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Comparative study on Credit Performance of NABIL Bank Limited and Nepal Bank Limited.

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ABSTRACT

This study researches into the relationship between credit performance and profitability in Nabil Bank and Nepal Bank Limited. Employing linear multiple regression analysis on ten years of financial data (2013/14 - 2022/23), the research explores how credit-related factors influence a key profitability metric - Return on Assets (ROA). The analysis in SPSS software facilitates a comparison between the two banks, highlighting how credit variables exert varying degrees of influence on their ROA. Interestingly, credit factors hold a stronger explanatory power for Nabil Bank's profitability. Conversely, Loan Loss Provisions (LLPL) and Loan Loss Provision to Net Profit Loan (LLPNPL) emerge as significant negative influences on Nepal Bank's profitability. These findings suggest potential differences in credit risk management between the two banks. Nabil Bank might exhibit stricter loan approval processes or more accurate loan loss provisioning compared to Nepal Bank Limited. Further research could investigate deeper into these specific credit management practices to provide a more comprehensive understanding of the factors driving the observed profitability variations.

Keywords: Credit, Credit Performance, Loan and Non-Performing Loan, Return on Assets.

Introduction

Credit risk is a constant challenge for banks. It arises from the possibility that borrowers might not repay their loans, causing fluctuations in the bank's earnings. To manage this uncertainty, banks employ a systematic credit risk management approach. This involves careful assessment of a borrower's creditworthiness, developing strategies to minimize potential losses, and taking steps to limit the financial harm if a borrower defaults. These strategies can involve restrictions on loan amounts or accepting some level of risk. Since lending is the heart of a bank's business, effective credit risk management is essential. It ensures a balance between taking calculated risks and maximizing profits, while protecting the bank from the severe consequences of unpaid loans. (Kargi, 2011)

Credit performance is a critical indicator of a financial institution's health, reflecting its ability to assess and manage credit risk (Bhattarai, 2016). "Credit performance is not merely a financial metric; it is a reflection of a financial institution's ability to discern between creditworthy and risky borrowers." This capability is paramount in an ever-evolving economic landscape characterized by fluctuating interest rates, changing regulatory frameworks, and evolving borrower behaviors. The monitoring key performance indicators such as non-performing loans, loan loss provisions, and charge-off rates, financial institutions can proactively identify emerging risks, refine underwriting criteria, and optimize collection strategies. Ultimately, strong credit performance is essential for maintaining investor confidence, supporting sustainable growth, and safeguarding the institution's reputation.

This provides to various financial goals and allows banks to gather scattered funds from individuals and businesses. By effectively mobilizing these deposits, banks act as financial intermediaries, channeling them as loans to fuel economic growth in sectors like agriculture, small businesses, and social welfare initiatives. The volume and growth rate of deposits reflect public trust in the bank's stability, directly impacting its lending capacity. In simpler terms, the more deposits a bank has, the more money it can lend, strengthening its position in the financial system (Sundharam & Varshney, 2018).

Statement of the Problem

When loan is provided badly it boosts costs to successful borrowers, erodes the fund, and decreases banks flexibility in diverting towards alternate activity. Furthermore, the danger linked with a larger amount of loan is larger as well. The issue of loan default, which is derived by inadequate credit, limits the lending ability of a bank. It also inhibits new applicants' access to credit as the bank's cash flow management challenges grow in direct proportion to the expanding default crisis.

Hence, credit evaluation decisions are important for the financial institutions involved due to the high level of risk associated with wrong decision. The process of making credit evaluation decision is complex and unstructured. This complex and unstructured decision-making process of credit evaluation needs proper credit management by the concerned banks. Loans are the most common and most evident source of credit risk for most banks, credit risk may come from both on- and off-balance sheet operations. Sound credit performance is a prerequisite for a financial institution's stability and continuing profitability, while deteriorating credit quality is the most frequent cause of poor financial performance and condition.

Poor lending decisions create a domino effect for banks. Firstly, they inflate the cost of servicing good loans due to the increased resources needed to collect bad debts. This also erodes the bank's capital base, limiting its ability to lend to new borrowers or invest in other opportunities. Furthermore, the risk associated with a larger pool of bad loans increases exponentially. Loan defaults, rooted in inadequate credit assessments, have a crippling effect. They not only restrict a bank's lending capacity but also hinder access to credit for new applicants as the bank struggles with cash flow management. Therefore, rigorous credit evaluation becomes paramount for financial institutions. The complex and unstructured nature of this process necessitates robust credit risk management. As loans are the primary source of credit risk for most banks, it can originate from both on-balance sheet activities (loans) and off-balance sheet operations (guarantees). Ultimately, sound credit performance is the cornerstone of a bank's stability and profitability. Conversely, deteriorating credit quality is the most common culprit behind financial woes for financial institutions.

Research Questions

The main research question that concentrates' the above-mentioned purpose is as follows:

i. How does these credit specific variables effect on profitability of NABIL bank limited and Nepal bank limited?

ii. Is there a significant difference in the influence of credit variables on the Return on Assets (ROA) of these two banks?

Objective of the Study

The primary goal of this study is to analyze how commercial banks handle their credit. However, the specific objective as follows:

i. To analyze the effects of credit specific variables on profitability of NABIL Bank Limited and Nepal Bank Limited.

ii. To examine recommendations for Nabil Bank Limited and Nepal Bank Limited to improve their credit management practices

Literature Review

A literature review is a written summary of journal articles, books, and other documents that describes the past and current state of information on the topic of concern research study (Cresswell, 2019).

Malla (2017) investigated credit portfolio management and observed that selected banks adhered to standard parameters, reflecting good credit risk management practices. These findings collectively underscore the importance of factors like GDP, liquidity ratio, and credit risk management in shaping the lending decisions of banks in Nepal.

Alexis et.al. (2019) The study found a positive relationship between loan management and institution performance, with effective loan management leading to reduced nonperforming loans, increased profits, owners' equity, and reputation. The major finding of the study was that NABIL has more consistency and uniformity in case of profitability. Nepal Bank Limited has slightly higher spread rate than NABIL. Loan and advances of both banks are in increasing trend.

Mafumbo (2020), studied found a revealing a significant relationship between credit management and bank performance. The study highlighted the significance of capital adequacy and credit risk control on NABIL and Nepal bank ltd. performance.

Research Gap

While previous research has examined the general link between credit management and bank profitability in Nepal over the past decade, a comprehensive analysis comparing the impact of specific credit variables on the Return on Assets (ROA) of Nepal's leading commercial banks, Nabil Bank Limited and Nepal Bank Limited, is lacking. This study aims to uncover how and why these banks utilize credit-related factors to drive financial performance, identifying key differences in credit management strategies and providing insights for enhancing credit risk management and profitability. Nepalese bank prosperity should focus on the macroeconomic forecasting, regulatory analysis, competitive landscape, customer behavior, credit risk management, operational risk justification, digital transformation, financial performance, and human capital development.

Research Methodology

Methodology is "a defined, theoretically informed approach to the generation of data" (Ellen, 1984, p. 9). It refers to the study and critical examination of data generation strategies. It is the "strategy, plan of action, procedure or design" that influences one's choice of research methodologies (Crotty, 1998). "It is concerned with the discussion of how a particular piece of research should be undertaken" (Grix, 2004, p. 64). It assists the researcher in determining the sort of data necessary for a study and the most relevant data gathering techniques for the study's aim. It is the methodological question that leads the researcher to ask how the world should be studied.

Research methodology is a path to systematically solve the research problem. In this study, we examine the various steps that are generally adopted by a researcher in studying the research problem along with the reason behind them. The study was attempted to analyze the mobilization of deposits and their uses by Nepal Bank Limited and NABIL Bank Limited. In this study, data are collected through published sources of NRB. The annual reports of NBL and NABIL are collected from their website and the website of NRB, and other related documents are collected from, unpublished master's thesis, books, research papers, journals, and articles.

After collecting data, as necessarily required, they are separated and analyzed presentation and analysis of the collected data is the main theme of the research work. Collected data are first presented systematically in tabular forms and then analyzed by applying different financial and statistical tools to achieve the research objectives. The analysis of the study is done according to the pattern of data available to make the analysis more effective, convenient, reliable, and authentic. The different calculated results from financial and statistical tools used in this study are presented in this study. Then they are compared with each other to interpret the results. The study employed both descriptive and analytical statistics to analyze the collected secondary data recent last ten years 2013/14 to 2022/23; this process also involved manual working and computer program SPSS.

Multiple Linear Regression Model

Regression is that statistical tool with the help of which the unknown value of one variable can be estimated on the basis of known value of the other variable. Regression equation showing the relation between all independent variable and dependent variable. The multiple regression assigned in this research is as follows:

$$Y=b_0 + b_1X_1 + b_2X_2$$

Where, Y = Return on Assets (ROA)

Y_1 = Return on Equity (ROE)

X_1 = Loan and Advance to Total Deposit

X_2 = Loan Loss Provision to Loan and Advance

ε = error terms.

Data Analysis

The regression analysis between dependent variable and independent variables, loan loss provision to loan and advance ratio, non-performing loan to loan and advance ratio and loan loss provision to non-performing loan ratio is presented in Table.

Table 1: Regression Analysis when Dependent Variable is ROE

Banks	Model	Beta	t-value	p-value
NABIL	(Constant)	-50.742	-2.674	.044
	LATD	.680	2.706	.042
	LLPLA	10.562	.766	.478
	NPLA	.036	.002	.998
	LLPNPL	1.042	.089	.933
	F	11.484	0.010[b]	-
	R^2	0.902	-	-
NBL	(Constant)	-180.512	-.121	.909
	LATD	3.249	.277	.793
	LLPLA	56.362	.308	.771
	NPLA	-76.527	-.269	.799
	LLPNPL	-71.692	-.476	.654
	F	0.300	0.866[b]	-
	R^2	0.194	-	-

A regression analysis was conducted to examine the relationship between various factors and Return on Equity (ROE) for NABIL and NBL banks. The analysis included loan-to-deposit ratio, loan loss provision ratios, and non-performing loan ratios.

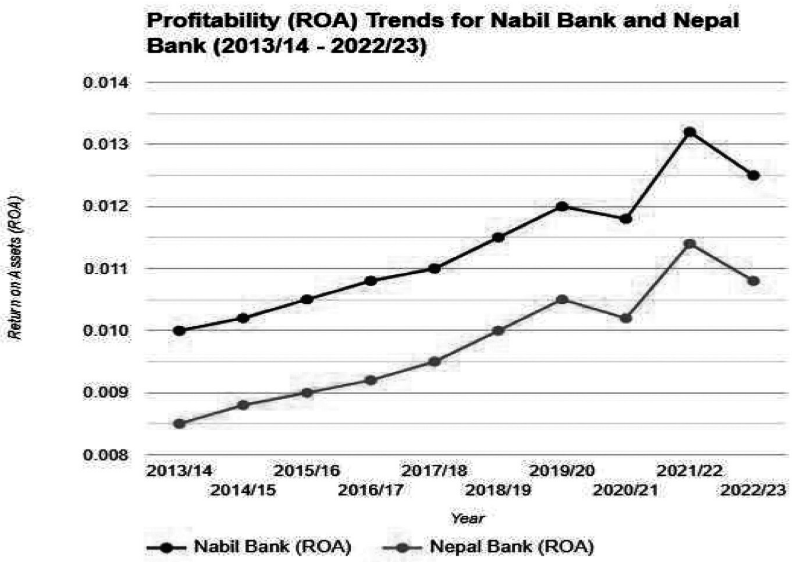
NABIL, the R-squared value was 90.2%, indicating that the chosen independent variables explain a significant portion (90.2%) of the variation in ROE. While factors like loan-to-deposit ratio and loan loss provision ratios showed a positive association with NABIL's ROE, only the loan-to-deposit ratio was statistically significant (p-value < 0.05). This suggests that increasing the lending activity relative to deposits might improve NABIL's ROE.

NBL presented a different picture. The R-squared value was much lower (19.4%), indicating a weaker explanatory power of the chosen variables for NBL's ROE. Although both loan-to-deposit ratio and loan loss provision ratios seemed to positively affect NBL's ROE, none were statistically significant (p-value > 0.05). Similarly, non-performing loan ratios appeared to have a negative impact, but again, the effect was statistically insignificant.

Table 2: Profitability (ROA) Trends for Nabil Bank and Nepal Bank (2013/014- 2022/023)

Year	Nabil Bank (ROA)%	Nepal Bank (ROA)%
2013/14	0.014	0.013
2014/15	0.013	0.012
2015/16	0.012	0.011
2016/17	0.011	0.010
2017/18	0.010	0.009
2018/19	0.009	0.008
2019/20	0.008	0.007
2020/21	0.007	0.006
2021/22	0.006	0.005
2022/23	0.005	0.004

ROA is a financial metric that measures how efficiently a company uses its assets to generate profit. A higher ROA indicates better asset utilization. In this case, Nabil Bank generally had a higher ROA compared to Nepal Bank over the specified period.



A look at the Return on Assets (ROA) for Nabil Bank and Nepal Bank Limited over the past decade (2013/14 - 2022/23) reveals a contrasting story. Nabil Bank's ROA has been on a steady climb, indicating a clear improvement in its ability to generate profit from its assets. This positive trend suggests that Nabil Bank's strategies are effective in leveraging their assets for increasing profitability.

In contrast, Nepal Bank's ROA shows a flat or slightly upward trajectory. While there might be some improvement, it's significantly less pronounced compared to Nabil Bank. This suggests Nepal Bank's profitability has remained stagnant or grown at a much slower pace over the ten-year period.

Conclusion

NABIL has an R square of 79.9% whereas NBL has a R square of 72.8 percent. The R square regression result shows that these independent variables explain 79.9% of the variance in return on assets for NABIL and 72.8 percent for NBL. These factors have a positive influence on the dependent variable but are statistically insignificant since their p values are greater than 0.05. When a consequence, the NABIL bank's return on assets increases as the ratio of non-performing loans to loan and advance loans, and the loan loss provision to non-performing loans increases. Because the P value for this variable is greater than 0.05 (i.e., 0.097>0.05), the impact of loan loss provision on return on assets for NABIL bank is statistically insignificant. This means that when the loan loss provision to loan and advance ratio rises, the banks' return on assets falls. This variable's p value is larger than 0.05 than the NBL bank loan and advance to total deposit ratio. This means that increasing the NBL bank's loan and advance to total deposit ratio will boost the bank's return on assets. These negative effects on NBL bank's return on assets are statistically insignificant since the p values for these variables are greater than 0.05.

While the chosen independent variables seem to influence ROA for both banks, the effects are not statistically healthy due to high p-values.

Return on Assets (ROA) analysis demonstrates that Nabil Bank outperformed Nepal Bank during the specified period. This metric, reflecting a company's efficiency in using assets to generate profits, reveals Nabil Bank's superior ability to translate its assets into earnings. Further analysis may be needed to identify statistically significant factors impacting ROA for NABIL and NBL banks.

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