

CREDIT RISK MANAGEMENT IN THE COMMERCIAL BANKING SECTOR: REFLECTIONS FROM A HISTORICAL COMPARATIVE STUDY IN NEPAL

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ABSTRACT

Introduction: Credit risk management underpins the stability and value creation of commercial banks, particularly in markets where capital markets are shallow and bank intermediation is dominant. This study provides a historical baseline of credit management in Nepal by comparing two large institutions—anonimised as Bank A (majority state-owned commercial bank) and Bank B (private commercial bank with foreign JV origins)—over FY 2006/07–2010/11. We assess liquidity, intermediation, profitability, asset quality, and the funding–lending–profit transmission to inform contemporary practice under evolving Nepal Rastra Bank (NRB) guidance.

Methods: A retrospective descriptive–comparative design was applied using audited, publicly available financial statements. Ratio analysis covered liquidity (e.g., cash & bank/ deposits), activity/efficiency (loan–deposit and loans/assets), profitability (ROA, interest income/interest expense, yield on loans, EPS), and lending–efficiency/asset–quality (NPL/loans, loan–loss provisions/loans). Pearson correlations examined links between deposits, loans, and net profit. Names are anonimised to mitigate legal/ethical risk; all figures are reported exactly as in source tables.

Results: Liquidity buffers were higher at Bank A (cash & bank/ deposits 0.216 vs 0.063; cash/ current deposits 0.948 vs 0.432; cash/savings 0.368 vs 0.172), while both banks' current ratios averaged <1 (Bank B 0.773, Bank A 0.634). Intermediation intensity was stronger at Bank B (loans/deposits 0.707 vs 0.402; loans/assets 0.610 vs 0.384). Profitability favoured Bank B (ROA 0.023 vs 0.014), though Bank A's average loan yield was higher (0.164 vs 0.112). Asset quality and risk costs were markedly better at Bank B (NPL/loans 0.012 vs 0.094; LLP/loans 0.003 vs 0.043). Funding translated more directly into profitable lending at Bank B (deposits↔loans $r=0.941$; loans↔profit $r=0.987$) than at Bank A (deposits↔loans $r=0.631$; loans↔profit $r=-0.355$).

Conclusions: Over 2006–2010, Bank B combined higher intermediation with lower measured credit risk and more reliable earnings transmission, whereas Bank A prioritised immediate liquidity and investments but bore higher risk costs and weaker lending–profit links. These

contrasts highlight governance, underwriting discipline, and forward-looking provisioning as levers for stronger, more resilient credit management under NRB's current ECL-aligned regime.

Keywords: credit risk management; commercial banking; Nepal; non-performing loans (NPLs); expected credit loss (ECL); profitability; return on assets (ROA); earnings per share (EPS); loan-loss provisioning; liquidity–intermediation trade-off; credit-risk principles; Nepal Rastra Bank (NRB); comparative study.

INTRODUCTION

Credit is a contractual transfer of purchasing power today in exchange for repayment (principal plus interest) in the future (Fisher, 2006). In banking, credit risk—the possibility that a borrower fails to meet obligations—sits at the core of value creation and prudential oversight (Jesus & Gabriel, 2006). Global principles, originating with the Basel Committee's Principles for the Management of Credit Risk, emphasise that banks should identify, measure, monitor, and control credit risk across individual exposures and portfolios under board-approved policies, with independent review and supervisory evaluation—standards that continue to anchor sound practice (BCBS, 2000; 2025).

In developing economies with relatively shallow capital markets, commercial banks intermediate most savings and investment flows (Sa, 2006; Tyson, 2023). A large empirical literature associates better-functioning financial systems with stronger long-run growth by improving (i) information production and capital allocation, (ii) monitoring and corporate governance, (iii) risk sharing, (iv) savings mobilisation, and (v) transaction services (Makinde, 2016; Aghion et al., 2018; Levine, 2021). In Nepal, this intermediation operates within the prudential architecture set by Nepal Rastra Bank (NRB). Recent NRB guidance aligned with NFRS 9 embeds expected-credit-loss (ECL) concepts into classification, provisioning, and reporting, reinforcing forward-looking risk management within the supervisory regime (NRB, 2025).

Against this backdrop, the present study provides a historical baseline of credit management in Nepal's commercial banking sector over 2006–2010 using publicly available data for two large institutions anonymised as Bank A and Bank B. To manage legal/ethical risk, banks are anonymous in the manuscript narrative; however, public sources establish that Bank A is a majority state-owned legacy commercial bank (the Government of Nepal held about 51% as of 2024/25), while Bank B is a private commercial bank that began as Nepal's first foreign joint-venture (JV) bank. These institutional characteristics are referenced solely for context and do not imply any claims about current performance. The authors disclose that all analyses refer to historical, public information, and no statements are made about present-day practices or solvency.

Lending remains the mainstay of commercial banking, simultaneously generating earnings and risk (Machiraju, 2008; Jones et al., 2018). Effective credit management, therefore, requires, inter alia, a clearly articulated risk appetite; board-approved policies and well-defined granting criteria; portfolio limits (including single-name and connected-counterparty exposures); strong administration, measurement, and monitoring; arm's-length decision making; and independent, ongoing review—subject to supervisory evaluation and prudential limits consistent with international principles and NRB directives (Smithson, 2003; Hilbers et al., 2005; Bohn & Stein, 2009; Brown & Moles, 2014; NRB, 2020; 2025).

Purpose of the study: The objective is to assess how deposits were mobilised and utilised by Bank A and Bank B during 2006–2010 and what that implied for credit risk and profitability.

Specifically, the study (i) evaluates liquidity positions; (ii) examines the volume and composition of loans and advances; (iii) analyses the allocation of deposits across lending and investments; and (iv) investigates relationships among deposits, loans/advances, and net profit. A brief 2025 reflection then situates these historical findings within today's regulatory and market context, shaped by NRB's ECL-aligned guidance.

METHODS

Study design and setting

This is a retrospective, descriptive–comparative study of credit management in two Nepali commercial banks over FY 2006–2010 (five fiscal years). The design matches the article's objective of (i) documenting how deposits were mobilised and utilised; (ii) profiling liquidity, credit, investment, and profitability patterns; and (iii) relating these historical patterns to a short 2025 reflection (presented later, outside Methods). To manage legal/ethical risk, the banks are anonymised as Bank A (majority state-owned legacy commercial bank) and Bank B (private commercial bank with foreign–JV origins). Analyses are confined to historical public information.

Population, sample, and period

The population is the set of licensed commercial banks operating in Nepal during the study window. A purposive sample of two banks (Bank A and Bank B) was selected to represent distinct ownership/heritage profiles that are salient in Nepal's banking history. The period of analysis spans five consecutive fiscal years, 2006–2010. Where reports followed the Nepali fiscal year (mid-July to mid-July), figures were treated consistently on a fiscal-year basis.

Data sources and collection

Primary evidence consists of published annual reports of Bank A and Bank B (financial statements, notes, management discussion), complemented by Nepal Rastra Bank (NRB) publications (e.g., Banking & Financial Statistics, Unified Directives, relevant circulars) for category definitions and cross-checks. Where needed, older prospectuses, stock exchange filings, and archived disclosures were used to reconcile series. No non-public or confidential data was accessed.

Data were extracted to a structured spreadsheet with the following steps: (i) transcribe audited line items exactly as reported; (ii) standardize labels (e.g., “loans and advances,” “investment,” “deposits”); (iii) reconcile any restatements across years; (iv) flag obvious transcription anomalies for re-check against source PDFs; and (v) compute ratios from standardized components. All figures are in NPR and unadjusted for inflation (see Limitations).

Variables and measures

Analyses emphasise credit-management outcomes observable in public financials. For each bank (b) and year (t), indicators and formulas are as follows.

Liquidity

- i) $\text{Current Ratio} = \text{Current Assets} / \text{Current Liabilities}$ (reported for completeness, though less diagnostic for banks).
- ii) $\text{Cash \& Bank to Total Deposits} = (\text{Cash} + \text{Bank Balances}) / \text{Total Deposits}$.
- iii) $\text{Cash \& Bank to Current Deposits} = (\text{Cash} + \text{Bank Balances}) / \text{Current Deposits}$.
- iv) $\text{Cash \& Bank to Interest-Sensitive Deposits} = (\text{Cash} + \text{Bank Balances}) / \text{Savings Deposits}$ (operationalised as the most rate-sensitive category during the period).

Activity / Efficiency

- i) $\text{Loan-to-Deposit Ratio (LDR)} = \text{Loans and Advances} / \text{Total Deposits}$.
- ii) $\text{Loans to Total Assets} = \text{Loans and Advances} / \text{Total Assets}$.

111) Investment to Deposits = Total Investment / Total Deposits.

Profitability

1) Interest Income to Interest Expense = Interest Income / Interest Expense (spread proxy).

11) Return on Loans and Advances = Net Profit / Loans and Advances.

111) Return on Assets (ROA) = Net Profit / Total Assets.

111) Interest Yield on Loans = Interest Income / Loans and Advances.

11) Earnings per Share (EPS) = Net Profit after Tax / Weighted Average Common Shares Outstanding (reported where disclosed).

Lending Efficiency / Asset Quality

1) Non-Performing Loans (NPL) Ratio = NPL / Loans and Advances (used when disclosed in the period's reports).

11) Loan-Loss Provision to Loans (LLP/Loans) = Loan-Loss Provision / Loans and Advances.

Note: Where NPL series are missing or non-comparable, LLP/Loans is used as a consistent proxy for risk costs.

Line items are taken as reported in audited financial statements. If a label changes (e.g., consolidation of sub-categories) and the mapping is explicit in notes, a consistent series is constructed, and the change is documented.

Analytical approach

The analysis proceeds in three layers:

1. Descriptive profiles and trends

For each indicator and bank, year-by-year values are presented alongside:

1) Arithmetic Mean = (sum of annual values) / N;

11) Sample Standard Deviation = the square root of the average squared deviation from the mean;

111) Coefficient of Variation (CV) = (Standard Deviation / Mean) × 100%.

Linear time trends are summarised by ordinary least squares slopes of each indicator on year (estimated separately for each bank).

2. Association among funding, credit, and profitability

To address mobilisation and performance, Pearson correlations are computed between Deposits, Loans & Advances, and Net Profit within each bank and for a pooled panel with bank fixed-effects summaries. r^2 values describe variance explained in bivariate fits. Given $N = 5$ per bank, correlation magnitudes are interpreted cautiously and triangulated with trend evidence. For transparency, the probable error (P.E.) of r may be reported as $P.E. = 0.6745 \times \sqrt{1 - r^2} / \sqrt{N}$ when useful for small-sample interpretation.

3. Comparative assessment

Bank A vs. Bank B comparisons emphasise differences in means (informally, due to small N), relative variability (CV), and direction/magnitude of trend slopes for key ratios: LDR, Loans/Assets, Investment/Deposits, ROA, Interest Yield, LLP/Loans, and—where available—NPL/Loans.

No leverage, risk-weighted assets, or capital-adequacy metrics are modelled because consistent series were not the focus of the credit-management objectives for 2006–2010.

Data management, quality, and reproducibility

A two-pass validation was applied. First, all computed ratios were re-checked against component numerators/denominators; second, any outliers triggered a return to the source page for

confirmation. All calculations are captured in a transparent workbook with formula cells visible. A de-identified dataset (Bank A/Bank B labels only) and the calculation workbook can be shared upon acceptance.

Ethical considerations and disclosures

Only public documents were used; no confidential information was accessed. Bank identities are anonymised in the manuscript (Bank A/Bank B). The author's views are personal and do not represent the employer. The study makes no claims about present-day practices or solvency.

RESULTS

Throughout this section, the two sample institutions are anonymised as Bank A (state-owned legacy commercial bank) and Bank B (private commercial bank with foreign-JV origins). All figures cover FY 2006/07–2010/11 and are reproduced exactly from the source tables; only names were anonymised.

Liquidity position

Table 1. Current Ratio (Bank B and Bank A)

Year	Bank B			Bank A		
	Current Assets	Current Liabilities	Ratios	Current Assets	Current Liabilities	Ratios
2006/07	17509.137	24817.790	0.91	17741.063	31164.963	0.57
2007/08	25988.555	33950.842	0.71	17178.295	33482.241	0.51
2008/09	31515.334	39854.024	0.79	27186.689	47178.989	0.58
2009/10	36787.150	47275.782	0.78	33702.235	45075.167	0.75
2010/11	42945.158	52167.906	0.82	37085.147	48683.083	0.76
Average	Average	Average	0.773			0.634
S.D	S.D	S.D	0.043			0.113
C.V	C.V	C.V	5.595%			17.891%

Bank B's mean current ratio exceeded Bank A's, with lower variability; both averages remained below 1.0, reflecting banking-sector balance-sheet structure.

Table 2. Cash & Bank Balance to Total Deposit Ratio

Year	Bank B			Bank A		
	Cash & Bank Balance	Total Deposit	Ratios	Cash & Bank Balance	Total Deposit	Ratios
2006/07	1399.825	23342.285	0.060	7174.06	35829.760	0.200
2007/08	2671.141	31915.047	0.084	7117.29	39014.200	0.182
2008/09	3372.512	37348.255	0.090	9171.790	45194.232	0.203
2009/10	1400.097	46340.700	0.030	10141.280	42882.039	0.236
2010/11	2458.549	49608.376	0.050	12013.865	46808.435	0.257
Average	Average	Average	0.063			0.216
S.D	S.D	S.D	0.025			0.030
C.V	C.V	C.V	39.046%			13.942%

Bank A maintained a higher cash-to-deposits cushion than Bank B across the period; Bank B's ratio dipped notably in 2009/10.

Table 3. Cash & Bank Balance to Current Deposit Ratio

Year	Bank B			Bank A		
	Cash & Bank Balance	Current Deposit	Ratios	Cash & Bank Balance	Current Deposit	Ratios
2006/07	1399.825	3395.240	0.412	7174.06	7826.294	0.917
2007/08	2671.141	5284.368	0.505	7117.29	8178.393	0.870
2008/09	3372.512	5480.533	0.615	9171.790	9923.275	0.924
2009/10	1400.097	7904.619	0.177	10141.280	10942.415	0.927
2010/11	2458.549	5456.894	0.451	12013.865	10905.854	1.102
Average	Average	Average	0.432			0.948
S.D	S.D	S.D	0.162			0.089
C.V	C.V	C.V	37.440%			9.381%

Against current deposits, Bank A held a substantially stronger immediate liquidity buffer throughout.

Table 4. Cash & Bank Balance to Saving Deposits Ratio

Year	Bank B			Bank A		
	Cash & Bank Balance	Saving Deposit	Ratios	Cash & Bank Balance	Saving Deposit	Ratios
2006/07	1399.825	10187.354	0.137	7174.06	23245.625	0.309
2007/08	2671.141	12159.966	0.220	7117.29	21284.329	0.334
2008/09	3372.512	14620.407	0.231	9171.790	31284.260	0.293
2009/10	1400.097	13783.585	0.102	10141.280	27313.755	0.371
2010/11	2458.549	14288.520	0.172	12013.865	22501.339	0.534
Average	Average	Average	0.172			0.368
S.D	S.D	S.D	0.054			0.097
C.V	C.V	C.V	31.62%			26.394%

Relative to savings deposits, Bank A's cushion exceeded Bank B's on average, with a greater late-period increase.

Activity/efficiency

Table 5. Loans & Advances to Total Deposit Ratio

Year	Bank B			Bank A		
	Loan & Advances	Total Deposit	Ratios	Loan & Advances	Total Deposit	Ratios
2006/07	15545.778	23342.285	0.666	9756.16	35829.760	0.272
2007/08	21365.053	31915.047	0.669	10584.781	39014.200	0.271
2008/09	27589.933	37348.255	0.739	17614.898	45194.232	0.390
2009/10	32268.873	46340.700	0.696	23560.955	42882.039	0.549
2010/11	38034.097	49608.376	0.767	24671.281	46808.435	0.527
Average	Average	Average	0.707			0.402
S.D	S.D	S.D	0.044			0.134
C.V	C.V	C.V	6.232%			33.245%

Bank B consistently deployed a larger share of deposits into loans than Bank A, implying more aggressive intermediation.

Table 6. Loans & Advances to Total Assets Ratio

Year	Bank B			Bank A		
	Loan & Advances	Total Assets	Ratios	Loan & Advances	Total Assets	Ratios
2006/07	15545.778	27253.393	0.57	9756.16	35919.000	0.272
2007/08	21365.053	37132.759	0.575	10584.781	39258.000	0.270
2008/09	27589.933	43867.397	0.629	17614.898	47559.110	0.370
2009/10	32268.873	52079.725	0.620	23560.955	44736.652	0.527
2010/11	38034.097	58099.619	0.655	24671.281	51158.657	0.482
Average	Average	Average	0.610			0.384
S.D	S.D	S.D	0.036			0.118
C.V	C.V	C.V	5.918%			30.778%

Loans as a share of assets were higher at Bank B on average; Bank A's ratio rose after 2008/09.

Table 7. Total Investment to Total Deposit Ratio

Year	Bank B			Bank A		
	Total Investment	Total Deposit	Ratios	Total Investment	Total Deposit	Ratios
2006/07	8945.310	23342.285	0.383	24246.000	35829.760	0.677
2007/08	9939.771	31915.047	0.311	26657.000	39014.200	0.683
2008/09	10826.379	37348.255	0.289	13397.559	45194.232	0.296
2009/10	13600.916	46340.700	0.293	5784.372	42882.039	0.135
2010/11	13003.205	49608.376	0.262	7585.544	46808.435	0.162
Average	Average	Average	0.308			0.391
S.D	S.D	S.D	0.046			0.271
C.V	C.V	C.V	14.801%			69.395%

Both banks' investment-to-deposit ratios trended down; Bank A started higher and exhibited more volatility.

Profitability

Table 8. Interest Income to Interest Expenses Ratio

Year	Bank B			Bank A		
	Interest Income	Interest Expenses	Ratios	Interest Income	Interest Expenses	Ratios
2006/07	1587.758	555.710	2.857	2049.169	774.000	2.648
2007/08	1978.696	758.436	2.609	1849.354	773.294	2.392
2008/09	2798.486	1,153.280	2.427	2690.058	791.710	3.398
2009/10	4047.725	1,960.107	2.065	3067.553	909.990	3.371
2010/11	5258.269	2,946.691	1.784	3740.719	1482.204	2.524
Average	Average	Average	2.348			2.866
S.D	S.D	S.D	0.428			0.482
C.V	C.V	C.V	18.205%			16.802%

The interest income-to-expense ratio declined for Bank B over time; Bank A peaked around 2008/09–2009/10.

Table 9. Return on Loans & Advances

Year	Net Profit	Bank B		Net Profit	Bank A	
		Loan and Advances	Ratios		Loan and Advances	Ratios
2006/07	673.959	15545.778	0.043	1328.000	9756.16	0.136
2007/08	746.468	21365.053	0.035	250.131	10584.781	0.024
2008/09	1031.053	27589.933	0.037	894.254	17614.898	0.051
2009/10	1139.011	32268.873	0.035	249.382	23560.955	0.011
2010/11	1337.745	38034.097	0.035	128.346	24671.281	0.005
Average	Average	Average	0.035			0.045
S.D	S.D	S.D	0.004			0.048
C.V	C.V	C.V	9.567%			106.238%

Return on loans and advances eased as loan books expanded; Bank A's series showed higher variability.

Table 10. Net Profit to Total Assets (ROA)

Year	Net Profit	Bank B		Net Profit	Bank A	
		Total Assets	Ratios		Total Assets	Ratios
2006/07	673.959	27253.393	0.025	1328.000	35919.167	0.037
2007/08	746.468	37132.759	0.020	250.131	39258.334	0.006
2008/09	1031.053	43867.397	0.024	894.254	47559.110	0.019
2009/10	1139.011	52079.725	0.022	249.382	44736.652	0.006
2010/11	1337.745	58099.619	0.023	128.346	51158.657	0.003
Average	Average	Average	0.023			0.014
S.D	S.D	S.D	0.002			0.014
C.V	C.V	C.V	7.740%			101.437%

ROA was higher and more stable for Bank B; Bank A's ROA fluctuated sharply.

Table 11. Interest Income to Total Loans & Advances

Year	Interest Income	Bank B		Interest Income	Bank A	
		Loan & Advances	Ratios		Loan & Advances	Ratios
2006/07	1587.758	15545.778	0.102	2049.169	9756.16	0.210
2007/08	1978.696	21365.053	0.091	1849.354	10584.781	0.175
2008/09	2798.486	27589.933	0.101	2690.058	17614.898	0.153
2009/10	4047.725	32268.873	0.125	3067.553	23560.955	0.130
2010/11	5258.269	38034.097	0.138	3740.719	24671.281	0.152
Average	Average	Average	0.112			0.164
S.D	S.D	S.D	0.019			0.030
C.V	C.V	C.V	17.0%			18.454%

Bank A recorded a higher average interest income relative to loans; Bank B's yield increased late in the period.

Table 12. Earnings Per Share (EPS)

Bank	2006/07	2007/08	2008/09	2009/10	2010/11	Average
BANK B	1.40	1.08	1.07	0.786	0.706	1.008
BANK A	0.596	0.628	2.350	0.655	0.337	0.913

EPS for both banks peaked around 2008/09 and then declined; Bank B's five-year average slightly exceeded Bank A's.

Lending efficiency/asset quality

Table 13. Loan-Loss Provision to Loans & Advances

Year	Bank B			Bank A		
	Loan Loss Provision	Loan & Advances	Ratios	Loan Loss Provision	Loan & Advances	Ratios
2006/07	3.208	15545.778	0.0001	698.127	9756.16	0.072
2007/08	37.952	21365.053	0.002	720.427	10584.781	0.068
2008/09	22.583	27589.933	0.001	567.839	17614.898	0.032
2009/10	355.829	32268.873	0.011	453.798	23560.955	0.019
2010/11	109.470	38034.097	0.003	543.200	24671.281	0.022
Average	Average	Average	0.003			0.043
S.D	S.D	S.D	0.004			0.025
C.V	C.V	C.V	132.098%			59.379%

LLP-to-loans was very low on average for Bank B; Bank A's provisioning was higher but trended down, indicating improving asset quality.

Table 14. Non-Performing Loans to Loans & Advances

Year	Bank B			Bank A		
	Non-performing Loan	Loan & Advances	Ratios	Non-performing Loan	Loan & Advances	Ratios
2006/07	178.293	15545.778	0.011	1317.114	9756.16	0.135
2007/08	161.085	21365.053	0.008	1856.332	10584.781	0.175
2008/09	224.817	27589.933	0.008	966.723	17614.898	0.055
2009/10	487.541	32268.873	0.015	1219.673	23560.955	0.052
2010/11	689.851	38034.097	0.018	1344.118	24671.281	0.054
Average	Average	Average	0.012			0.094
SD	SD	SD	0.005			0.057
C.V	C.V	C.V	37.55%			60.868%

Bank B's NPL ratio remained well below Bank A's; both improved at points within the window.

Correlation analysis

Table 15. Deposits vs. Loans & Advances (Correlation)

Bank	Correlation (rxy)	P.E.	6 P.E.
Bank B	0.941	0.0022	0.0132
Bank A	0.631	0.036	0.216

A strong, statistically significant positive association between deposits and loans & advances is evident for Bank B. A positive association between deposits and loans & advances is observed for Bank A over the five years.

Table 16. Loans & Advances vs. Net Profit (Correlation)

Bank	Correlation (rxy)	P.E.	6 P.E.
Bank B	0.987	0.0076	0.0461
Bank A	-0.355	0.018	0.108

A very strong, statistically significant positive association between loans & advances and net profit exists for Bank B. For Bank A, the correlation between loans & advances and net profit is negative and not statistically significant across the period.

Overall findings reflect that Bank B exhibits stronger and more stable profitability with lower observed credit risk (lower NPL and LLP ratios), while Bank A maintains comparatively higher immediate liquidity buffers and a larger allocation to investments relative to deposits. Correlation results indicate funding growth translated more directly into loan growth and profits at Bank B than at Bank A over FY 2006/07–2010/11.

DISCUSSION

This comparative study assessed credit-risk management in two Nepali commercial banks over FY 2006/07–2010/11, anonymised as Bank A (majority state-owned, legacy commercial bank) and Bank B (private commercial bank with foreign–JV origins). Drawing on audited financials, liquidity, activity/efficiency, profitability and lending-efficiency ratios were analysed, supplemented by correlation tests between deposits, loans and advances, and net profit. The aim is to interpret the five-year patterns through the lens of international guidance and Nepal’s supervisory context while preserving all reported statistics.

Liquidity, buffers, and intermediation trade-offs

Both institutions operated with average current ratios below unity (Bank B: 0.773; Bank A: 0.634), a common feature of deposit-taking balance sheets). Bank A consistently maintained larger on-balance-sheet cushions—cash and bank balance to total deposits averaged 0.216 versus 0.063 at Bank B; cash to current deposits averaged 0.948 vs. 0.432; and cash to savings deposits averaged 0.368 vs. 0.172. While such buffers support withdrawal needs, excessive liquidity can depress earnings if not redeployed into remunerative assets. International principles, therefore, emphasise board-approved risk appetite and policies that balance funding resilience with prudent credit intermediation (Basel Committee on Banking Supervision [BCBS], 2000, 2025).

Intermediation intensity and portfolio mix

Bank B consistently transformed a larger share of deposits into loans (mean loans/deposits 0.707 vs. 0.402) and held a higher loans-to-assets mix (0.610 vs. 0.384). Bank A, in contrast, allocated a higher fraction of deposits to investments (0.391 vs. 0.308) with greater volatility. The finance-and-growth literature links effective intermediation and information production to superior real-sector outcomes (Levine, 2005; Popov, 2018). Yet rapid loan expansion without commensurate underwriting capacity can raise future credit losses—an issue supervisors repeatedly flag in emerging banking systems (Drucker & Puri, 2005; Jansen et al., 2025).

Earnings capacity and margin behaviour

Despite a declining interest income-to-interest expense ratio at Bank B (mean 2.348 vs. Bank A’s 2.866), Bank B delivered more stable earnings on assets (ROA mean 0.023 vs. 0.014), while Bank A’s returns on loans were higher on average (0.048 vs. 0.035) but highly volatile (C.V. 106.2%). Cross-country evidence attributes variation in margins and profitability to operating costs, market structure, regulation, and risk (Financial, 2001; Pasiouras et al., 2006; Ghosh & Petrova, 2021; O’Connell, 2023). In South-Asian settings, higher loan-to-deposit ratios and cost discipline can support net interest margins provided asset quality is preserved (Salika & Ao, 2018; Afzal et al., 2021).

Asset quality, provisioning, and risk costs

Lending-efficiency indicators point to materially lower credit risk at Bank B. Average non-performing loans (NPLs) to loans were 0.012 at Bank B vs. 0.094 at Bank A, and loan-loss provisions (LLP) to loans averaged 0.003 vs. 0.043. Empirical research links elevated NPLs with weaker profitability and constrained lending (Klein, 2013; Huljak et al., 2022). The contrast in our sample is consistent with these channels: Bank B's lower NPL/LLP ratios coexisted with stronger ROA, while Bank A's higher risk costs likely diluted earnings transmission.

From deposits to loans to profits: strength of transmission

Correlation results reinforce the ratio evidence. For Bank B, deposits and loans were strongly associated ($r = 0.941$), and loans and net profit were very strongly associated ($r = 0.987$). For Bank A, the deposits–loans link was positive ($r = 0.631$), but the loans–profit correlation was negative and not statistically significant ($r = -0.355$). These patterns suggest that Bank B's underwriting and pricing preserved risk-adjusted returns more effectively, whereas Bank A's lending generated weaker earnings after risk costs. Similar mechanisms are documented in studies relating cost efficiency, risk management, and profitability in banks (Athanasoglou et al., 2006; Sun & Chang, 2011; Matthews, 2013; Oyeniyi et al., 2021).

Regulatory context and 2025 reflections

Since 2010, Nepal Rastra Bank (NRB) has strengthened supervisory expectations, including unified directives on asset classification and provisioning (NRB, 2020) and the adoption of NFRS-9 expected-credit-loss (ECL)–aligned guidance (NRB, 2025). Globally, the Basel Committee has reaffirmed governance, credit-granting standards, portfolio monitoring, and internal control expectations (BCBS, 2000, 2025). Viewed against these frameworks, the 2006–2010 baseline highlights imbalances—excess liquidity with weak deployment at Bank A; a more active intermediation model with comparatively disciplined asset quality at Bank B—that contemporary, forward-looking regimes aim to identify earlier and remediate more decisively.

Limitations and future research

Three constraints qualify the findings. First, the study of two commercial banks and a five-year window limits sample and cycle coverage. Second, ratio-based and bivariate correlations cannot control for macroeconomic shocks, market power, or cost heterogeneity. Third, public financial statements do not reveal loan-level underwriting quality or internal controls. Extending the analysis to post-2010 data with panel methods and ECL-based stress testing would strengthen causal interpretation and policy relevance.

CONCLUSION

Across 2006–2010, Bank B combined higher intermediation (loans/deposits 0.707; loans/assets 0.610) with lower measured credit risk (NPL/loans 0.012; LLP/loans 0.003) and stronger earnings transmission (ROA 0.023; $r_{\text{deposits, loans}} = 0.941$; $r_{\text{loans, profit}} = 0.987$). Bank A prioritised immediate liquidity (cash and bank balance to deposits 0.216; stronger cushions against current and savings deposits) but showed weaker intermediation intensity (loans/deposits 0.402; loans/assets 0.384) and higher risk costs (NPL/loans 0.094; LLP/loans 0.043), consistent with diluted profitability.

These contrasts accord with international evidence that profitability depends jointly on margins, efficiency, and asset quality, and with supervisory principles emphasising calibrated risk appetite, sound credit-granting, and rigorous monitoring. For policy and practice, the historical baseline offers a benchmark for assessing progress under NRB's updated directives and NFRS-9 ECL guidance. Future work should revisit the comparison using post-2010 data and multivariate designs to identify the drivers of profitability and credit risk under current rules.

CONFLICT OF INTEREST

The authors declared no conflict of interest.

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