NPA, are 0.1757 and 1.0541 respectively. Further, the lower the value of ‘r’ than the value of 6 P.E. ($r = 0.6462 < 6$ P.E. $= 1.0541$) verifies that the relationship between NP and NPA is statistically insignificant and hence NPA has no role to play to vary the value of NP in case of NIBL.

4.1.9.4 Regression line of NP on NPA

Let NP be the dependent factor, Y and NPA be the independent factor, X. Then the regression line of dependent variable, NP on the independent variable, NPA is given by;

$$Y_c = a + bX$$

$$NP_{NABIL} = 847.32 - 1.26\ NPA_{NABIL}$$

$$NP_{NIBL} = -89.90 + 1.63\ NPA_{NIBL}$$

Table 4.12

Regression Analysis of NP on NPA

Bank	a-value	b-value	t-cal	t-tab	Remarks
NABIL	847.32	-1.26	1.30	2.776	Insignificant
NIBL	-89.90	1.63	1.47	2.776	Insignificant

(Source: Appendix- III)

The table 4.12 demonstrates the regression line of dependent variable, NP on independent variable, NPA. The table delineates that the beta coefficient of NPA on regression line of NABIL is -1.26, which indicates that if NPA increases by Re. 1, NP decreases by Rs. 1.26, assuming that the other variable, 847.32, remains stable. However, the lower the value of t_{cal}, 1.30, than the value of t_{tab}, 2.776, at 5% level of significance and 4 d.f. denies this fact and implies that there exist no significant relationship between NP and NPA.

Similarly, the regression line of Net Profit on Non Performing Assets of NIBL indicates that Net Profit has positive relationship with Non Performing Assets and hence NP increases along with the increase in NPA and vice-versa. The beta coefficient of NPA, 1.63, signals that NP increases by Rs. 1.63 along with per rupee increase in NPA, if the other variable, -89.90 remains constant. However, the t-statistics shows that t_{cal}, 1.47, is lower than t_{tab}, 2.776, at 5% level of significance and 4 d.f. and hence denies to agree that Net Profit should increase by Rs. 1.47 when Non Performing Assets increases by Re. 1.

4.1.10 Relationship of Net Profit with NPA and PL

To measure the joint effect of NPA and Performing Loan (PL) on Net Profit (NP), the multiple correlation and multiple regression analysis have been analyzed.

4.1.10.1 Multiple Correlations between NP, NPA and PL

Let correlation coefficient between NP and NPA be denoted by r_{12}, NPA and PL be denoted by r_{23}, and NP and PL be denoted by r_{13}. Then the multiple correlation coefficient of NP on NPA and PL is given by; *(Appendix-IV)*

$$R_{1.23} = \sqrt{\frac{r^2_{12} + r^2_{13} - 2\, r_{12}\, r_{23}\, r_{13}}{1 - r^2_{23}}}$$

$R_{NP.NPA\ PL}$ (NABIL) = 0.9583

$R_{NP.NPA\ PL}$ (NIBL) = 0.9959

Table 4.13

Multiple Correlations between NP, NPA and PL

Banks	R	Relationship	R^2	P.E.	6 P.E.	Remarks
NABIL	0.9583	+ ve	0.9183	0.0246	0.1478	Significant
NIBL	0.9959	+ ve	0.9918	0.0025	0.0148	Significant

(Source: Appendix-IV)

The above table 4.13 shows the multiple correlation between Net Profit (NP), Non-Performing Assets (NPA) and Performing Loan (PL) of two concerned banks during the year covered for research. The multiple correlation coefficients (R) between NP, NPA and PL of NABIL and NIBL are 0.9583 and 0.9959 respectively, which show the positive relationship between these variables of both the banks.

The coefficient of multiple determination (R^2) of NABIL is 0.9183, which is lower than that of NIBL (i.e. 0.9918). It shows that, in case of NABIL, 91.83% of variation in dependent variable (NP) is explained by the variation in independent variables (NPA and PL). Similarly, 99.18% variation in dependent variable (NP) of NIBL is explained by the variation in independent variables (NPA and PL).

To measure the significance of the relationship between NP, NPA and PL of the two concerned banks, it would be more preferable to calculate the probable error of correlation coefficient. The same table depicts that R of NABIL is greater than 6 P.E (R = 0.9583 > 6 P.E. = 0.1478) and R of NIBL is also higher than 6 P.E. (R = 9959 > 6 P.E. = 0.0148). So, it can be concluded that the relationship between NP, NPA and PL is statistically significant in both banks, NABIL and NIBL.

4.1.10.2 Multiple Regression Equation of NP on NPA and PL

Let NP, NPA and PL be denoted by X_1, X_2 and X_3 respectively. Then the multiple regression equation of NP on NPA and PL is given by;

$$X_1 = a + b_1 X_2 + b_2 X_3$$

$$NP_{NABIL} = 354.07 - 0.19\ NPA_{NABIL} + 0.02\ PL_{NABIL}$$

$$NP_{NIBL} = -94.21 + 0.36\ NPA_{NIBL} + 0.03\ PL_{NIBL}$$

Table 4.14

Multiple Regression Line of NP on NPA and PL

Banks	No. of year	Constant (a)	Regression Coefficient (b)	
			b_1	b_2
NABIL	5	354.07	-0.19	0.02
NIBL	5	-94.21	0.36	0.03

(Source: Appendix IV)

The above table 4.14 represents the linear relationship between NP, with NPA and PL of two concerned banks. The constant (a) is positive in NABIL (-354.07) and negative in NIBL (-94.21). In case of NABIL, the beta coefficient of NPA and PL are -0.19 and 0.02 respectively. It indicates that a one-rupee increase in NPA leads to Rs.

0.19 decrease in NP if PL remains constant and one rupee increase in PL leads to an average about Rs. 0.02 increase in NP if NPA remains constant.

On the other hand, in case of NIBL, the regression coefficients of NPA and PL are 0.36 and 0.03 respectively, which indicates that a one-rupee increase in NPA causes Rs. 0.36 increase in NP if PL remains stable and one-rupee increase in PL leads to an average about Rs. 0.03 increase in NP if NPA remains uniform. Hence, it can be concluded that both Non Performing Assets and Performing Loan have direct influence on Net Profit.

4.1.11 Trend Analysis

The trend analysis aids to predict the future value on the basis of the past years. To know the components of non-performing assets and NPA as a whole of the sampled banks in future the trend analysis has been used.

4.1.11.1 Trend Analysis of Sub-Standard Loan (SSL)

Let Year (X) 1, 2, 3, 4 and 5 denotes fiscal year 2003/04, 2004/05, 2005/06, 2006/0 and 2007/08 respectively. Then regression line of Sub-standard Loan (Y) on year is given by;

$$Y = a + b X$$

$$SSL_{NABIL} = 2.82 + 18.58 X$$

$$SSL_{NIBL} = -16.46 + 19.79 X$$

The trend value of Sub-standard Loan (SSL) calculated from this regression equation is presented in the following table.

Table 4.15

Trend Analysis of Sub-Standard Loan

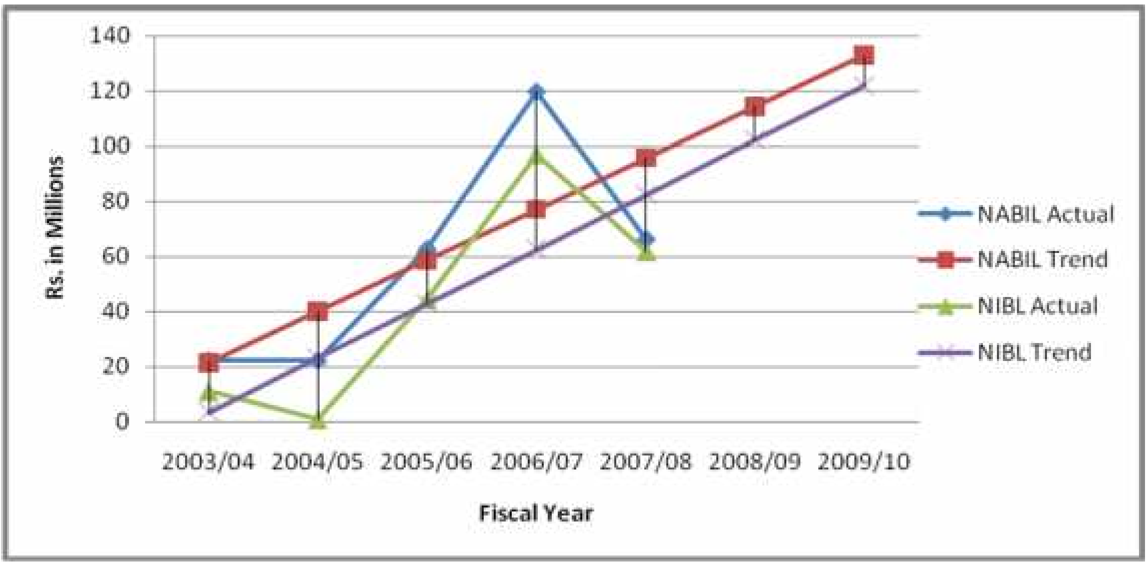
Fiscal Year	NABIL		NIBL	
	Actual	**Trend**	**Actual**	**Trend**
2003/04	22.14	21.40	10.84	3.33
2004/05	22.07	39.98	0.82	23.12
2005/06	62.67	58.56	44.24	42.91
2006/07	119.70	77.14	96.89	62.69
2007/08	66.22	95.72	61.74	82.48
2008/09		114.30		102.27
2009/10		132.88		122.05

(Source: Appendix V)

The table 4.15 shows that the trend sub-standard loan of NABIL and NIBL follows increasing trend. The table depicts that the sub-standard loan in the fiscal year 2008/09 and 2009/10 will be Rs. 114.30 millions and Rs. 132.88 millions respectively in NABIL and Rs. 102.27 millions and Rs. 122.05 millions respectively in NIBL. Likewise, the regression equation shows the positive relation of sub-standard loan with the year and in each fiscal year the sub-standard loan will increase by Rs. 18.58 millions in NABIL and by Rs. 19.79 millions in NIBL.

Figure 4.11

Trend Analysis of Sub-Standard Loan



4.1.11.2 Trend Analysis of Doubtful Loan (DL)

The regression line of doubtful loan (DL) on year is given by:

$$DL_{NABIL} = 49.55 - 5.08\,X$$

$$DL_{NIBL} = 71.78 - 7.52\,X$$

The trend value of Doubtful Loan calculated on the basis of the above regression equation is presented in the following table.

Table 4.16

Trend Analysis of Doubtful Loan

Fiscal Year	NABIL		NIBL	
	Actual	Trend	Actual	Trend
2003/04	65.55	44.46	63.88	64.26
2004/05	19.34	39.38	74.94	56.74
2005/06	29.57	34.30	0.49	49.22
2006/07	14.47	29.22	86.05	41.70
2007/08	42.58	24.14	20.72	34.17

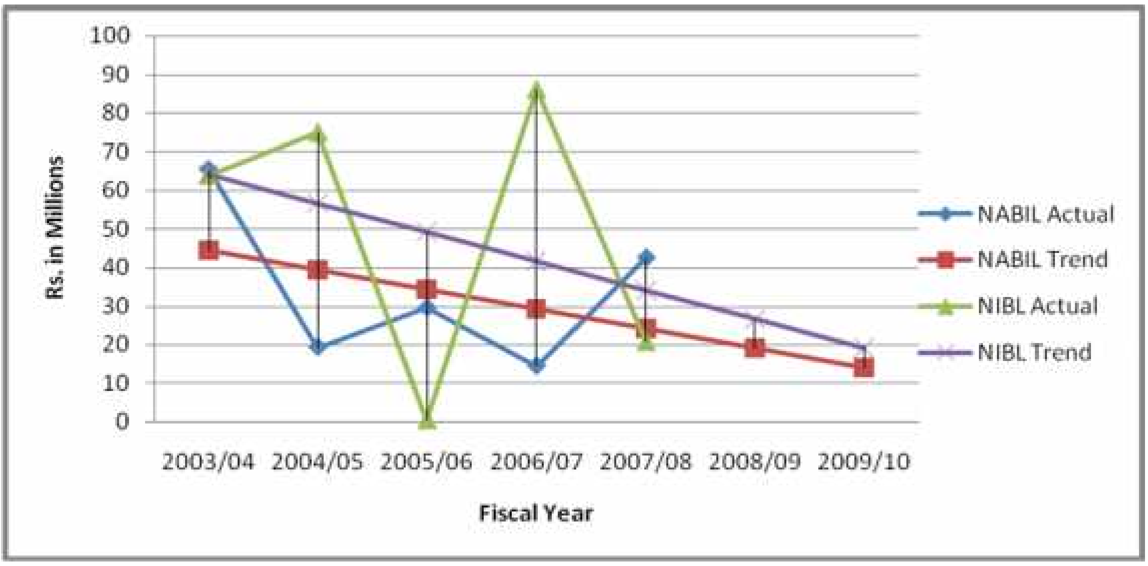
2008/09		19.06		26.65
2009/10		13.98		19.13

(Source: Appendix V)

The regression line shows that in each fiscal year, the doubtful loan decreases by Rs. 5.08 millions in NABIL and by Rs. 7.52 millions in NIBL. Also, the table shows that the predicted doubtful loan in the fiscal year 2008/09 and 2009/10 will be Rs. 19.06 millions and Rs. 13.98 millions respectively in NABIL and Rs. 26.65 millions and Rs. 19.13 millions in respectively in NIBL.

Figure 4.12

Trend Analysis of Doubtful Loan



4.1.11.3 Trend Analysis of Loss Loan (LL)

The regression equation of Loss Loan (dependent variable) on Year (independent variable) is;

LL_{NABIL} = 212.19 – 36.98 X

LL_{NIBL}= 118.78 + 27.45 X

The trend value of Loan Loss computed from the regression line is presented in the table below:

Table 4.17

Trend Analysis of LL

Fiscal Year	NABIL		NIBL	
	Actual	Trend	Actual	Trend
2003/04	198.99	175.21	106.72	146.23
2004/05	120.50	138.24	205.11	173.68
2005/06	90.39	101.26	227.76	201.13
2006/07	44.12	64.28	239.03	228.58
2007/08	52.29	27.30	227.01	256.03

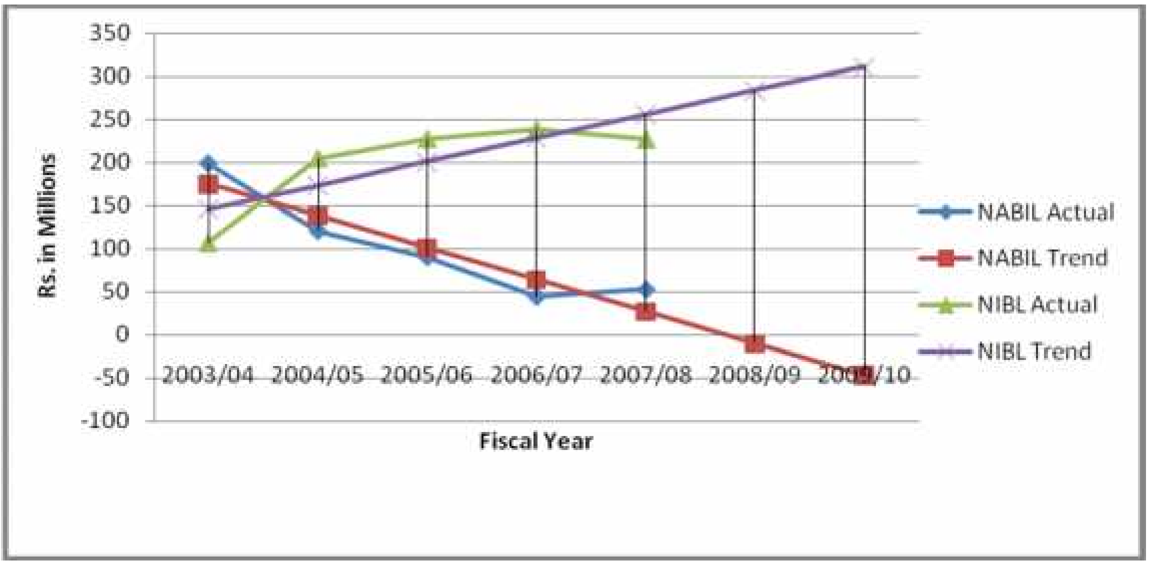
2008/09		-9.68		283.48
2009/10		-46.65		310.93

(Source: Appendix V)

The table shows that the estimated loan loss that NABIL will maintain in the fiscal year 2008/09 and 2009/10 will be nil and the estimated loan loss of NIBL will be Rs. 283.48 millions and Rs. 310.93 millions in the fiscal year 2008/09 and 2009/10 respectively. The regression line also shows that the loan loss will decrease by Rs. 36.98 millions per year in NABIL and increase by Rs. 27.45 millions per year in NIBL. The decrease of loan loss to zero in the future year indicates that NABIL gives more emphasis on reducing the credit risk, whereas the increase of loan loss implies that NIBL will fail to reduce the credit risk.

Figure 4.13

Trend Analysis of Loan Loss



4.1.11.4 Trend Analysis of Non Performing Assets (NPA)

Let the dependent Variable, NPA be denoted by Y and the independent variable, Year be denoted by X. Then, the regression equation of NPA on Year is given by;

$$NPA_{NABIL} = 255.86 - 21.74\ X$$

$$NPA_{NIBL} = 174.10 + 39.72\ X$$

Table 4.18

Trend Analysis of Non Performing Assets

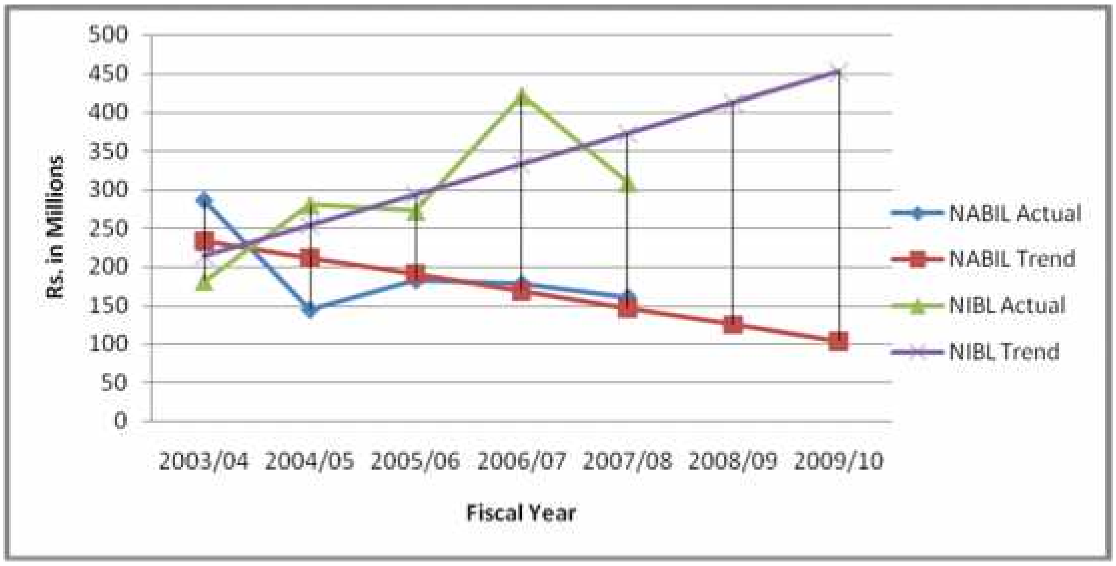
Fiscal Year	NABIL		NIBL	
	Actual	Trend	Actual	Trend
2003/04	286.68	234.12	181.44	213.82
2004/05	144.51	212.38	280.87	253.53
2005/06	182.62	190.64	272.49	293.25
2006/07	178.29	168.90	421.97	332.96
2007/08	161.09	147.16	309.47	372.68
2008/09		125.42		412.40
2009/10		103.68		452.11

(Source: Appendix V)

The table shows that the estimated value of non performing assets will be Rs. 125.42 millions and Rs. 103.68 millions in NABIL and Rs. 412.40 millions and Rs. 452.11 millions in NIBL in the fiscal year 2008/09 and 2009/10 respectively. Similarly, the regression line of non-performing assets on time period indicates that in each year, the non-performing assets decreases by Rs. 21.74 millions in NABIL, if the other variable (255.86) remains constant and the non-performing assets increases by 39.72 millions in NIBL, if the other variable (174.10) remains stable. This indicates that NABIL has good loan management policy than NIBL.

Figure 4.14

Trend Analysis of Non Performing Assets



4.2 Primary Data Analysis

For the purpose of collecting primary data, a questionnaire having a set of 8 questions were prepared and presented to 40 respondents. The respondents were selected randomly from Shareholders, Borrowers and Employees. The questions 1 to 8 contained objective question. The targeted 40 respondents were composed by 10 shareholders, 15 borrowers and 15 employees. Out of 40 questions distributed, responses from only 32 personnel obtained, which represented 80% of the total populated questions. Among the 32 respondents, 9 were shareholders, 12 were borrowers and 11 were employee of NABIL and NIBL banks.

4.2.1 Loan Floatation Basis

To examine the most important basis that should be considered while disbursing loan, the respondents were asked to express their view. The responses obtained from them have been presented in the table 4.19.

Table 4.19

Loan Floatation Basis

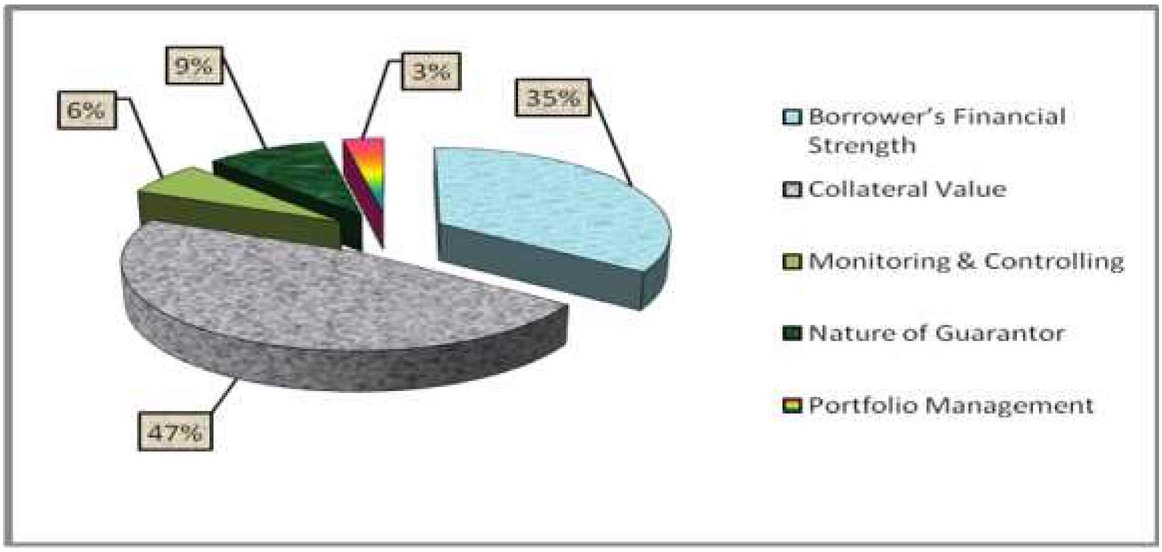
Basis	Responses			Total	
	Shareholder	**Borrower**	**Employee**	**Responses**	**%**
Borrower's Financial Strength	2	4	5	**11**	**35**
Collateral Value	4	6	5	**15**	**47**
Monitoring & Controlling	1	1	0	**2**	**6**
Nature of Guarantor	1	1	1	**3**	**9**
Portfolio Management	1	0	0	**1**	**3**
Total	**9**	**12**	**11**	**32**	**100**

Source: Opinion Survey, 2009

The Table 4.19 showed that the majority of the respondents stated that the collateral value should be given more consideration while disbursing loan. Out of the 32 respondents, 15 respondents (47%), supported this option. Besides collateral value, 35% of the respondents, 11 out of 32, opined that evaluation borrower's financial strength should be the main basis while floating loan. Similarly, 9% of the respondents (3 out of 32), 6% of the respondents (2 out of 32) and 3% of the respondents (1 out of 32) affirmed that nature of guarantor, monitoring and controlling and portfolio of loan management respectively should be the main basis for loan floatation.

Figure 4.15

Loan Floatation Basis



4.2.2 Internal Reasons for Turning Bad Loan

To know the internal reasons that turn out the good loan into bad loan, the respondents were asked on this regard. The responses obtained from the respondents have been presented in Table 4.20.

Table 4.20

Internal Reasons for Turning Bad Loan

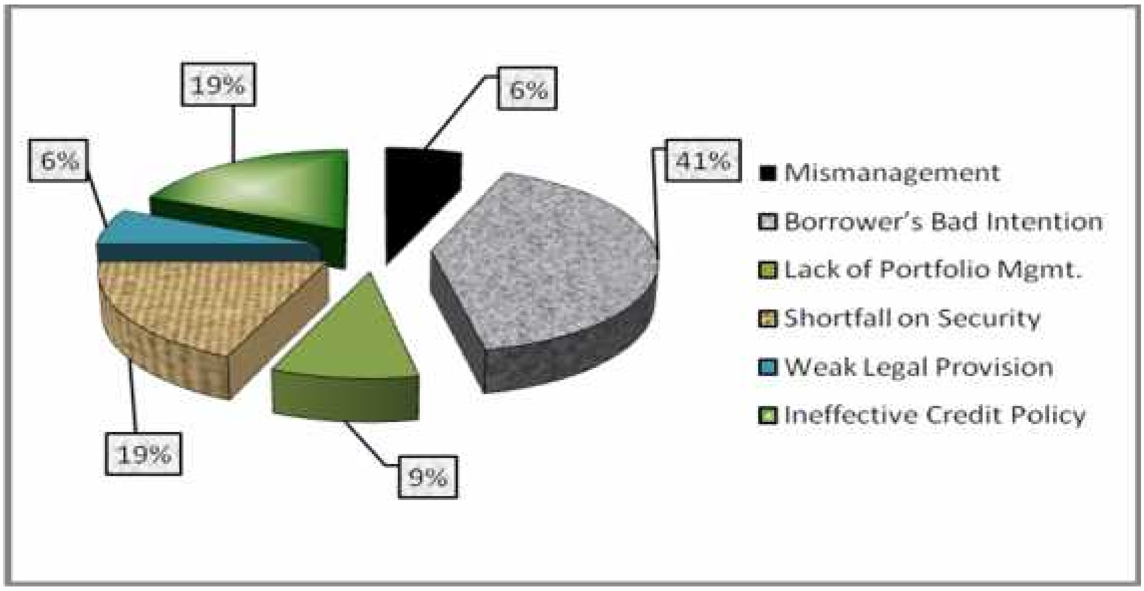
Reasons	Responses			Total	
	Shareholder	Borrower	Employee	Responses	%
Mismanagement	1	0	1	**2**	**6**
Borrower's Bad Intention	3	7	3	**13**	**41**
Lack of Portfolio Mgmt.	0	1	2	**3**	**9**
Shortfall on Security	3	1	2	**6**	**19**
Weak Legal Provision	0	0	2	**2**	**6**
Ineffective Credit Policy	2	3	1	**6**	**19**
Total	**9**	**12**	**11**	**32**	**100**

Source: Opinion Survey, 2009

The table 4.20 showed that the majority of the respondents, 13 out of 32 (41%) strongly affirmed that the bad intention of borrower turns the loan into bad loan. Similarly, 6 respondents (19%) said that overvaluation of security and ineffective credit policy of the bank each is equally responsible for turning loan into bad loan. However, 3 respondents (9%) stated that lack of good portfolio loan management is responsible for bad loan, while 2 respondents each (6%) opined that mismanagement and weak legal provisions are responsible for formation of bad loan. Considering the majority of each category, 3 out of 9 shareholders, 7 out of 12 borrowers, 3 out of 11 employees and the overall majority, 13 out of 32 respondents, it can be concluded that the borrower's bad intention is the major reason for turning bad loan.

Figure 4.16

Internal Reasons for Turning Bad Loan



4.2.3 External Reasons for Turning Bad Loan

Similarly, to know the external reasons that provokes the loan to turn into bad loan, the respondents were asked to express their view. The responses obtained from them have been presented in the Table 4.21.

Table 4.21

External Reasons for Turning Bad Loan

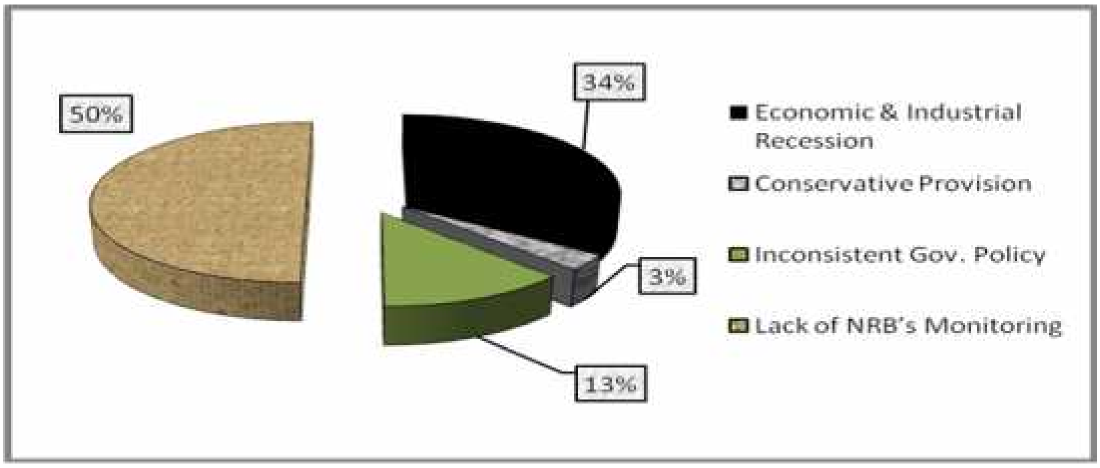
Reasons	Responses			Total	
	Shareholder	Borrower	Employee	Responses	%
Economic & Industrial Recession	3	5	3	**11**	**34**
Conservative Provision	0	1	0	**1**	**3**
Inconsistent Gov. Policy	1	2	1	**4**	**13**
Lack of NRB's Monitoring	5	4	7	**16**	**50**
Total	**9**	**12**	**11**	**32**	**100**

Source: Opinion Survey, 2009

The table 4.21 showed that the majority of the respondents, 16 out of 32, half of the total respondents, opined that the lack of NRB's monitoring and supervision is the main reason behind turning loan into bad loan. Likewise, 11 respondents, 34% of the total respondents, said that recession in economy and industry causes loan to turn bad. However, 3% of the respondents, 1 out of 32 and 13% of the respondents, 4 out of 32 stated that conservative provision for loan and inconsistent government policy are the main reasons for having bad loan. However, looking each category, the majority of the shareholders, 5 out of 9 and the majority of employee, 7 out of 11 supported lack of NRB's proper monitoring and supervision are the main reason, while the majority of the borrower stated that economic and industrial recession is the main reason for bad loan. Eventually on the basis of overall majority it can be considered that lack of NRB's proper monitoring and supervision is the main external reason that causes loan to turn bad.

Figure 4.17

External Reasons for Turning Bad Loan



4.2.4 Sector Covering More Default Loan

To control the process of turning good loan into bad, it is essential to know the major sector defaulting loan. Hence to examine the major sector that covers more default loan, the respondents were asked to express their opinions. The responses achieved from them have been presented in the Table 4.22.

Table 4.22

Sector Covering More Default Loan

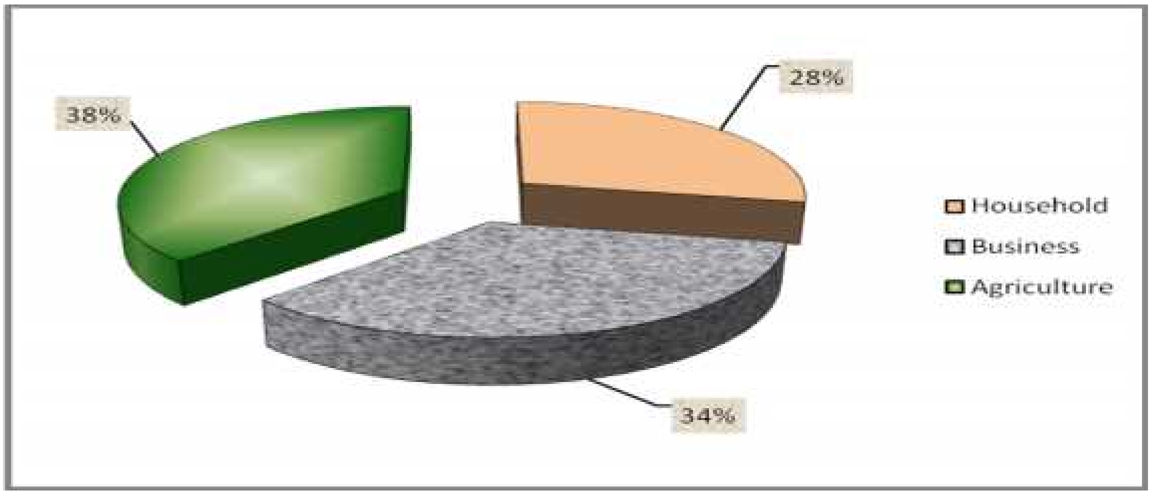
Sector	**Responses**			**Total**	
	Shareholder	**Borrower**	**Employee**	**Responses**	**%**
Household	2	4	3	**9**	**28**
Business	4	2	5	**11**	**34**
Agriculture	3	6	3	**12**	**38**
Total	**9**	**12**	**11**	**32**	**100**

Source: Opinion Survey, 2009

The table 4.22 depicted that the majority of the respondents, 12 out of 38 pointed out that agricultural sector covers the more default loan. While, 34% of the respondents, 11 out of 32, opined that business sector covers more default loan and 28% of the respondents, 9 out of 32, stated that household covers more default loan. Similarly, looking each category the majority of the shareholders, 4 out of 9 and the majority of the employees, 5 out of 11, strongly supported that business sector covers more default loan. However, the majority of the borrowers, 6 out of 11, said that agriculture sector covers more default loan. Eventually, considering the overall majority, 38% of the respondents, it can be concluded that agriculture sector is more risky while recovering loan than household and business sector.

Figure 4.18

Sector Covering More Default Loan



4.2.5 Effect of NPA on Financial Health of Bank

To investigate whether Non-Performing Assets actually affects the financial health of bank or not, the respondents were asked to opine their feelings. The responses obtained through questionnaire are presented in the Table 4.23.

Table 4.23

Effect of NPA on Financial Health of Bank

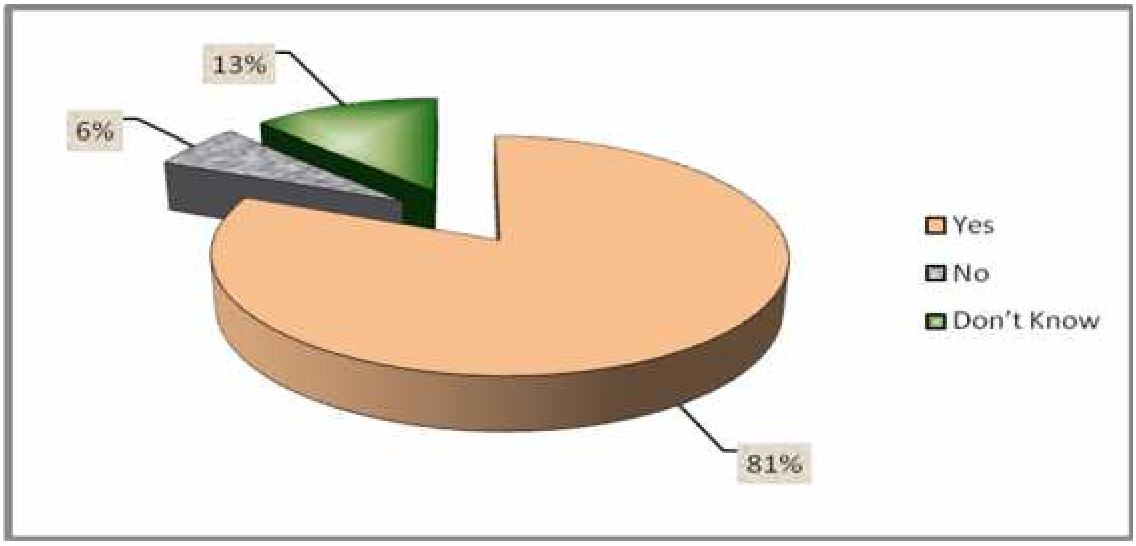
Effect	Responses			Total	
	Shareholder	Borrower	Employee	Responses	%
Yes	8	8	10	**26**	**81**
No	1	1	0	**2**	**6**
Don't Know	0	3	1	**4**	**13**
Total	**9**	**12**	**11**	**32**	**100**

Source: Opinion Survey, 2009

The table 4.23 delineated that the 81% of the respondents, 26 out of 32 were in the view that NPA has direct effect on the financial health of the bank, whereas only 6% of the respondents, 2 out of 32, were in the view that NPA has no effect in the financial health of the company, and 13% of the respondents, 4 out of 32 remained neutral on this query. Also, the majority of each category, 8 out of 9 shareholders, 8 out of 12 borrowers and 10 out of 11 employees were in the view that NPA has direct impact on the financial performance of the company. So, embracing the majority of each category and the whole majority, it cannot be denies with the fact that NPA has direct influence on the financial health of the bank.

Figure 4.19

Effect of NPA on Financial Health of Bank



4.2.6 Degree of Effect of NPA on Banking Industry

To know the degree of effect that NPA has on banking industry, the respondents were asked to express their view. The responses obtained from them have been presented in the Table 4.24.

Table 4.24

Degree of Effect of NPA on Banking Industry

Degree	Responses			Total	
	Shareholder	Borrower	Employee	Responses	%
Not affected	0	0	0	**0**	**0**

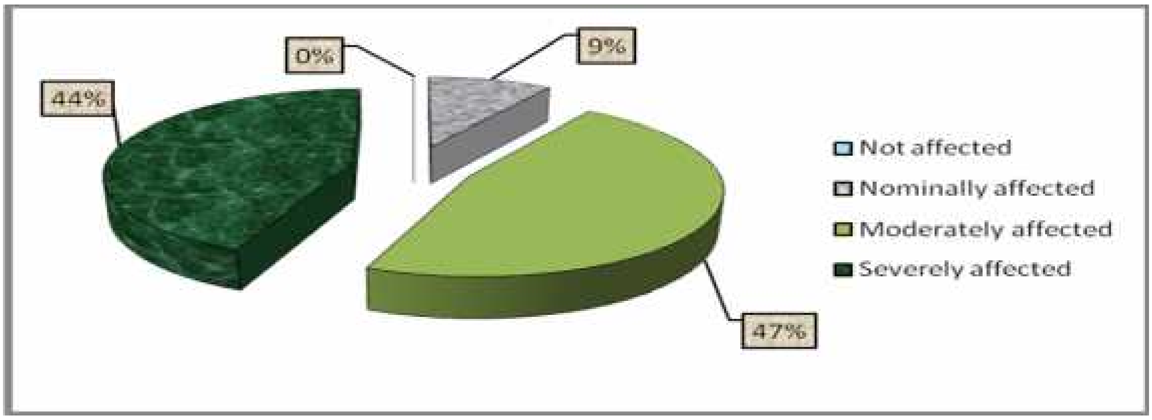
Nominally affected	0	1	2	**3**	**9**
Moderately affected	6	4	5	**15**	**47**
Severely affected	3	7	4	**14**	**44**
Total	**9**	**12**	**11**	**32**	**100**

Source: Opinion Survey, 2009

The table 4.24 demonstrated that 47% of the respondents, 15 out of 32, stated that the banking industry had been moderately affected by the problem of NPA. Similarly, 44% of the respondents, 14 out of 32 said that the problem of NPA had severe effect on the banking industry. Also, 9% of the respondents, 3 out of 32 stated that the banking industry had been nominally affected by the problem of NPA. Looking each category, the majority of the shareholders, 6 out of 9 and the majority of the employees, 5 out of 11 stated that banking industry had been moderately affected by NPA. However, the majority of the borrower, 7 out of 12, stated that the banking industry had been severely affected by the problem of NPA. Finally, considering the overall majority, 15 out of 32, it can be concluded that NPA has moderate effect on banking industry.

Figure 4.20

Degree of Effect of NPA on Banking Industry



4.2.7 Best measures to resolve NPA Problem

To solve the NPA problem has become the greatest challenge of today's banking industry to reduce the credit risk. Hence, to know what measures can be taken for resolving the NPA problem, the respondents were asked on this regard. The solution achieved from them has been presented in the Table 4.25.

Table 4.25

Best measures to resolve NPA Problem

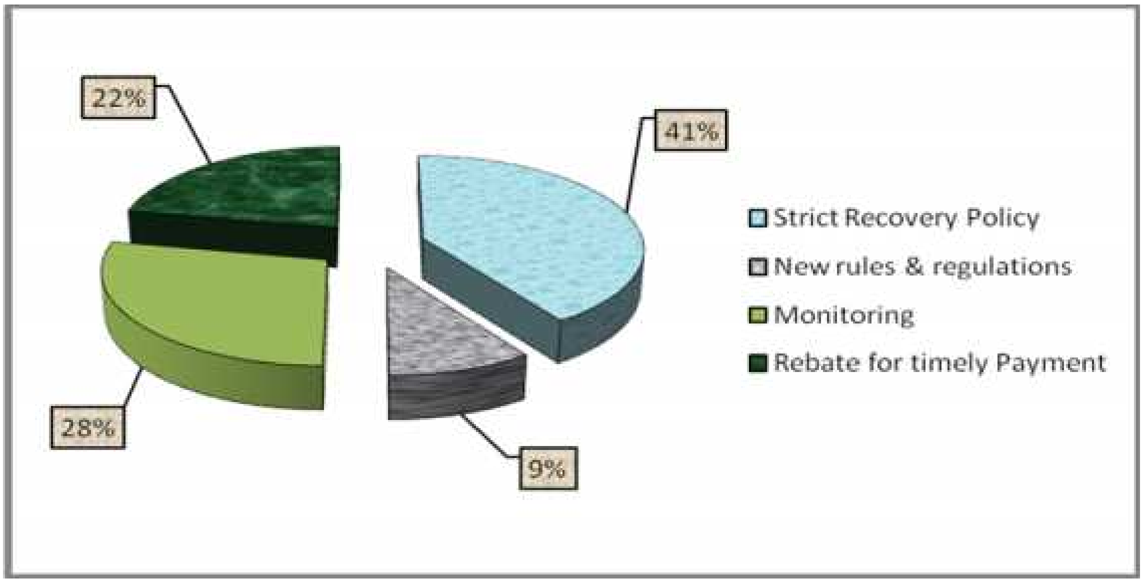
Degree	**Responses**			**Total**	
	Shareholder	**Borrower**	**Employee**	**Responses**	**%**
Strict Recovery Policy	4	6	3	**13**	**41**
New rules & regulations	0	1	2	**3**	**9**
Monitoring	2	3	4	**9**	**28**
Rebate for timely Payment	3	2	2	**7**	**22**
Total	**9**	**12**	**11**	**32**	**100**

Source: Opinion Survey, 2009

The table 4.25 depicted that 41% of the respondents, 13 out of 32 soughed that the adoption of strict recovery policy can only reduce the problem of NPA. Similarly, 28% of the respondents, 9 out of 32, 22% of the respondents, 7 out of 32, and 9% of the respondents, 3 out of 32 opined that monitoring of borrower's activities, providing rebate for timely payment and introduction of new rules and regulations regarding NPA respectively can reduce the problem of NPA. Looking each category, the majority of shareholders, 4 out of 9 and the majority of borrowers, 6 out of 12 suggested adoption of strict recovery policy, while the majority of the employees, 4 out of 11, suggested monitoring of borrower's activities can reduce the NPA problem. Finally, considering the majority of the respondents, 13 out of 32, it can be concluded that adoption of strict recovery policy is the best option for reducing NPA.

Figure 4.21

Best measures to resolve NPA Problem



4.2.8 Best Time to Follow up after Due date

To examine the best time within which the bank should follow up for recovery after due date, the respondents were asked on this regard. The responses obtained from them have been presented in the Table 4.26.

Table 4.26

Best Time to Follow up after Due date

Degree	Responses			Total	
	Shareholder	Borrower	Employee	Responses	%
Within a week	2	1	3	**6**	**19**
Within two weeks	4	3	6	**13**	**41**

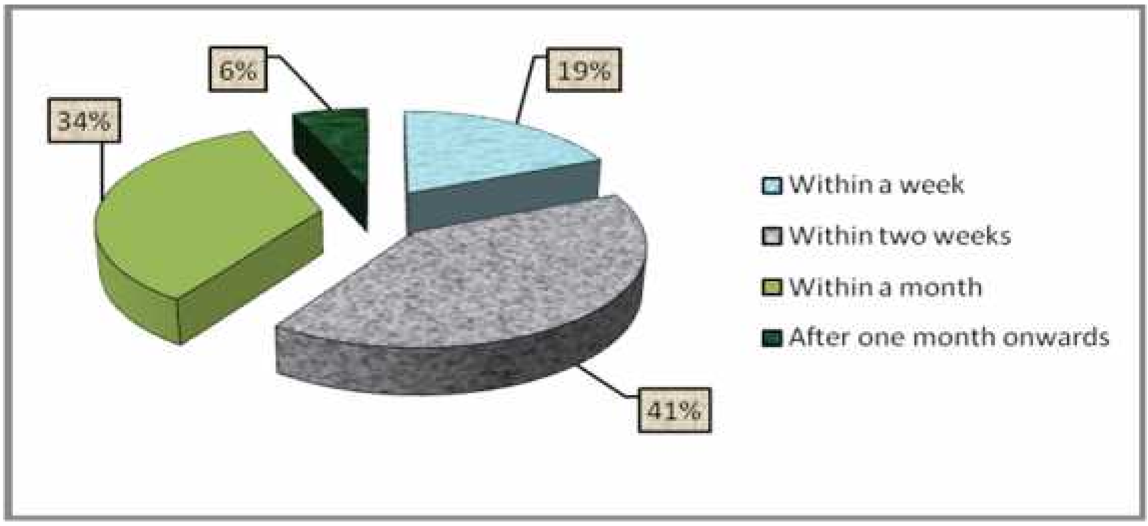
Within a month	3	6	2	**11**	**34**
After one month onwards	0	2	0	**2**	**6**
Total	**9**	**12**	**11**	**32**	**100**

Source: Opinion Survey, 2009

The table 4.26 demonstrated that 41% of the respondents, 13 out of 32, were in the view that banks should follow up for the recovery within two weeks after due date. Similarly, 34% of the respondents, 11 out of 32, opined that within a month after due date will be the best time that the bank should start for recovery. Also, 19% of the respondents, 6 out of 32 and 6% of the respondents, 2 out of 32 opined that within a week and after one month onward respectively will be the best time for follow up. Looking each category, the majority of shareholders, 4 out of 9 and the majority of employees, 6 out of 11 supported within two weeks, whereas the majority of borrowers, 6 out of 12, supported within a month for follow up after due date. Eventually, considering the overall majority, it can be concluded that within two weeks after the matured date of loan will be the best time for bank to follow up for recovery process.

Figure 4.22

Best Time to Follow up after Due date



4.3 Major Findings

On the basis of both primary and secondary data analysis, the following major findings have been drawn up;

Findings from Secondary Data Analysis

- In average, the performing loan of NABIL covered 98.42% of the total loans and advances, whereas the non-performing loan covered 1.58% of the total loans and advances. Similarly, in NIBL the performing loan occupied 97.84% and non-performing loan covered 2.16% of the total loans and advances.
- In average, sub-standard loan occupied 58.56%, doubtful loan occupied 34.30% and loss loan covered 101.26% of the total non-performing assets of NABIL. While in contrast, sub-standard loan covered 42.91%, doubtful loan covered 49.22% and loss loan covered 201.13% of the total non-performing loan in NIBL.
- In average, the non-performing assets represented 1.62% in NABIL and 2.21% in NIBL of the total performing loan of the respective bank, which indicated that NIBL has more risky investment sector than NABIL.
- Similarly, the non-performing assets covered 0.89% of the total assets of NABIL and 1.35% of the total assets of NIBL, thus implying more risky assets in NIBL compared to NABIL.
- Likewise, the non-performing asset to total deposit of NABIL was 1.04% and that of NIBL was 1.52%, which indicated better loan management in NABIL than in NIBL.
- In average, NABIL kept 2.85% of the total loans as loan loss provision and NIBL kept 2.75% of the total loans as loan loss provision. Similarly, the loan loss provision represented 202.98% and 132.83% of non-performing assets in NABIL and NIBL respectively.
- Also, the net profit to non-performing assets of NABIL was 341.60% in average and that of NIBL was 127.88% in average for the five year periods taken for research.

- There exists negative correlation of -0.4297 between NPA and TD of NABIL and positive correlation of 0.5877 between NPA and TD of NIBL. Similarly, the correlation coefficients between net profit and non-performing assets were -0.5999 in NABIL and 0.6462 in NIBL.
- The regression line showed that NPA of NABIL decreases by Rs. 0.0033 with per rupee increase in total deposit, while the NPA of NIBL increases by Rs. 0.0056 with per rupee increase in total deposit. Similarly, net profit of NABIL decreases by Rs. 1.26 with per rupee increase in NPA and net profit of NIBL increases by Rs. 1.63 with per rupee increase in NPA.
- The multiple correlations between net profit, non performing assets and performing loan were 0.9583 in NABIL and 0.9959 in NIBL. Similarly, the multiple regression equation of net profit on non performing assets and performing loan indicated that with per rupee increase in non-performing assets, the net profit of NABIL decreases by Rs. 0.19 and the net profit of NIBL increases by Rs. 0.36, if performing loan of the corresponding banks remain constant. Also, with per rupee increase in performing loan, the net profit of NABIL increases by Rs. 0.02 and the net profit of NIBL increases by Rs. 0.03, if the non-performing assets of the corresponding banks remain constant.
- The trend analysis showed that the sub-standard loan in the fiscal year 2008/09 will be Rs. 114.30 millions in NABIL and Rs. 102.27 millions in NIBL and in the fiscal year 2009/10 will be Rs. 132.88 millions in NABIL and Rs. 122.05 millions in NIBL. Similarly, the doubtful loan will be Rs. 19.06 millions in NABIL and Rs. 26.65 millions in NIBL in the fiscal year 2008/09 and will be Rs. 13.98 millions in NABIL and Rs. 19.13 millions in NIBL in the fiscal year 2009/10.
- Likewise, the loss loan of NABIL in the fiscal year 2008/09 and 2009/10 will be nil. While the loss loan of NIBL in the fiscal year 2008/09 and 2009/10 will be Rs. 283.48 millions and Rs. 310.93 millions respectively. Also, the total non-performing loan of NABIL in the fiscal year 2008/09 and 2009/10 will be Rs. 125.42 millions and Rs. 103.68 millions respectively, while that of NIBL in

the same period will be Rs. 412.40 millions and Rs. 452.11 millions respectively.

Findings from Primary Data Analysis

- 47% of the respondents were in the view that the collateral evaluation should be the main basis to be considered while disbursing loan.
- Similarly, 41% of the respondents, 13 out of 32, stated that bad intention of borrower is the main internal reason that provokes the loan to turn out into bad. Further, lack of NRB's proper monitoring and supervision is the major external reason that turns loan into bad. About 50% of the respondents, 16 out of 32, chose this option.
- 38% of the respondents said that agricultural is the major sector that covers more default loan. Similarly, 34% of the respondents and 28% of the respondents claimed business and household respectively that covers default loan.
- About 81% of the respondents, 26 out of 32 opined that NPA has effect on the financial health of the banks. Similarly, 47% of the respondents, 15 out of 32 stated that the banking industry has been moderately affected by the problem of NPA.
- Finally, 41% of the respondents, 13 out of 32, suggested adoption of strict recovery policy to reduce the problem of non-performing loan and the same percentage of the respondents suggested within two weeks after the due date will be the best time to follow up for loan recovery.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Financial institution plays crucial role in the process of economic growth of a country. Banks are the financial regulator, which collects funds and invest them in a productive sectors. A commercial bank means the bank, which deals with exchanging currency, accepting deposit, giving loan and doing other commercial transactions. Therefore, one of the functions of commercial bank is to provide loan. There is not so long history of commercial bank in Nepal. Nepal Bank Limited is the firs bank in Nepal, established on 30^{th} Kartik, 1994 B.S. But now there are 26 commercial banks have been extending their services in throughout the nation. There has been top competition between commercial banks.

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

In simple words, non-performing assets/loan are those loans which do not repay principle and interest on time to the banks. According the NRB directive, sub-standard, doubtful and loss loans are the non-performing loan. Higher non-performing assets can be a cause to decrease profit of the commercial banks. As the provisioning required as NRB circular is very much stick, major chuck of operating profit has been allocated for maintaining loan loss provisioning.

The main aim of this study, as mentioned in introduction chapter is to study the non performing assets of NABIL and NIBL bank. The specific objectives are: a) to find out the level of non performing assets in selected banks, b) to study and find out the impact of non-performing assets in the net profit, c) to find out the factors leading to the accumulation of non-performing assets, and d) to find out the portion of risky assets in the total assets of the banks.

Books, Articles and past Master's research works were reviewed in this research. This study is based on secondary as well as primary data. With regard to secondary data, two commercial banks, viz, NABIL and NIBL were taken as sample. The data collected from various sources are recorded systematically and presented in appropriate forms of tables and charts and appropriate mathematical, statistical and graphical tools have been applied to analyze the collected data in a suitable manner. The data of five consecutive years of the two commercial banks have been analyzed to meet the objectives of the study.

5.2 Conclusion

On the basis of the secondary and primary data analysis and the major findings drawn, it can be concluded that NABIL maintains less NPA than NIBL. Also, the composition of non-performing assets aids to conclude that NABIL has lower credit risk than NIBL, as NABIL gave more emphasis in converting the doubtful loan and loss loan into sub-standard loan, although NIBL remained able to reduce the doubtful loan but remained failed to control the increasing trend of loss loan. Also, the lower the representation of non-performing loan on performing loan of NABIL than that of NIBL helps to conclude that NABIL has better loan management policy than NIBL. Similarly, the lower the ratio of non-performing assets on total assets of NABIL than that of NIBL signals that NABIL has lower risky assets compared to that of NIBL. Likewise, the lower non-performing assets to total deposits of NABIL than that of NIBL indicates that NABIL remained more successful to effectively mobilized its total deposits in more secured sector than NIBL. Considering the higher loan loss provision to total loan and advances and loan loss provision to non-performing assets of NABIL than those of NIBL, it can be concluded that NABIL has the practice of keeping more provision than NIBL. Finally, the net profit to non-performing assets indicated that NABIL remained more successful to generate profit than NIBL through recovering the non-performing assets.

On the basis of simple correlation and regression analysis, it can be concluded that there was insignificant relationship between the non-performing assets and total deposits of both the banks. Similarly, there exists no significant relationship between the net profit and non-performing assets of both banks. However, the multiple regression analysis and multiple correlation of net profit on non-performing assets and performing loan aids to conclude that the non-performing assets and performing loan has significant joint effect on the net profit of both the sampled banks.

Likewise, on the basis of trend analysis, it can be concluded that the sub-standard loan of both banks, NABIL and NIBL, are going to increase in the future as well. However, doubtful loan is going to decrease in both banks and loss loan is going to decrease in NABIL and going to increase in NIBL. In overall, the non-performing assets of NABIL will decrease in the future, however, the NPA of NIBL will increase in the forthcoming years.

Eventually, the primary data analysis helps to conclude that collateral value should be the main basis while disbursing loan. Besides collateral value, the financial strength of borrower should also be judged. Also, it can be concluded that borrower's bad intention is the major internal reason and lack of NRB's proper monitoring is the major external reason behind turning the loan into bad loan. It can also be concluded that agriculture is much risky sector than business and household while loan disbursement. Also, NPA has inverse effect on the financial health of the banks and the bank is moderately affected by the problem of NPA. Finally, it can be concluded that strict recovery policy should be adopted to reduce the NPA and the follow for recovery should be done within the two weeks after due date of loan maturation.

5.3 Recommendations

Nepalese banking is in its very primitive experimental phase which is suffering from high level of non-performing assets. High level of non-performing assets not only decreases the profitability of the banks but also affect the entire financial as well as operational health of the organization. NPAs problem is not a problem that can be eradicated at all. Lending is a mechanism where uncertainty and risk are always adhered. Therefore, the exact remedies for preventing NPA generation could not be evolved as yet. That's why developed also have been facing problems of same sort. However, following are some of the recommendations which will help to reduce the level of NPA and expand the profitability of Nepalese Commercial banks:

- Compared to NABIL, NIBL has more risky assets. To reduce the risky assets and increase the profitability, it has become inherent for the bank to reduce NPA and invest in productive assets.
- NIBL should quest for more productive and secured sector for investment so as to divert its total deposits and earn more profitability in order to sustain in the industry.
- NIBL has remained unable to control the increasing trend of NPA, especially the loss loan. So effective plans and policies should be formulated giving more emphasis on decreasing the loan loss and eventually decreasing the NPA.
- One of the main causes of default loan and increasing the NPAs is that the banks are not taking much collateral or doing overvaluation of collateral. Therefore, banks should take enough collateral, so the bank at least can be able to recover its principle and invest amount in case of being unable to repay by the borrower.
- Lack of proper financial analysis of the borrower by the banks, is one of the major cause behind increasing NPA of Nepalese commercial banks. Thus proper financial analysis should be done before lending to the borrowers.
- No work can be success without proper management. Inefficient management may be the cause to increase the non-performng assets in Nepalese commercial banks. Therefore, both NABIL and NIBL should provide appropriate training regarding loan management, risk management, credit appraisal etc to the employee.
- The other factors which lead to non-performing assets are lack of proper supervision and monitoring, ineffectiveness of credit policy, political scenarios, and economic conditions. Besides that negligence in taking information from credit. Information Bureau may be also leading factor to

NPAs. It is recommended that bank should apply precaution before granting loan and advances to decrease the bad loan.

- Following the directives of NRB and acting upon it also reduce many of the credit risk. Besides there are penalty implication on non compliance of the directives. Hence all the two banks are recommended to adhere the directives and they are also suggested to come up with a stronger internal audit department to ensure that the directives are properly implemented.
- The main factors which leads to Non- performing loan are improper credit appraisal system, ineffective credit monitoring and supervision system etc. Besides that, negligence in taking information from Credit information Bureau may also lead to bad debts. Hence two banks are recommended to be more cautious and realistic while granting loans and advances. After advancing loans there should be regular supervision and follow up for proper utilization of loan.

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