

Lending Management of Nepalese Commercial Banks

(With reference to Nepal Bank Ltd and NABIL Bank Ltd)

A Thesis

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DECLARATION

I hereby declare that the work reported in this thesis entitled “**Lending Management of Nepalese Commercial Banks (with reference to Nepal Bank Ltd and NABIL Bank Ltd)**” submitted to office of the Dean, faculty of management, Tribhuvan University is my original work done in the form of the partial fulfillment of the requirement for the Master’s Degree in Business Study (M.B.S) under the supervision of Lecturer Ms. Pramila Lakhey of **P.K Campus, Tribhuvan University Kathmandu.**

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This thesis entitled “**Lending Management of Nepalese Commercial Banks (With reference to Nepal Bank Ltd and NABIL Bank Ltd)**” has been prepared for the partial fulfillment of the requirement of Master’s Degree of Business Studies (M.B.S) under the faculty of Management, Tribhuvan University.

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Jeenita Rai

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ABBREVIATIONS

AD	Annon Dominy (Latin Word)
ADB	Agriculture Development Bank
AGM	Annual General Meeting
AMC	Asset Management Company
ATM	Automatic Teller Machine
B.S.	Bikram Sambat (Nepali Year)
CBs	Commercial Banks
CIB	Credit Information Bureau
C&I	Commercial and industrial
CPM	Credit Portfolio Management
DBL	Dubai Bank Ltd
DEA	Data Envelopment Analysis
DRT	Debt Recovery Tribunal
DSCR	Debt Service Coverage Ratio
EBIL	Emirates Bank International ltd
FSRP	Financial Sector Reform Program
GON	Government of Nepal
HBL	Himalayan Bank Limited
IDA	International Development Agency
i.e.	That is
IRR	Internal Rate of Return
LLP	Loan Loss Provision
Ltd.	Limited

MBS	Master Degree in Business
Nabil	Nabil Bank Limited
NBL	Nepal Bank Limited
NBLB	National Bank Ltd, Bangladesh
NEPSE	Nepal Stock Exchange
NIBL	Nepal Investment Bank Limited
NIDC	Nepal Industrial Development Corporation
NGOs	Non-governmental Organizations
NPA	Non Performing Assets
NPL	Non-performing Loan
NRB	Nepal Rastra Bank
P.E.	Probable error
PSL	Priority sector lending
Pvt.	Private
r	Correlation
r^2	Coefficient of Determination
$R_{z.xy}$	Multiple Correlation
RBB	Rastriya Banijya Bank
ROI	Return on Investment
Rs	Rupees
SCBNL	Standard Chartered Bank Nepal Limited
T.U.	Tribhuvan University

CHAPTER-I

INTRODUCTION

1.1 Background of the study

Nepal is a least developed and land locked country situated between the two biggest and highly populated countries India and China. Therefore, Nepal is known as a buffer state. Economically, Nepal is dominated by these countries. Nepal is one of the very few countries in the world in terms of rich and unique cultural heritage, manifested in its architecture, temples, sculptures, monuments etc. It is also richly gifted with natural resources like vast forests, many perennial rivers and minerals.

The banking sector is largely responsible for collecting household savings and lending in different sectors. By lending their resources in the small-scale industries under intensive banking program has enabled the banks to share in the economic growth of the country. Despite of the above natural resources and attributes, Nepal is still a developing country characterized by high population growth rate, low per capital income and low rate of capital formation. Nepal remained in self-imposed isolation for more than a century until it saw the dawn of democracy in 1951 AD. The Nepalese economy relies heavily on short-term domestic debt and highly concession foreign aid loans of long maturity. Many reasons are there for the slow pace of development such as landlocked position, misuse of resources, absence of economic infrastructure, political instability, poor economic policy and institutional weaknesses.

As most of the labor forces are unemployed, it is necessary to transform the huge labor force in to industrial sector. Only few percentage of total population is involved in industrial sector and service sector. The economic development of nation is on initial stage. Nepal has adopted mixed and liberal economic policy with the implicit objective to help the state and the private sector. For the economic growth and development, government has now initiated various economic policies such as industrial policy, foreign investment policy, privatization policy and trade and transit policy.

Due to difficulties and lack of infrastructure development of financial sector, the growth of financial sector is badly affected. Domestic crisis create huge problem in development of financial sector in Nepal.

Privatization is most common and essential part of investment and other activities in financial sector of Nepal. Prior to the restoration of democracy, when the government had not liberalized its economic policy, there were only few numbers of industries in Nepal. Especially after restoration of the democracy, the concept of the liberalization policies has been incorporated as directive principal and policies. The open market concept creates several opportunities and threats. Rapid development in information and technology sector is also milestone for increasing investment activities. Thus, competitive environment was formed in national market as well as international market. The liberalization policy attracts foreign investor as well as national investor to invest in financial sector and commercial sector, which help to raise the life standard of people.

Capital accumulation plays an important role in accelerating the economic growth of a nation. Saving and investment program in this context has enabled the banks to share in the economic growth of the economy.

Banking institutions are inevitable for the recourse mobilization and all round development of the country. It is necessary for economic development, it maintains economic confident of various segment and extends credit to the people. Bank and banking activities have prominent role in the development of our country. The pace of development of the country grew as bank and its activities gradually developed.

The Nepalese financial sector is composed of banking sector and non-banking sector. Banking sector comprises Nepal Rasta Bank (NRB) commercial banks, development banks, micro credit development banks and finance companies. Other financial institutions comprise of the insurance companies, employee provident fund, citizens investment trust, co-cooperatives performing the limited banking activities. Nepal bank Limited and Rastriya Banijya Bank were the only commercial banks operating over the last three decades in Nepal before the operation of foreign joint venture banks. Today there are many commercial banks, development banks, finance company and co-operatives operating in the Nepali financial market. There has been a tremendous growth in banking transaction in terms of their length and breadth due to these commercial joint venture banks.

1.2 Origin of Banks in Nepal

Banks help in uplifting the industry, agriculture and business in the country. It is said to be concerned with the economic development of the country. According to the history, it is found that people of our country have been involved in business and trade since long time back. Though the production of copper utensil had been started during the 7th century, business relationship could not be established with India since India was involved in the production of copper utensil. However, the craft concerned with copper, wood and metal in our country did attract the Chinese and the Tibetan a lot, thus resulting in the establishment of business relationship with China and Tibet.

Prime Minister Ranadeep Singh established 'TEJARATH ADDA' in the 19th century in order to protect people from higher interest rate. The 'TEJARATH ADDA' was responsible for providing loans to the people working in the government offices based on the security and the public based on the collateral 'TEJARATH ADDA' was not to earn profit, it charged its creditors with a low interest rate of 5% per annum. It had no other sources besides the government so it limited in serving a certain area. Again, it was only subjected to lend but did not accept deposits, hence it could not be counted as a bank. However, it can be said that 'TEJARATH ADDA' was the main financial institution that led to the development of modern banking system into the country. As a basic need, cottage industries were started in the country thus establishing business relationship with India. When Chandra Shamsheer became the Prime Minister of our country in 1980 B.S., a treaty was signed which stated that Nepal could establish business relationship with countries beyond India as well. This led to the need of modern banking system in the country. This led to the establishment of Nepal Bank Limited as the first modern bank in our country in B.S. 1994 Kartik 30th according to the Nepal Bank Act 1993. Thus, the year B.S.1994 is said to be the Golden year for modern banking system in Nepal.

In 2016 BS, an industrial bank namely Nepal Industrial Development Corporation (NIDC) was established under NIDC act 2016.

Subsequently another fully state owned commercial bank "Rastriya Banijya Bank" was established on 10th Magh, 2022 BS under Rastriya Banijya Bank act 2021 which was the second commercial bank of Nepal.

In 2024 BS Agriculture Development Bank was established under Agricultural Development Bank act 2024 BS. Nepal Arab Bank Limited is the first Joint Venture Bank established in 2014 under the commercial Bank Act 2031 and companies Act 2021.

In 2042 BS, Nepal also adopted liberal free economic policy and allowed to establish Joint venture bank under collaboration with foreign bank as well as private sector. At present more than 31 commercial banks in Nepal, there came the hoard of the commercial bank widening vertically as well as horizontally.

1.3 Lending Management

Lending is regarded as one of the income generating sources in commercial banks. Lending is the credit provided by financial institutions to their client. Further, lending is regarded as the heart of the commercial banks in the sense that; it occupies large volume of transaction; it covers the main part of investment; the most of the investment activities based on lending; it is the main factor of creating profitability; it is the main source of creating profitability; it determines the profitability. It affects the overall economy of the country. It is proved from very beginning that lending is the shareholder's wealth maximization derivative. Thus, effective management of lending should seriously be considered by commercial banks.

The lending function is considered by the banking industry as the most important function for the utilization of funds. Since, banks earn their highest gross profit from loans; the administration of loan portfolios seriously affects the profitability of banks. Indeed, the large number of non-performing loans is the main cause of bank failure. With respect to performance, banks now use various tools to assess bank efficiency and related functions in the bank lending process. Traditionally, banks determined operating by using measures of bank profitability, such as return on equity, return on assets, and return on investment; also banks used operational ratios, such as monetary output per staff member, and total operating expenses per unit of output.

Lending management is the system which helps to manage lending effectively. In other words, lending management refers management of credit exposures arising from loans, corporate bonds, and credit derivatives. Lending exposures are the main source of investment in commercial banks and return on such investment is supposed to be main source of income.

1.4 Introduction to sample banks

1.4.1 Nepal Bank Limited (NBL)

The modern banking system started in Nepal after the establishment of Nepal Bank Limited (NBL), which commenced its operations on 30th Katrik, 1994 B.S. (1937A.D.) under the Nepal Bank Act 1994 B.S. (1937A.D.). As a semi-government financial institution it replaced Tejarath Adda by taking over its operation and overcoming its limitation. Accordingly, NBL had a Herculean responsibility of attracting people towards banking sector from pre-dominant Sahu Mahajan's transaction and of introducing other banking services as well.

The NBL established its banking operations from the initial authorized capital of Rs. 10 million, issued capital Rs. 2.5 million, and paid up capital of Rs. 842 thousand out of 51% of the shares from government of Nepal (GON) and remaining 49% from equity partition of the public. At the time of establishment, the deposits and loan of Nepal Bank Limited were Rs.17 lakhs and 20 lakhs respectively. (www.nepalbank.com.np)

After suffering from huge loss & facing many problems by NBL, GON decided to handover bank's management to foreign management team. At the same time, World Bank decided to give loan of U.S \$24 million on 1st phase and U.S \$75 million on 2nd phase under highly popular Financial Sector Reform Program (FSRP). The agreement was done between GON & the World Bank on Oct. 28th 1999. From July 22nd, 2002 (2059 ashad 17), NBL was taken on contract for two years with an agreement to improve financial position. As per contract the agreement was extended for plus one year in August, 2004. As per agreement, International Development Agency (IDA) provided loan amounting to U.S \$ 550000 toward the restructuring & privatizing. The contract period of the management team, which expired on 21 July 2004 was renewed initially for one more year. Later, the contract period was extended up to July 2007.

Nepal Bank Limited has now launched new services such as SMS banking, various saving and deposit scheme, Web Remittance and ABBS. Altogether NBL have 109 operating branch distributed over 55 district of Nepal.

Of the total Rs. 7 Arab loan and grant from World Bank to Nepal, the cost of Rs.6 Arab has been already spent on FSRP.

Share Capital of Nepal Bank Limited as at 2012

Authorized Capital	Rs. 6,000,000,000
Issued Capital	Rs. 4,000,000,000
Paid-up Capital	Rs. 380,382,600

1.4.2 Nabil Bank Limited (Nabil)

Nabil Bank Limited, the first joint venture bank of Nepal, started operations in 2nd July 1984 A.D. as the name of Nepal Arab Bank Ltd under the company act. Dubai Bank Ltd was the initial foreign joint venture partner of this bank with 50% equity investment. The shares owned by DBL were transferred to Emirates Bank International Ltd (EBIL), Dubai. Later EBIL sold its entire holding to National Bank Ltd, Bangladesh (NBLB). Hence 50% of equity shares of Nabil Bank Ltd are held by NBLB and out of remaining, financial institutions have taken 20% and 30% were issued to general public of Nepal. Nabil was incorporated with the objective of extending international standard modern banking services to various sectors of the society. Pursuing its objective, Nabil provides a full range of commercial banking services through its 28 points representation across the nation and over 170 reputed correspondent banks across the globe.

Nabil, as a pioneer in introducing many innovative products and marketing concepts in the domestic banking sector, represents a milestone in the banking history of Nepal as it started an era of modern banking with customer satisfaction measured as a focal objective while doing business.

Highly qualified and experienced management team manages operations of the bank, including day-to-day operations and risk management. Bank is fully equipped with modern technology, which includes ATM's credit cards, state-of-art world-renowned software from Infosys Technologies System, Bangalore, India and Internet banking system and Tele-banking system.

Share Capital of Nabil Bank as at 2012

Authorized Capital	Rs. 2,100,000,000
Issued Capital	Rs. 2,029,769,400
Paid-Up Capital	Rs. 2,029,769,400

1.5 Focus of the study

Financial institutions are currently viewed as catalyst in the process of economic growth of country. A key factor in the development of an economy is the mobilization of the domestic resources. As intermediaries, the financial institution helps the process of resources mobilization. The government in turn is required to regulate their activities so that the financial policies are implemented as per the requirement of the country. Policy such as lending to priority and deprived sectors, lending to the educated unemployed people, lending for creation of entrepreneurs in the society are certain examples which the government in the developing economy try to implement with the help of financial institutions.

Bank creates funds from its depositors and lends the same to needy person or business institutions in terms of loan, advances and investment. So, proper financial decision making is more important in banking transaction for its efficiency and profitability. Most of the financial decision making are concerned with lending policy and lending management. It plays the vital role in the business succession, so efficient lending management is needed. This study deals with the lending position, non-performing loan, lending portfolio management and relation of lending in profitability of the selected banks.

1.6 Statement of the Problem

Capital resource is the prime source of the economic development of the country. Economic development of a country succeeds only when the development of the capital formation mechanism exists. The major cause of this chronic problem is the lack of economic development or the slow rate of the national economic growth. With the increased sophistication and liberalization of financial markets, this has made the problem of debt management one of the

most important issues in economic policy. More than 60% of the domestic debt have maturities of one year or shorter and less than 9% of domestic debt has maturities of 10 years or longer.

Commercial banks suffered from various types of problems such as non-performing loan. They do not mobilize their deposit properly in terms of development of the nation. It is no debate that high profitable institutions can easily get their goals and can serve the society. To improve the profitability situation of the bank, it is necessary to establish the higher creditability position of the bank. Credit is the most effective area in commercial bank. While granting the loan, banks need to analyze the document submitted by the borrowers, to avoid possible misuse of funds which may result in increasing NPL. Thus lending management is considered as the main issues in Nepalese banking sector. Commercial bank's investment has been found to be lower productive due to the lack of supervision regarding whether there is a proper utilization of their investment or not.

Lending management concept in commercial banks has appeared as a major research gap, There is lack of scientific research that could identify the issues of lending management in commercial banks. In this regard, the performance of the commercial banks is to be analyzed in terms of lending. Some research questions regarding to the credit practices, liquidity position, economic and industrial environment, management quality are considered as clear evident in present situation.

1. Is the lending practices adopted by sampled commercial banks in good position?
2. What is the lending efficiency of the sampled Nepalese commercial banks?
3. Does credit positions of bank influence the profitability?
4. Does internal performance cause for increase in non-performing loan?
5. How does the commercial bank manage lending portfolio?

1.7 Objectives of the Study

This research study entitled "Lending Management of Commercial Banks" covers following objectives.

- To analyze the diversification of lending of selected banks
- To examine lending position of selected banks in priority sector

- To examine the impact of loan and deposit on profit of the selected banks
- To explore the relationship between loan and deposit with non-performing loan and profitability

1.8 Limitations of the Study

The main limitations of this study are presented below.

- a) The findings of this study depend upon the data and information of a five-year time horizon.
- b) This study concentrates only on the portfolio of lending, impact of deposit, loan and non-performing loan in profit. Also, data and information of the sampled commercial banks only are used by the researcher.
- c) The research study is mostly based upon the secondary data and information. Hence, the validity of results depends upon the accuracy of data supplied.

1.9 Organization Structure of the Study

Chapter-I: Introduction

This chapter includes the basic concept and background of the study. It has served orientation for readers to know about the basic information of research area, various problem of the study, objectives of the study, significance of the study and limitations of the study.

Chapter-II: Review of the Literature

The second chapter of the study covers readers that are familiar with important research that has been carried out in similar areas. It also establishes that the study as a link in a chain of research that is developing and emerging knowledge about concerned field.

Chapter-III: Research Methodology

Research methodology refers to the various steps to adopt by researcher in studying a problem with certain objectives in view. It incorporates various sources of data related with the study and various tools and techniques such as statistical and financial employed for analyzing and presenting the data.

Chapter-IV: Presentation and analysis of data

This chapter is the main part of the research. This chapter analyses the data related with study and presents the finding of the study and also comments briefly on them.

Chapter-V: Summary, Conclusion and Recommendation

This chapter deals with the summary and conclusion. It also recommends to the concerned for the better improvement

CHAPTER-II

Review of Literature

Several research works have been conducted in various aspects of commercial banks for instance financial performance, investment policy, resource mobilization compliance of Nepal Rastra Banks directives by banks, risk and return analysis etc. This chapter focuses on reviewing prior researches, books and journals so that the theoretical framework can be built.

2.1 Conceptual Review

2.1.1 Meaning and Function of the Commercial Banks

Commercial banks are those banks that pool together the savings of the community and arrange for their productive use. They supply the financial needs of modern business by various means. They accept deposits from the public on condition that they are repayable on demand or on short notice. In other words, a bank is a financial intermediary, a dealer in loans and in debts. It borrows from one set of people and lends out to needy ones. Some banks draw their capital mainly from their shareholders, other's mainly from depositors. Some lend to industry, other to government. Some deal in short loans, borrowings and lending for short periods, other deal in long periods. The business of individual bank may differ, their essential function however, is to gather saving together and lend out what they collect.

Commercial bank plays an important role in directing affairs of the economy in various ways. The operations of commercial banks record the economic pulse of the country. The size and composition of their transaction mirror the economic happenings in the country. For instance, the mass failure of commercial banks during 1980 has reflected the phenomenon of several global depressions around the world. Commercial banks have played a vital role in giving direction financing the requirements of trade and industry in the country. They endeavor to promote enterprise development by investing loans and sometimes through the investment in shares and debentures. Therefore, they support the country's overall economic development process by financing in various ways.

In the Nepalese context, the Nepal Commercial Bank Act 2031 B.S. defines a commercial bank as one, which exchanges money, deposits money, accepts deposits, grants loans and performs commercial banking functions.

The American Institute of Banking has laid down the four major functions of the commercial banks such as receiving and handling deposit, handling payments for its clients, making loans and investments and creating money by extension of credit. Nepal Commercial Bank Act 2031 B.S. has emphasized the major functions of commercial bank which are mentioned below.

- They accept custody of funds with or without interest and open fixed accounts and saving accounts in the name of depositors.
- They make available credit in the form of loan, overdraft and co-financing to the industry, commerce, agriculture, export and service.
- They help to issue shares and debentures of any company or any other corporate body, guarantee or underwrite such shares or debentures and undertake any agency business but do not become a managing agent.
- Conduct transactions in bonds, provisional notes or bills of exchange, foreign exchange relating to commerce or corporation.
- Collection, sale and purchase of bills, collection and dissemination of trade information, provide service of opening and making payment of letter of credit, help industry and business by providing bank guarantee.
- They issue letter of credit, Draft and traveler's cheque. They purchase, sell or accept the securities of government.

2.1.2 Meaning and Definition of Lending

Commercial banks primary function is to get involved in lending activity. It is apparent that loan is defined as a thing that is lent, esp. a sum of money. Likewise, debt means a sum of money owed to somebody. However in financial terms loan or debt means principal or interest availed to the borrowers against the security. Debt means money that owes or will lend to individual or person (Ghimire, 2005).

Further the term loan is defined as a lending. Delivery by one party and receipt by another party, a sum of money upon agreement expressed or implied, to repay it with or without interest.

Anything furnished for temporary use to a person at his request; on that condition it shall be returned. Therefore, loan includes-

- The creation of debt by lender's payment of or agreement to pay money to the debtor or to a third party for his account of the debtor
- The creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately
- The creation of debt pursuant to a lender credit card or similar arrangement
- The forbearance of debt arising from a loan

With respect to alternative view, debt means 'principal and interest' provided to debtor by banks or financial institutions, with the pledge of immovable or movable property or other securities or guarantee or without guarantee and the word also means over dues of the transaction beyond balance or fees, commission and interest incurred in that relation.

2.1.3 Objectives of Lending Policy

The credit policy should be carefully established, properly communicated to the lending officers and implemented effectively by the lending officers. The basic objective of credit policy is to maintain credit management and control over it. Moreover it is specified as follows

a) To profit the interest of depositors

Loans are the risky assets though a bank invests the most of its resources in granting loans and advances. The increasing of non-performing loan causes the non-existence of banks. It is very quality of assets that led bankruptcy of many banks in South East Asia. The objective of sound loan policy is to protect depositors' interest and maximize returns to the shareholder by striking a balance between liquidity and profitability.

b) To contribute to economic development

A sound credit policy is required to ensure that the loans are given to the productive sector, which contributes to capital formulation and employment generation.

c) To give guidance to lending officials

A borrower should be assured that there would be no discrimination whether he/she deals with one officer or another. A sound credit policy is imperative to achieve a uniform standard procedure throughout the organization.

d) To establish a standard for control

Every policy requires periodic follow-up to ensure its proper implementation. A sound credit policy helps to determine the variance between actual performance and practice and to take corrective actions. A sound policy is always flexible and works as a guideline. If the variation between the practice and policy is observed, proper education to lending officer or amendment of the policy will become inevitable.

2.1.4 Principle of Lending Policy

One of the basic functions of commercial banks is to provide credit. Out of their total income, on an average 60-70% of income consist from lending activities. Such income based on lending is known as exposure based income because banks are exposed to default risk. In order to mitigate default risk, it would be wise to follow the principles of good lending.

❖ Seven Principles of Good Lending

I. Principle of Safety

When lending is made, a banker must ensure that the advance made is safe. This means the money will definitely come back. It demands that loan should be granted only to reliable borrowers. It must be ensured that the reputation of the borrower is impeccable in the business community. The integrity of the borrower must be undoubted, particularly where the security is inadequate to cover the advance. If the borrower is a dishonest person, he might divert borrowed fund to some other purpose other than initially projected to the bank. By all means, the loan extended by the bank, must be safe and secure. The banker is only a custodian of deposit of the public. Hence the banker must ensure that the advance made is not only on safe hands but also remains so, throughout the period of lending and is repaid with interest when it is due (Shrestha, 2009,p.82).

II. Principle of Liquidity

When a banker demands his money back, the borrower must be in a position to repay within a reasonable period. This is possible if the borrower has invested in short-term requirements and not on the purchase of fixed assets. Banks often make a tuning of their deposit with their lending such as long-term deposit with long term lending and short-term deposit with short-term lending. The major

portion of bank's deposit are payable on demand on short time. If the bankers lend only to borrower who would make the payment slowly, bank may not retain the ability to meet the daily demands of the depositors. Hence, this will blemish the bank image, which can even lead to failure. Therefore, bankers attach great importance to liquidity (Shrestha,2009,p.83).

III. Principle of Purpose

Bankers allow loans and advances to the customers only for productive purpose and not for horsing or for speculative business, the banker must avoid such a customer as the client may drag the bank along with it, at the time of downfalls. The funds should be utilized for increasing production turnover or for starting new business venture only, which generates employment. The business of the borrower should be a legal one and in consonance with the government's policies. If the client is involved in a business, which is against the government's policies, against the environmental policies or which may bring health hazards to the community it operates in, though the proposal may look lucrative, it must be turned down outright.

IV. Principle of Profitability

Profitability is very important element, which influences the banking activities. Commercial banks are established like any other commercial institutions for the sake of market profit. Without profit, no one can expect banks to make payment of interest on deposits maintained by them. Banks incur large administrative expenses in the cause of maintaining service efficiency and attractive premises. Default risk is always high in the banking business as banks deal in loans and advances. Loan loss provisioning is maintained according to the classification of loans. Banks have to make provision for depreciation of fixed assets. Profit alone ensures all such expenses. Hence, profitability is one of the most important factors to be considered, before extending any credit facility.

V. Principle of Spread

Another equally important principal of good lending is to spread the advance in various sectors, many firms and industries, and against different securities. It would be appropriate to quote the saying, "Do not put all your eggs in one

basket.” A successful banker is the person who can assess such risk and spread the lending over a large number of borrower, different industries and areas and against different types of securities. If lending is made only against one type of securities and if that type of security depreciates steeply, he will run a great risk of losing the advance. If the bank has many branches across the country, in some places they might lend on sugarcane and in some other place they might lend against the stock of rice or jute.

VI. Principle of Security

A prudent banker will always endeavor to obtain maximum security available from the borrower. These should usually be sufficient margin to provide against fluctuations in value. The customer should be asked to provide everything available and acceptable to the bank so that he may not borrow against those securities from other sources. No compromise should be made in obtaining maximum securities from the client. At the time of distress situation also, the securities must be sufficient to cover the bank’s loan. At all times, bank must be in a safe position to realize its lending. It should however be noted that a loan proposal should not be judged merely in the basis of realizable value of the assets owned by the unit but it should primarily be considered in terms of its earning capacity.

VII. Principle of National Interest, Suitability

Bankers must ascertain on what type of business the customer is involved, whether it serves the National interest or not, whether the firm is acting responsibly towards the society that it is operating in, like brick industry or the cement industry and the precautions taken by it against environment pollution. Central bank issues directives, prohibiting banks to invest in various sectors such as the import of arms and ammunitions etc. In addition, bankers must remain vigilant of the law and order situation where the borrower carries its business (shrestha, 2009,p.85).

2.1.5 Key characteristics of lending policy

Every policy has own characteristics. The lending policy has the following characteristics:

a) Approved by top management

The lending policy is always prepared by the top management of an institution and is approved by the board of directors. It may be revised time to time.

b) Practical and manageable

The lending policy, prepared by the bank is not for theoretical rather it is for practical and manageable to apply.

c) Flexibility

Rigid lending policy is not practical. It has been flexible according to the demand of customer.

d) Compliance

Lending policy is compliance with NRB policy as well as economic and political condition of the country.

2.1.6 Systems and Procedure of lending management

A sound lending management interacts all the areas of lending effectively that ultimately helps to operate the organization successfully. Basically, a bank has to follow the following systems and procedures in lending management (Shrestha, 2009).

a) Lending organization

Banks must operate within a sound and well-defined criteria for new lending as well as the expansion of existing lending. The lending should be extended within the target markets and lending strategy of the institution. Before allowing a credit facility, the banks must make an assessment of risk profile of the customer transaction. This may include.

- i. Credit assessment of the borrower's industry, and macro economic factors
- ii. The purpose of credit and source of repayments
- iii. The track record/repayment history of borrower
- iv. Assess/evaluate the repayments capacity of the borrower
- v. The purpose terms and conditions and covenants
- vi. Adequacy and enforceability of collaterals

vii. Approved from appropriate authority

While structuring credit facilities institutions should appraise the amount and timing of the cash flows as well as financial position of the borrower and intended purpose of the funds. It is utmost important that due consideration should be priced to cover all embedded costs. Relevant terms and conditions should be laid down to protect the institution's interest.

Institutions have to make sure that the credit is used for the purpose it was borrowed. Where the obligor has utilized funds for purpose not shown in the original proposal, institutions should take steps to determine the implications on credit worthiness. In case of corporate loans where borrower own group of companies such diligence becomes more important. Institutions should classify such connected companies and conduct credit assessment on consolidated/group basis.

b) Limit setting

An important element of credit risk management is to establish exposure limits for single obligors and group of connected obligors. Institutions are expected to develop their own limit structure while remaining within the exposure limits set by the central bank (Nepal Rastra Bank). The size of the limits should be based on the credit strength of the obligor, genuine requirement of credit, economic conditions and the institution's risk tolerance. Appropriate limits should be set for respective products and activities. Institutions may establish limits for a specific industry, economic sector or geographic region to avoid concentration risk.

c) Lending administration

Ongoing administration of the credit portfolio is an essential of the lending process. Lending administration function is basically a back office activity that supports and controls extension and maintenance of lending. A typical lending administration unit performs following functions:

i) Loan Documentation

When loans and advance are extended to the customers, various types of securities are obtained against the loan amount, as a safeguard measure in case the customer fails to repay the loan amount or the interest on due. For creating charge on various securities, different types of documents are extended. Different documents serve different purposes and are mainly categorized into two types, namely standard documents and non-standard documents. These are pointed out below:

a) Standard Documents

- i) Promissory Note
- ii) Sanction letter (letter of agreements)
- iii) Assignment of Account Receivables
- iv) Power of Attorney
- v) Letter of Continuity
- vi) General Letter of Hypothecation
- vii) Supplementary agreements
- viii) General Letter of Trust Receipt
- ix) Subordination Agreement
- x) Letter of Guarantee
- xi) Letter of Indemnity
- xii) General Counter Guarantee
- xiii) Wealth Statement
- xiv) Cross Guarantee
- xv) Letter of set off
- xvi) Bill Purchase Agreement

b) Non Standard Documents

- i) Loan Deed
- ii) Mortgage Deed
- iii) Board Resolution of Borrower

i) Credit disbursement

The lending administration functions should ensure that the loan application has proper approval before entering facility limits into computer systems. Disbursement should be

affected only after completion of covenants and receipt of collateral holdings. In case of exceptions necessary approval should be obtained from competent authorities.

ii) Lending monitoring

After the loan is approved and draw down allowed, the loan should be continuously watched over. These include keeping track of borrowers' compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments.

iii) Maintenance of lending files

Institutions should devise procedural guidelines and standard for maintenance of lending files. The lending files not only include all correspondence with the borrower but should also contain sufficient information necessary to assess financial health of the borrower and its repayment performance. It need not mention that information should be filed in organized way so that external/internal auditors or NRB inspector could review it easily.

iv) Collateral and security documents

Institutions should ensure that all security documents are kept in a fireproof safe under dual control. Registers for documents should be maintained to keep track of their movement. Procedures should also be established to track and review relevant insurance coverage for certain facilities/collateral. Physical checks on security documents should be conducted on a regular basis.

2.1.7 Lending Monitoring and Control

Lending risk monitoring refers to incessant monitoring of individual credits inclusive of off-balance sheet exposures to obligor as well as overall credit portfolio of the bank. Banks need to enunciate a system that enables them to monitor quality of the lending portfolio of day-to-day basis and take remedial measures as and when any deterioration occurs. Such a system would enable a bank to ascertain whether loans are being serviced as per facility terms, the adequacy of provisions and the overall risk profile is within limits established by management and compliance of regulatory limits. Establishing an efficient and effective lending monitoring system would help senior management to monitor the overall quality of the total lending portfolio and its trends. Consequently the management could fine tune or reassess its credit strategy/policy accordingly before encountering any major setback. The banks' lending policy

should explicitly provide procedural guideline relating to credit risk monitoring. At the minimum it should lay down procedure relating to:

- I. The roles and responsibilities of individuals responsible for lending risk monitoring
- II. The assessment procedures and analysis techniques (for individual loans and overall portfolio)
- III. The frequency of monitoring
- IV. The periodic examination of collaterals and loan covenants
- V. The frequency of site visits
- VI. The identifications of any deterioration in loan.

a) Financial Position and Business Conditions

The most important aspect about an obligor is its financial health, as it would determine its repayment capacity. Consequently institutions need carefully watch financial standing of obligor. The key financial performance indicators on profitability, equity, leverage and liquidity should be analyzed. While making such analysis due consideration should be given to business/industry risk, borrowers' position within the industry and external factors such as economic condition, government policies, and regulation.

b) Conduct of Accounts

In case of existing obligor the operation in the account would give a fair idea about the quality of credit facility. Institutions should monitor case of repeat extensions of due dates for trust receipt and bills.

c) Loan Covenants

The obligor's ability to adhere to negative pledge and financial covenants stated in the loan agreement should be assessed and breach detected should be addressed promptly.

d) Collateral Valuation

Since the value of collateral could deteriorate resulting in insecure lending, banks need to reassess value of collateral in periodic basis. The frequency of such valuation is very subjective and depends upon nature of collaterals. For instance loan granted against shares need revaluation on almost daily basis whereas if there is mortgage of a residential property the revaluation may not be necessary as frequently. In case of credit facilities secured against inventory or goods at the obligor's premises, appropriate inspection should be conducted to verify the existing valuation of the collateral.

2.1.8 Managing lending problems

The institution should establish a system that helps to identify problem loan ahead of time when there may be more options available for remedial measures. Once the loan is identified as problem, it should be managed under a dedicated remedial process.

A bank's lending risk policies should clearly set out how the bank will manage problem lending. Banks differ on the methods and organization they use to manage problem lending. Responsibility for such lending may be assigned to the originating business functions, a specialized workout sections or a combination of the two, depending upon the size and nature of the lending and the reason for its problems. When a bank has significant lending –related problems, it is important to segregate the workout function from the credit origination function. The additional resources, expertise and more concentrated focus of a specialized workout section normally improve collection results.

A problem loan management process encompasses following basic elements:

a) Workout remedial strategies

Sometimes appropriate remedial strategies such as restructuring of loan facility, enhancement in lending limits or reduction in interest rates helps improve obligor's repayment capacity. However it depends upon business conditions, the nature of problems being faced and most importantly obligor's commitment and willingness to repay the loan. While such remedial strategies often bring up positive results, institutions need to exercise great caution in adapting such measures and ensure that such a policy must not encourage obligors to default intentionally. The institution's interest should be the primary consideration in case of such workout plans it needs not mention here that competent authority, before their implementation, should approve such workout plan.

b) Review of Collateral and Security Document

Institutions have to ascertain the loan recoverable amount by updating the values of available collateral with formal valuation. Security document should also be reviewed to ensure the completeness and enforceability of contracts and collateral guarantee.

c) Status Report and Review

Problem of lending should be subject to more frequent review and monitoring. The review should update the status and development of the accounts and progress of the remedial plans. Progress made on problem loan should be reported to the senior management.

2.1.9 Project Appraisal

Before providing credit to the customer, bank makes analysis from various aspects and angle. It will help the bank to see whether project is really suitable to invest. The purpose of project appraisal is to achieve the guarantee of reasonable return from the project. The project appraisal answers the following questions:

- Is the project technically sound?
- Will the project provide a reasonable return?
- Is the project in line with the overall economic objectives of the country?

Generally, the project appraisal involves the investigation from the following aspects (Gautam, 2004, p. 258):

- a) Financial aspects
- b) Economic aspects
- c) Management/Organizational aspects
- d) Legal aspects

2.1.10 Need of Lending Policy in Commercial Banks

In banks fund management, the cost of handling is, of course as important as the availability of funding. Competition, deregulation, economic conditions and increased sophistication in money management in the part of retail and wholesale depositors have increased the cost of banks fund tremendously.

Making an unsecured loan involves taking a risk and losses on some loans are to be expected. Commercial banks are increasingly facing lending risk (counter party risk) in various financial instruments other than loans, including acceptances, inter bank transactions, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, and in the settlement of transactions. Thus the need of credit policy is the most as the banks should always

try to mitigate the risk related to the loan provided. Steps that the banks can take to limit loan losses included obtaining sufficient information on loan and borrowers as well as establishing an internal system of loan review in addition to the loan review of regulatory agencies. Bank can also affect or offset credit risk in their loan portfolios by watching the business cycle, varying, loan rates against the degree of risk and recognizing risk in loan concentration. Although specific credit risk policy and practice may differ among banks depending upon the nature and complexity of their credit activities, a comparative credit risk management program should address the following areas:

- i) Establishing an appropriate credit risk environment,
- ii) Operating under a sound credit granting process,
- iii) Maintaining an appropriate credit administration, measurement and monitoring process
- iv) Ensuring adequate controls over credit risk

2.1.11 Loan Disbursement and Classification

One of the main functions of commercial bank is to create credit from its borrowed fund. Loan and advances are the assets coming from such activities. Loans and advances dominate the assets side of the balance sheet of any bank and also constitute the primary sources of income to the banks. They are also the least liquid of the bank's entire asset. Loans and advances may take different form and are allowed against various types of securities. Loans, overdraft, discounting of bills of exchange etc are some of the forms of the bank lending. Granting loans and advances always carry a certain degree of risk. Loan and advances are also regarded as risky assets of banks.

Loan classification refers to categories or grade based on the perceived risk and other relevant characteristics of loan and as per guideline of central bank. The process of continual review and classification of loans enables banks monitor the quality of their loan portfolios and when necessary to take remedial actions to counter deterioration in the credit quality in this portfolio. In most of the countries, a number of day a past due payments represents a minimum condition for loan classification purposes.

However some criteria which exhibit forward looking features are also considered. In the context of Nepal, as per guidelines of NRB loans are classified into four categories namely pass, substandard, doubtful and loss.

Pass category: All loans and advances the principal of which are not past due or past due for a period up to three months. Only loans under pass category are termed as performing loan.

Substandard Category: All loans and advances the principal of which are past due for a period of more than three months and up to six months.

Doubtful Category: All loans and advances the principal of which are past due for a period more than six months and up to one years.

Loss Category: All loans and advances the principal of which are past due for a period of more than one year.

Performing loans are those loans that repay principal and interest timely to the bank from the cash flow it generates. In the context of Nepal, the loans classified as a pass category is termed as performing loan.

Non-performing loan are the loan that does not repay principal and interest timely to the bank. Non-performing loan (NPL) has many different meanings which vary from the country to country. In some countries non-performing loan means the loan impaired. In some countries it means that the payments are past due, but there are significant differences among countries how many days a payment period should be in arrears before past due status is triggered. Nevertheless, a rather common feature of non-performing loan appears to be that a payment of more than 90 days past due. In Nepal also, if the loan is past due for over 3 months it is non-performing loan. Hence the loans falling under substandard, doubtful and loss categories are regarded as non-performing loan.

2.1.12 Loan Loss Provision

Loan loss provision is the accumulated amount or fund that is proved as a safeguard to cover possible losses upon classification of risk inherited by individual loans. There is risk inherent in every loan. Hence, provision is made as cushion against possible losses and to reflect the true

picture of the bank's asset. There is practice of showing net loan (total loans-loan loss provision) in financial statements. The amount required for provisioning depends upon the level of non-performing asset and their quality. High amount of provision is an indication of the bank's credit portfolio that needs serious attention. One percent provision of total credit is an ideal position as it is the minimum requirement for all good loans. In Nepal 1% 25% 50% and 100% provision are made for pass, substandard, doubtful loan and losses respectively.

2.1.13 Lending Process

Commercial bank follows several steps to disburse loan to the borrowers. The lending policies might be different from one bank to another. In general, these steps can be pointed out as follows.

Application: the needy are required to submit an application to the bank along with required documents. The documents required for credit proposal appraisal and processing by banks are as follows:

- Loan application
- Citizenship certificate of applicant
- Firm/company registration certificate (if self employed)
- Income tax registration certificate (if self employed)
- Authenticated partnership deed in case of partnership firm, and memorandum and article of association in case of company
- Attested copy of board resolution in case of company resolved to avail loan and banking facilities from bank against the pledge, hypothecation, and mortgage of fixed property owned by company or property of third party named.
- Letter of authority authorizing to sign loan deed and other relevant document paper which are deemed necessary while dealing with bank on behalf of firm/company.
- Feasibility report/scheme (for new project)

Lending appraisal and processing

Basically, appraisal of loan proposal is processing for the analysis of reliability scheme proposed. It also helps to assess the actual financial assistance needed to operate the scheme.

Commercial banks carry out loan appraisal on the basis of past performance, future forecast and information available from the documents submitted by aspirant borrowers.

The bank tries to ascertain the following during loan processing:

- The cost of estimate is examined so that the appropriate estimate can be accepted. Under and over estimates are rejected. Similarly, the specification of machinery should be proper.
- Working capital projection has to be reasonable as compared to past performance and on the basis of target for future expansion.
- The return rates should be adequate like return on investment (ROI), internal rate of return (IRR) and debt service coverage ratio (DSCR)
- The capacity, competency, integrity and commitment of promoters/parents/proprietors/directors/personnel should be intact.
- SWOT (strength, weakness, opportunity and threat) analysis of the proposed project must give reasonable assurance.

2.1.14 Portfolio Analysis

In financial leverage, portfolio could be defined as the composite mixed of ownership to financial assets/investments in which a particular investor wishes to invest. Thus, portfolios are composition of investments in various sectors which in turn are composed of expected risk and return of their component investments. It helps an investor to make optimal investment decision minimizing overall risk and maximizing overall return. Portfolio theory was first developed by Markowitz in connection with the investment in stock market securities. The ground theory was that, if the correlation between the assets return is not positive, investing in two assets can minimize risk.

Portfolio Management

In general, portfolio management is the process of selecting a combination of investment alternatives that provide the investor a maximum attainable return for a given level of risk or a minimum risk for a given level of return. Portfolio management can also be taken as the management of risk and return. It aims to determine an appropriate mix of investments that attains optimum level of risk and return depending upon the attitude of investor.

According to Lawrence J. Giman (1973), "Portfolio means a collection or group assets."

According to Weston and Brigham (1983), "A portfolio simply represents the practice among investors of having their funds in more than one asset. The combination of investment assets is called a portfolio."

According to Sharpe, Alexander and Bailey (2000), "Portfolio construction involves identifying those specific assets in which to invest as well as determining the proportions of the investors wealth to put in to each one."

Portfolio management of banks' loan investments basically are the allocation of funds to different types of consumption and investment loans having different degrees of risk and varying rates of return in such a way that balances the conflicting goal of maximizing return and minimizing risk. The process of managing banks' loan investments considers a number of relevant and influencing factors such as the availability of funds, liquidity required, central bank's rules and regulations that abide banks, risk associated with the respective industries, and the expected rate of return on respective loan sanctioned sectors. In addition, the banks should carefully examine the macroeconomic indicators such as interest rates, inflation, aggregate expected money multiplier, national income; saving ratio etc, effective management of banks' loan investments can lead the banks into the success as loan investments constitute the major portion of a traditional bank's total assets.

2.2 Review of Related Studies

The article of Ready (2005), provides an overview of the credit portfolio management function, structural alternatives, the skill necessary for its effective implementation, and a final word on training and compensation. The focus is on corporate credit portfolios, as these often present the largest concentration challenges though they can be easily modified.

Modern portfolio management of bank assets has fundamentally changed the requirements for individuals using this technique: their backgrounds, their training, and their skills on using available resources. While traditional credit training remains necessary, today's portfolio manager augments this background with knowledge of early-warning systems, alternative structures to better set risk/return parameters, and more.

In the article by Paul Van Mass (2002), head of the credit products Europe, Bank of America, "Active loan portfolio management through the use of credit derivatives" he gives the reader a brief overview of common derivatives the size and scope of their markets and their role on structured credit products. This case study uses as a reference to a current deal that Bank of America has structured using credit derivatives. In his study researcher shows that credit derivatives market has grown and it is continuing to grow at far greater rate.

According to the research, credit derivatives market is widely predicted that volumes will continue to increase dramatically. An increase in liquidity through new market participation has aided and will continue to aid growth. Moreover, there has been an increased use of credit derivatives by banks for managing credit risk, for example concentration risk which has improved liquidity. This activity is facilitating an increased understanding of credit risk and investor willingness to accept structured transactions. The most frequently one of the derivatives is credit default swaps.

Barbara and Sotiris (2001), in the article "Service failures and service Recovery in retail banking the customers' perspective", focus on an empirical investigation of service failures and service recovery in retail banking. Different types of failures and recovery strategies used by Greek banks were identified using the critical incident technique.

The importance and benefits of providing service quality are well documented in the academic literature, and business participations strive to design and implements programs to ensure that the customer is satisfied with his/her encounters with a service firm and, in turn with various dimensions of service quality. However, quality discrepancies and shortfalls are likely to occur, especially when human input is largely responsible for the “Production” and delivery of the offering. The problem that arises for organizations are what happens when a service shortfall occurs; how can they recover from service failure?

In the article, “The internal performance measures of bank lending: a value-added approach” Lin Peter Wei-Shong, Mei Alberk Kuo-Chung (2006), define that the lending function is considered by the banking industry as the most important function for the utilization of funds. Since, banks earn their highest gross profits from loans; the administration of loan portfolios seriously affects the profitability of banks. Indeed, the large number of non-performing loans is the main cause of bank failure. Banks are learning to review their risk portfolios using the criteria laid down by Basel II. Greenspan has indicated that Basel’s goal is to induce bankers to improve their risk management capability, including how the institutions price products, serves for loss, and control their operations (Rehm, 2002). This research is in line with the purpose of Basel II, i.e. to reduce a bank’s operational risk during the lending process through a better monitoring of the employees in the lending department.

According to them, with respect to performance, banks now use various measures to assess bank efficiency and related functions in the bank lending process. Traditionally, banks determined operating efficiency by using measures of bank profitability, such as return on equity, return on assets, and return on investment; also, banks used operational ratios, such as monetary output per staff member, and total operating expenses per unit of output.

Grasing (2002), describes the efforts of the Nolan Company to develop benchmarks for commercial banks involving many of the top performing banks. The goal of establishing the benchmarked banks was to establish drivers of high performance. The cost for each completed loan, the cost per thousand dollars of loans, the non-interest revenue from each loan per each thousand dollars, the total number of loans per employee, and the dollar amount of loans per employee were used as the performance measures for commercial banking.

Corsby, Nick French and Meilanie Oughton (2003), in the article “Bank lending valuation on commercial property, Does European mortgage lending value add anything to the process?” researchers try to find out mortgage lending value in term in Europe should be based on sustainable values and this recommendation is compared to the current basis used for bank lending valuations mainly market value. According to them, the mortgage lending value shall mean that the value of the property as determined by a values making a product assessment of the future marketability of the property by taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of property. Speculative elements shall not be taken into account in the assessment of the mortgage lending value. The mortgage lending value shall be documented in a transparent and clear manner.

In very simplistic term, bank lending falls into two categories: asset specific and corporate loan. These loans, in turn, can be divided into two further categories of secured and unsecured lending. It is in the case of secured lending that valuations are most directly and commonly used. In unsecured lending valuations are frequently relied on indirectly.

Classification of Loan and Advance

The classification criteria are as follows:

Pass Category: All loans and advances the principal of which are not past due or past due for a period up to three months. Only loans under pass category are termed as performing loan.

Substandard Category: All loans and advances the principal of which are past due for a period of more than three months and up to six months.

Doubtful Category: All loans and advances the principal of which are past for a period more than six months and up to one year.

Loss Category: All loans and advances the principal of which are past due for a period of more than one year.

Lending institutions are not restricted from classifying the loan and advance from low risk category to high-risk category. For instances, loans falling under sub standard may be classified into doubtful or loss and loans falling under doubtful may be classified into loss category.

Under this clause, banks and financial institutions may debit the borrower's current account, irrespective of the balance available, for recovery of interest and principal. By doing so, it may buy a month's time for collecting the same. This may save the lending institutions from requiring classifying the loan to a higher category. However, in respect of the interest, the cushion is not available since the directive has expressively mentioned that the recognition of interest shall be on cash basis only (NRB, 2006, directive no 4 and 15).

2.3 Review of Thesis

Ojha (2002), in his dissertation about "lending practices" has found that the high volume of liquidity reveals that the degree of lending strength has been prevailing in all the commercial banks. The lack of reliable lending opportunities and fear of losing the principal in rural sector has been keeping these banks less oriented towards the lending functions. Hence, the government should take appropriate action to initiate these banks to attract to flow credit in rural economy.

He has found out that normal guidance of Nepal Rastra Bank and acting upon reduces many on the credit risk arising from borrower's defaulter, lack of proper credit appraisal, defaulter by blacklisted borrowers, and professional defaulter. He thinks that these banks have to follow the directives of NRB strictly and be more cautious and realistic while granting loans and advances.

Khadka (2002), has carried out research on "A Comparative Study on Investment Policy of Commercial Banks NBL, NABIL, SCBNL, and NIBL" with objective to find out the relationship between deposits, investments, loans and advances and net profit. She found that NBL is comparatively less successful 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 of banking. Profitability positions of NBL are comparatively worse than that of other CBs. It predicts that NBL may not maintain the confidence of shareholders, depositors and its all customers if it cannot increase its volume even in future.

Shrestha (2004), conducted a thesis “A Study on non-performing loans and loan loss provisioning of commercial banks” and revealed that SCBNL had risk averse attitude on the management or they had policy of investing low in the risky assets i.e. loans and advances as compared to NBL and Nabil because the loan and advance to total assets ratio of NBL, Nabil and SCBNL during the study period was appeared to be 52.3%, 47% and 29.24% respectively.

SCBNL has the higher consistent and variability on ratio during the study period where as the NBL has the lower consistent and variability as comparison to other two banks. Nabil has moderate level of consistency and variability. In the same way, the proportion of non-performing loan to loans of NBL was found higher than other two banks. Not only has public sector bank, even private sector bank as Nabil has higher proportion of non-performing loan. However, in recent time Nabil shows significant decrement in non-performing asset, which are the result of effective credit management and its efforts of recovering bad loans through the establishment of recovery cell.

Ghimire (2005), explored in his research “Non-performing assets of commercial bank: cause and effect” and found that Nepalese banking sector in recent days are facing several problems. With the level of increasing NPA profitability performance of the bank has been badly affected. To find out the cause of NPA increment with commercial banks basis of loan flotation procedures, follow up practice carried out by the bank for the recovery of overdue loan outstanding, internal responsible factor causing NPA growth has been tried to sort out.

Gurung (2006), explored in his research “Lending policy and recovery management of Standard Chartered Bank Nepal Ltd and Nabil Bank Ltd” has found out that the deposit collection by the banks shows that increasing but in a fluctuating trend. The trend analysis of deposit collection the increase in deposit collection in the forthcoming years will continue. Out of different types of deposit collection account, higher amount has been collected in saving deposit account. Out of the total deposit collection, SCBNL has disbursed 36% of average as a loan and Nabil has disbursed 52% of its deposit collection as a loan disbursement to deposit collection ratio of commercial banks, it is around 60%. Thus this ratio is quite low in the case of sample bank especially of SCBNL. It is further proved by the calculation of correlation coefficient, which is 0.75 and 0.23 of SCBNL and Nabil respectively.

Neupane (2006), conducted the research “Non-performing loan and loan loss provisioning of NBL, RBB and NABIL” and found that measurement of lending strength in relative term has revealed that the loan and advance to total assets of NBL is higher but issued loan and advances are not generating the desired income. RBB shows the highest degree of deviation and variation while NABIL has the most consistent ratio throughout the study period.

Tamang. (2008), conducted a research “ A comparative study on credit management of HBL and Nabil ltd” has found out that the credit practices of Nabil in terms of loan advances to deposit ratio was found relatively low mean scores than HBL. It indicates that Nabil has been strong to mobilize its total deposit as loan and advance in comparison to HBL. Efficiency in terms of loan and advances to current asset ratio was found higher in Nabil which indicates that short term lending practices of Nabil was relatively good position in his study period. HBL has the best performance to generate interest income. This means the HBL earned more profit than the Nabil. Lending policy of Nabil Bank in terms of loss provision to total loan and advances was found relatively better than that of HBL because the mean score of the result was relatively low (i.e, $0.0451 \leq 0.0777$). The finding also showed meaningful that quality of management in both banks was good.

2.4 Research Gap

Previous researchers analyzed the lending policy in term of credit practices, credit management of lending practices. The past researches in measuring the performance of bank lending have focused on the final measures that are incapable of solving the problems of overdue loans and bad debts. In fact lending management is determined by various factors. Researchers have not properly analyzed about portfolio of lending and its impact on the profitability in Nepalese context. In this study portfolio of lending is measured by lending practices, trend analysis and various statistical tool as well as financial tools are used for analyzing survey data. Bank’s internal performance for its lending is crucial and it has great value in lending management. Other factors such as banking environment, quality of management in terms of lending may be the strong determinant for lending management in banks. Clearly these are the issues in Nepalese commercial banks. The previous studies cannot be ignored because they provide the foundation to the present study. This study tries to define lending management by applying lending portfolio

management, priority sector lending, non-performing loan analysis and financial condition analysis. Probably this will be the new research in the area of lending management.

CHAPTER III

RESEARCH METHODOLOGY

Research methodology is a way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. Research is the process of a systematic and in depth study or search of any particular topic, subject or area of investigation backed up by the collection, compilation, presentation and interpretation of relevant details or data. Methodology refers to the various steps that are generally adopted by a researcher in studying his/her research problem along with the logic behind it. So the research methodology is a systematic way of conducting the research in an effective and practical way so that it can explain how the research is done. Research methodology describes the methods and processes applied in the entire aspect of the study. This chapter describes research design, population and sample procedure, sources of data and analysis of data.

3.1 Research Design

This study follows the descriptive as well as analytical method of analysis to meet the stated objective of the study. Descriptive studies are primarily concerned to find out 'what is'. The secondary data are analyzed as the part of the analytical study. Financial statements of selected commercial banks are tabulated using spreadsheet.

3.2 Sources of Data

The research is based on secondary sources of data. Published financial statements of commercial banks are collected. Similarly, financial statement of selected commercial banks and NRB related information are collected and tabulated in spreadsheet. Such secondary information is gathered from the department of commercial banks.

3.3 Population and Sample Survey Design

A small portion chosen from the population for studying its properties is called sample and the number of units in the sample is known as the sample size. The method of selecting for study a small portion of the population to draw conclusion about characteristics of the population is known as sampling. Sampling may be defined as the selection on part of the population on the basis of which a judgment or inference about the universe is made. (Sharma & Chaudhary, 2058).

In this research, two banks are taken out of more than 31 commercial banks in Nepal. The first commercial bank of Nepal (NBL) and first private sector joint-venture bank (NABIL) are taken for study. The sample organizations are follows.

Nepal Bank Limited (NBL)

Nabil Bank Limited (NABIL)

3.4 Methods of data collection

The required data i.e. relevant reports and statements for analysis are directly collected from the credit administration department, account department of NBL, annual report of Nabil collected from website of the bank, statistical bulletin published by NRB and other publication from NRB, magazine, newspaper and other relevant materials and information are collected from the Central Library and other related website.

3.5 Data Processing technique

First of all raw information has been received. After collection of raw information the processing has been done. Then after, all collected data have been grouped accordingly and are presented and refined for the purpose of the study. This processing procedure is required for sequential analysis of data to meet the objective of this research.

3.6 Tools and techniques employed

To make the study more specific and reliable, the following types of tools are used for the analysis of data

- a) Financial tools
- b) Statistical tools

To meet the objectives of the study data are analyzed by using financial tools such as ratio analysis, percentage etc. Graph chart and table are used to support analysis.

Financial tools used

The financial ratio has been used to examine the financial strengths and weaknesses of the bank.

The financial ratios used in this study are as follows-

- i) Priority sector lending to loan and advance ratio
- ii) Loan and advances to deposit ratio
- iii) Non-performing loan to loan and advance ratio
- iv) Total profit to loan and advance ratio

Statistical tools used

The statistical tools used in this study are as follows:

1. Coefficient of correlation analysis (r): Correlation coefficient is used to define the relationship between deposit, NPL and LLP with loan and advance.

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

2. Coefficient of determination (r^2)

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

4. Multiple correlation (R) = $\sqrt{\frac{r_{xz}^2 + r_{yz}^2 - 2r_{xz}r_{xy}r_{yz}}{1 - r_{xy}^2}}$

CHAPTER-IV

DATA PRESENTATION AND ANALYSIS

Presentation and analysis of data is very important stage of research study. Its main purpose is to change the unprocessed data into understandable form. It is the process of organizing the data by tabulating and then placing that data in presentable form by using various table, figures and sources.

Lending management is one of the most important factors which help facilitate effective performance of bank management. Lending management is the formal expression of the commercial banks' goals and objectives stated in financial term for specific future period. Credit is the very basic indicator for determining profit. This chapter deals with the various aspects of lending management such as financial analysis, portfolio of lending, priority sector lending, non-performing loan, correlation and trend analysis.

4.1 Financial condition analysis of Nepal Bank Limited and Nebil Bank Limited

Financial analysis assists in identifying the major strengths and weaknesses of any institution. It indicates whether a company has enough cash to meet its obligations and ability to utilize properties and their available resources. Financial analysis can also be used to assess the company's liability and determine condition of the banks. Lending management is necessary to find out the comparative credit practices between the competitors.

Below are the comparative analysis of NBL and Nabil.

i) Priority sector lending (PSL) to total loan and advance ratio

Commercial banks invest some part of loan to the priority and deprived sector. For example, banks grant loan on agriculture, domestic industries, services, and power sector and machine and import raw materials is called priority sector lending. There are two categories of priority sector credit such as insured and uninsured. The table represents priority sector lending to total loan and advance ratio.

Table 4.1

Priority sector lending (PSL) to total loan and advance ratio

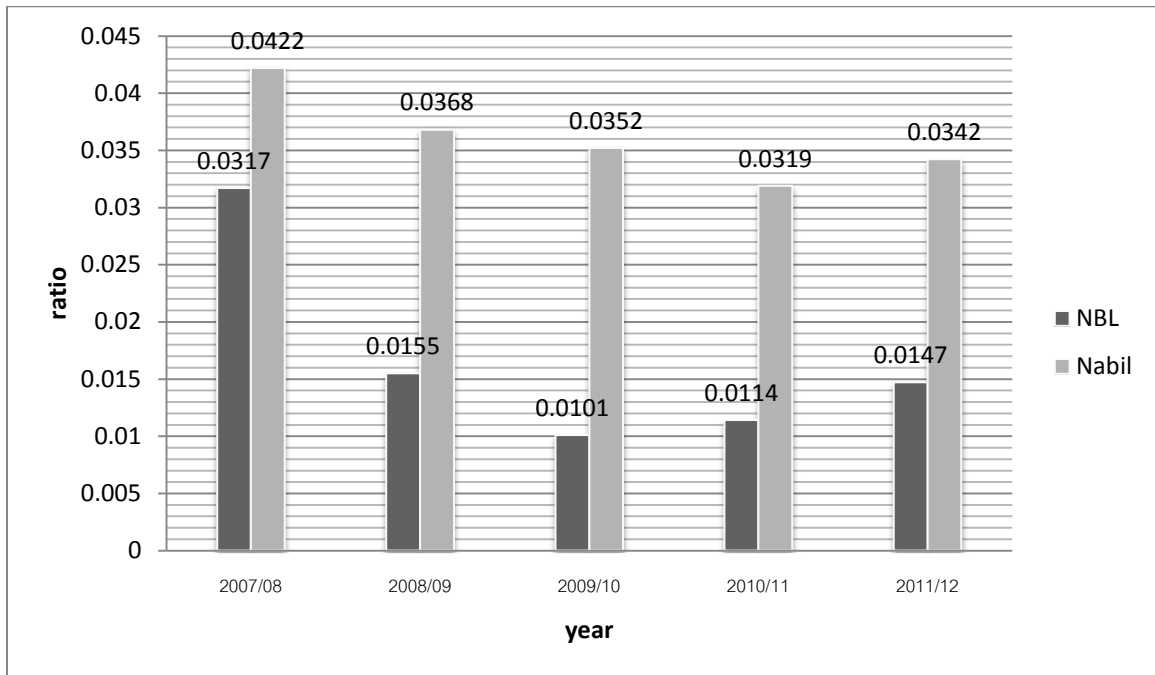
Bank	2007/08	2008/09	2009/10	2010/11	2011/12
NBL	0.0317	0.0155	0.0101	0.0114	0.0147
Nabil	0.0422	0.0368	0.0352	0.0319	0.0342

Source: Annual Report and concerning department of respective banks

(See Annex no.1.1)

Figure 4.1

Priority sector lending to total loan and advance ratio



Nabil has maintained higher PSL to total loan and advance ratio with compare to NBL. Therefore, Nabil is more conscious about priority sector investment for the economic development of the country. It seems both bank reduced their investment in priority sector.

ii) Total loan and advance to total deposit ratio

The main sources of bank's lending depend on its deposit. This ratio is calculated to find out how successfully the banks are utilizing their deposits on loan and advances for profit generating activities. Greater ratio indicates the better utilization of total deposits. The ratios are presented in the following table.

Table 4.2

Total loan and advances to total deposit ratio

Year	2007/08	2008/09	2009/10	2010/11	2011/12
NBL	0.3805	0.4328	0.5842	0.5705	0.5298
Nabil	0.6818	0.7496	0.7117	0.7829	0.7791

Source: Annual Report and concerning department of respective banks

(See Annex no. 1.2)

Figure 4.2

Total loan and advances to total deposit ratio

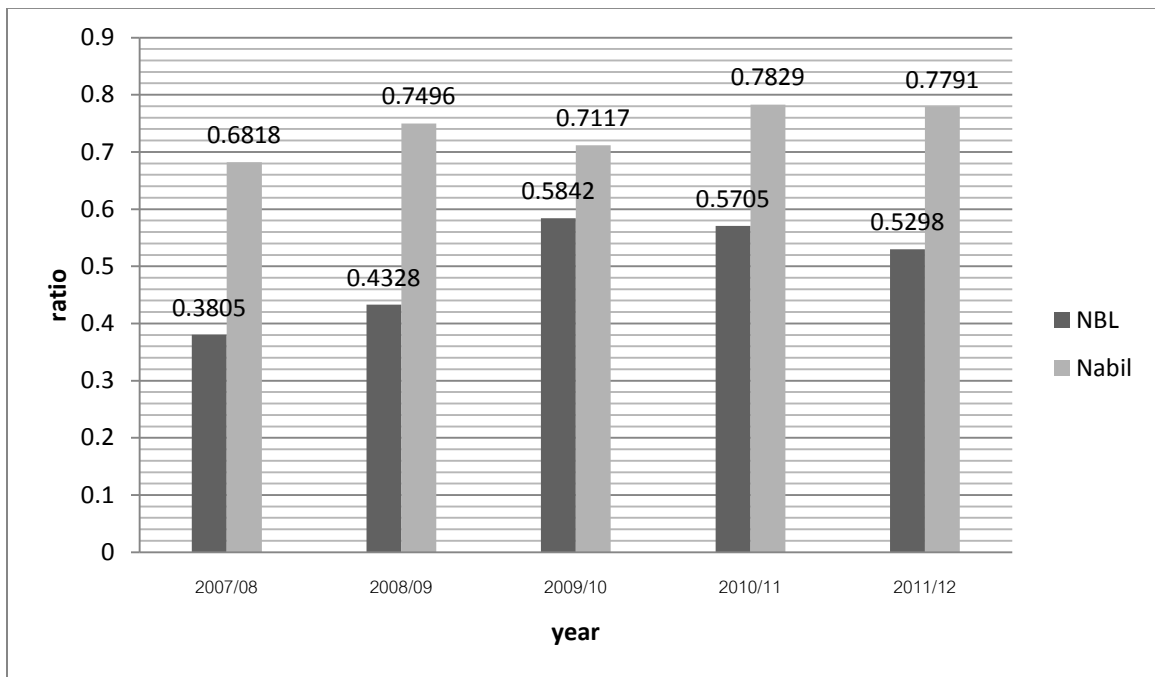


Table 4.2 shows the total deposit, total loan and lending deposit ratio of NBL and Nabil. The ratio of NBL is increasing up to the year 2009/10 but after this year it is decreasing slowly. Ratio of Nabil is in increasing trend up to the year 2008/09 and then is fluctuating over the period. From this ratio both bank ratios are in same trend. It seems that Nabil has utilized the most of its collected funds than NBL.

iii) Non-performing loans to total loan and advance ratio

Non-performing loan is the financial burden for the financial institution. In Nepal, NRB has classified non-performing loan as substandard, doubtful and loss. NRB has directed all commercial banks to create loan loss provision against the different types of non-performing loan in different ratio. The following table represents the non-performing loan to total loan ratio.

Table 4.3
Non-performing loan to total loan and advances ratio

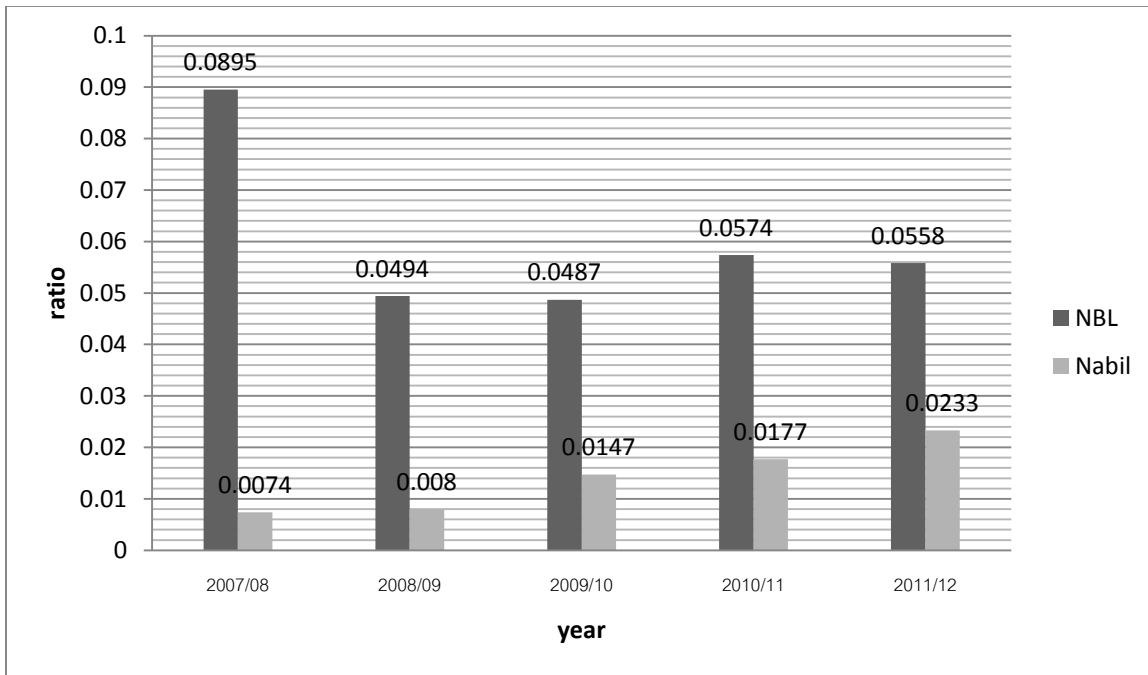
Year	2007/08	2008/09	2009/10	2010/11	2011/12
NBL	0.0895	0.0494	0.0487	0.0574	0.0558
Nabil	0.0074	0.008	0.0147	0.0177	0.0233

Source: Annual Report and concerning department of respective banks

(See Annex no. 1.3)

Figure 4.3

Non-performing loan to total loan and advances ratio



The table 4.3 indicates the ratio of nonperforming loan to total loan and advance of Nepal bank ltd and Nabil bank ltd. In comparison. NBL has more proportion of NPL than Nabil. Nonperforming loan of both banks is fluctuating all over the study period. NBL was able to decrease the ratio of NPL up to the year 2009/10 and then started to increase. However, NPL of Nabil bank is in increasing trend.

The result showed Nepal Bank is seriously affected by the nonperforming loan. The higher volume of nonperforming loan results increased in loan loss provision amount and then it eventually reduces the profit.

iv) Total profit to total loan and advance ratio

This ratio measures the percentage of total income against loan and advances. The high ratio indicates the more earnings. The following table represents ratio of total profit over total loan and advance.

Table 4.4

Total profit to loan and advance ratio

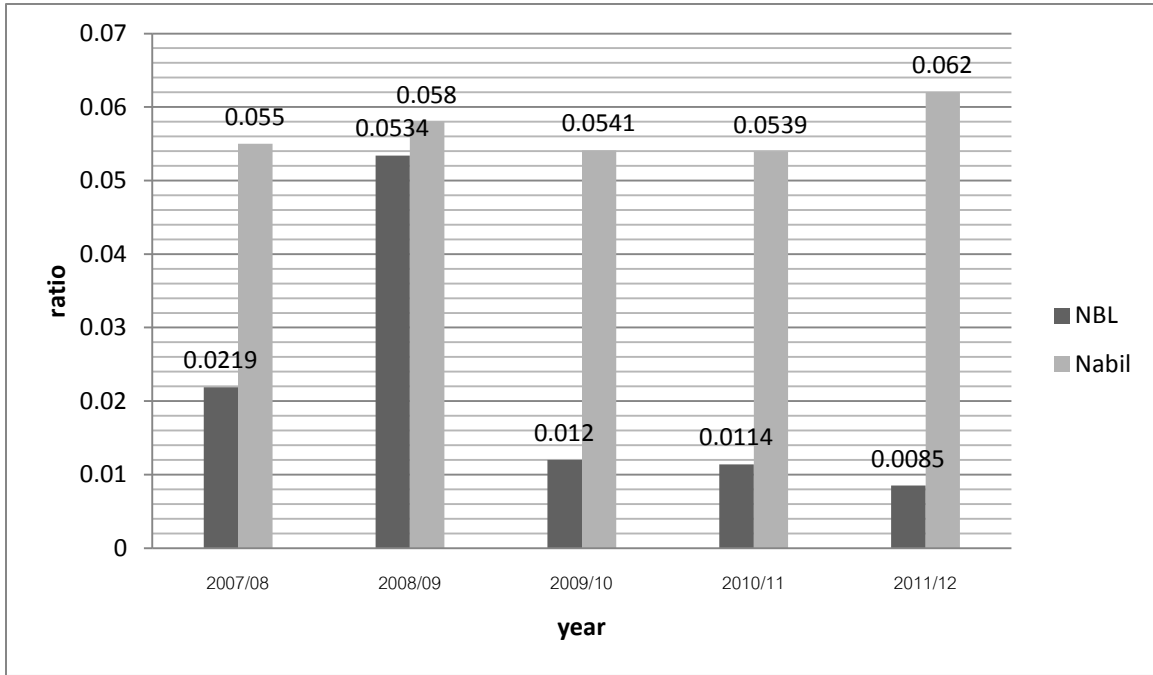
Bank	2007/08	2008/09	2009/10	2010/11	2011/12
NBL	0.0219	0.0534	0.0111	0.0120	0.0085
Nabil	0.0550	0.0580	0.0541	0.0539	0.0620

Source: Annual Report and concerning department of respective banks

(See Annex no.1.4)

Figure 4.4

Total profit to loan and advance ratio



In the year 2007/08 and 2008/09 NBL's profit tremendously increased and the year 2009/10, profit was diminished in high ratio. The main cause of high profit ratio is collecting of NPL and due interest after privatization of management. The reason for high diminishing in the year 2009/10 is termination of ICCMT and political situation. Nabil has decreasing trend of profit ratio till F/Y 2008/09 then after slowly increased. Profit trend of NBL is more fluctuating than the Nabil.

4.2 Priority sector lending (PSL) analysis

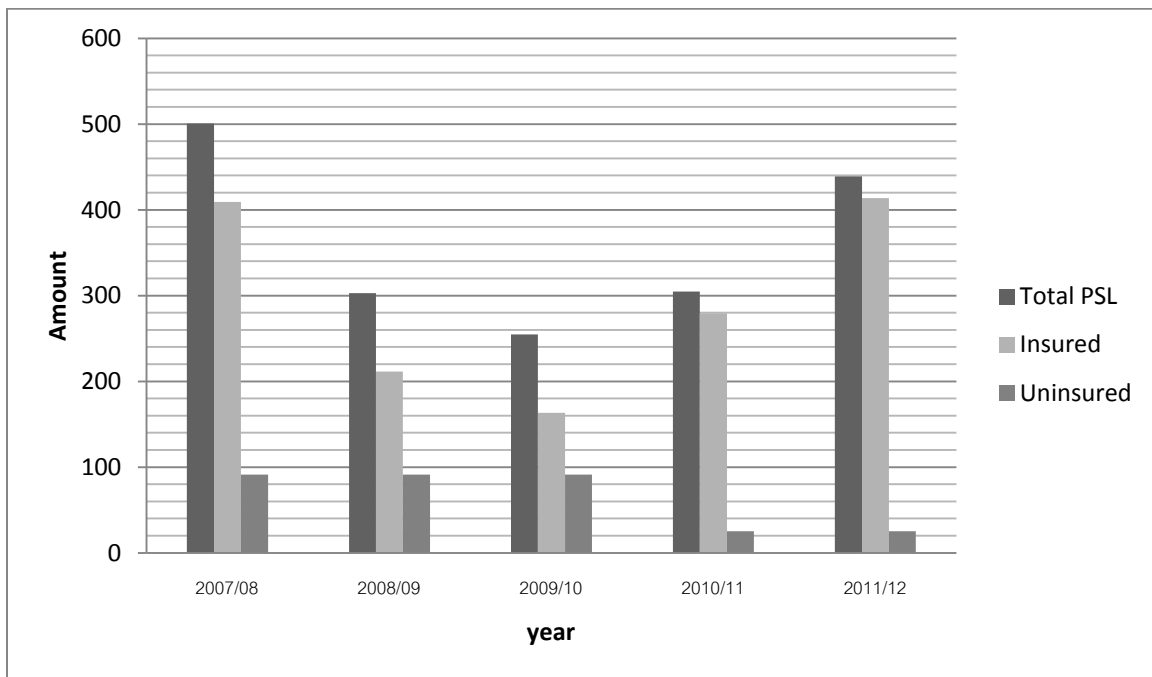
All commercial banks must invest at least 3% in priority sector out of total loan and advances. The small loan amount directly and indirectly invest in agriculture, domestic industries, services, power sector and machine and import raw materials is called priority sector lending. There are two categories of priority sector loan insured and uninsured. Uninsured PSL shall need full loan loss provision. However, in case of insured loans, the provisioning requirement will be 25% of the prescribed normal rates.

Table 4.5
Priority sector lending of NBL

Year	Rs in million		
	Total PSL	Insured	Uninsured
2007/08	500.54	409.23	91.31
2008/09	302.84	211.55	91.29
2009/10	254.57	163.4	91.16
2010/11	304.6	279.36	25.23
2011/12	439.04	413.8	25.23

Source: Annual Report and concerning department of respective banks

Figure 4.5
Priority sector lending of NBL



Above table and figure 4.5 shows the priority sector lending under insured and uninsured of NBL. Insured PSL is higher than the uninsured in the research period. Insured out of total PSL is continuously decreasing up to the year 2009/10 and then started to increase. Uninsured out of

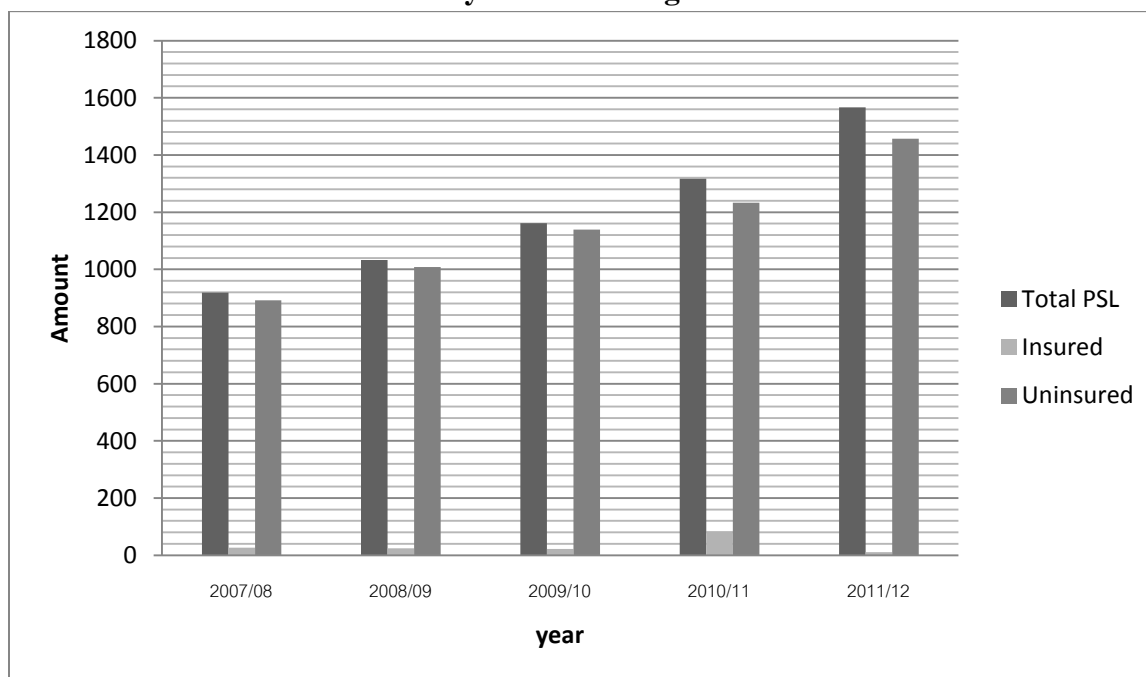
total PSL seems constant with 91 million up to the year 2009/10 and again remains constant with 25 million in the year 2010/11 and 2011/12.

Table 4.6
Priority sector lending of Nabil

Rs in Million			
Year	Total PSL	Insured	Uninsured
2007/08	918.64	26.91	891.73
2008/09	1,032.62	23.94	1,008.68
2009/10	1,161.55	22.42	1,139.13
2010/11	1,317.56	84.13	1,233.23
2011/12	1,566.54	11.02	1,456.52

Source: Annual Report and concerning department of respective banks

Figure 4.6
Priority sector lending of Nabil



Above table and figure shows the PSL under insured and uninsured of Nabil. Nabil has higher volume of uninsured PSL in each of the study period. Above figure shows that Nabil's insured PSL is lesser than uninsured.

It is apparent from table and figure 4.5 and 4.6 NBL invest high volume in insured priority sector and Nabil invest high volume in uninsured priority sector. Uninsured priority sector investment reduces profit because it requires full loan loss provisioning. So, NBL performed well while making investment in PSL.

4.3 Non-performing loan analysis of NBL and Nabil

Non-performing loan is one of the growing problems for the loan granting institution in Nepal. Due to unfair intention of borrower and the economic and political crisis in Nepal NPL has become major problem since last 10 years. In Nepal NRB has classified nonperforming loan as substandard, doubtful and loss.

Table 4.7
Non-performing loan of NBL

Rs in million				
Year	NPL	Substandard	Doubtful	Bad
2007/08	1,410.80	63.97	20.00	1,326.83
2008/09	966.72	64.76	17.88	884.07
2009/10	1,219.67	326.03	16.27	877.43
2010/11	1,534.85	78.18	100.62	1,172.25
2011/12	1,657.53	36.16	61.47	1,559.90

Source: Annual Report and concerning department of respective banks

Figure 4.7

Non-performing loan of NBL

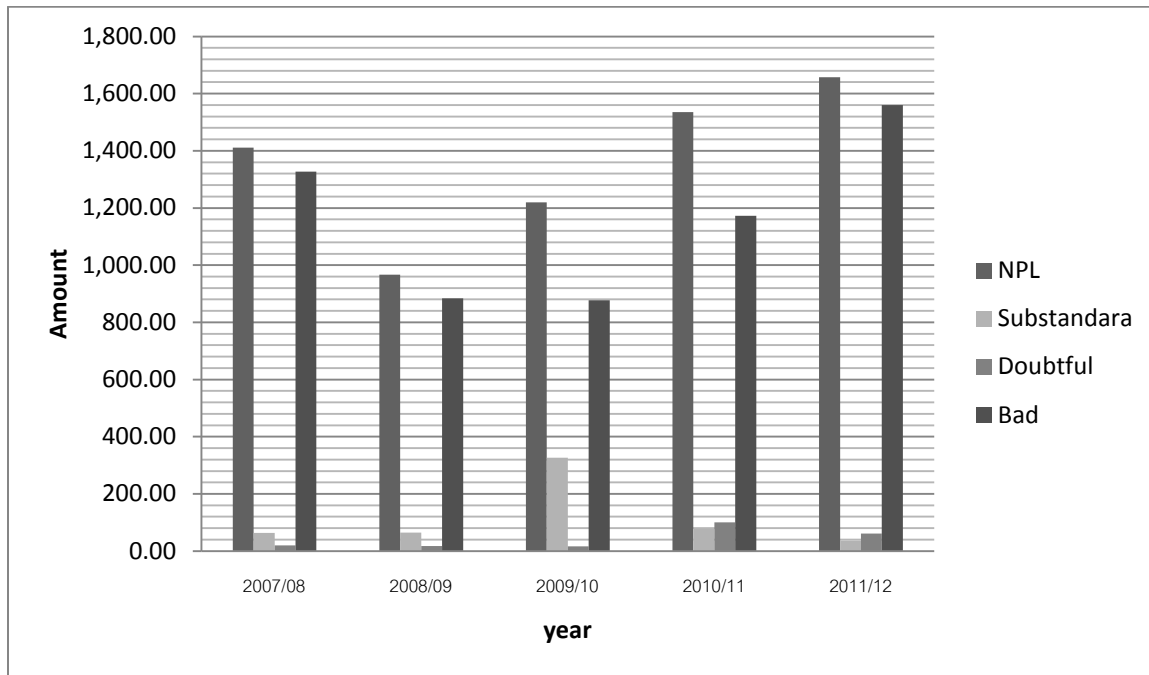


Table and figure 4.7 shows the total NPL, substandard, doubtful and bad loan. Out of total NPL, NBL has higher volume of loan loss provision. Higher loan loss provision reduced the total profit. Doubtful loan is less than substandard up to the year 2009/10 and then in increasing trend. Above figure shows that NPL of NBL is increasing year by year except the year 2008/09.

Table 4.8

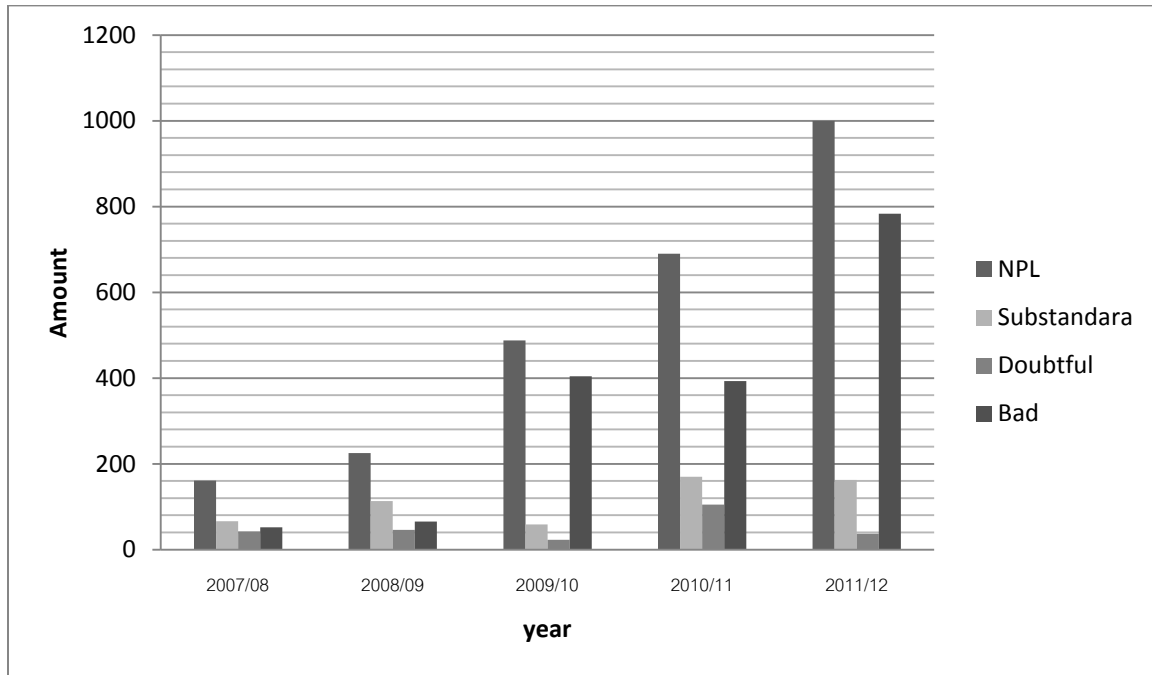
Non-performing loan of Nabil Bank Ltd.

Rs in million

Year	NPL	Substandard	Doubtful	Bad
2007/08	161.09	66.22	42.57	52.29
2008/09	224.81	113.30	45.76	65.75
2009/10	487.54	59.02	22.73	404.53
2010/11	689.85	170.21	104.65	392.84
2011/12	1000.0	162.44	36.78	783.63

Source: Annual Report and concerning department of respective banks

Figure 4.8
NPL of Nabil Bank Ltd.



Above table and figure shows the total non-performing loan and substandard, doubtful and bad loan. Nabil has tremendous increase in bad loan over the research period. But it has fluctuating trend of substandard loan.

From the table and figure analysis, NBL has higher volume of non-performing loan and it has higher bad loan than Nabil. Higher bad loan indicates that the poor performance and ineffective credit policy of the bank. Higher the bad loan higher volume of loan loss provision. In comparison Nabil perform better while making credit policy. From the analysis, it shows that Nabil has effective recovery system than the NBL. NBL is not taking proper legal action to recover its bad loan.

4.4 Correlation analysis

Correlation coefficient is used to define the relationship between two or more variable. In this study it is used to see the close consistency between two banks.

4.4.1 Correlation coefficient between deposit and loan and advances of NBL

The correlation and coefficient of partial determination of NBL is presented in the table 4.9

Coefficient of correlation determination between deposit and loan and advances of NBL

Table 4.9

Correlation coefficient between deposit and loan and advances of NBL

Correlation Coefficient	Coefficient of Determination	Probable error	6 P.E
0.0891	0.0079	0.2992	1.7952

(See Annex no.3.1)

The above table shows that the correlation coefficient between deposit and loan and advances is 0.0891. There is highly positive correlation between loan and advances and deposit collection. The coefficient of determination is 0.0079 which depicts 0.79% of loan. It shows that increase in deposit does lead to increase loan and advances. In accordance to increase in deposit NBL's loan and advances is in increasing trend.

Probable error (P.E.) is calculated to be 0.2992 and 6 P.E. is 1.7952 Probable error of the correlation coefficient denoted by P.E. is the measure of testing the reliability of the calculated value of 'r'. Here, 'r' is less than 6 P.E. then there is evidence of significant relationship between loan and deposit.

4.4.2 Correlation coefficient between deposit and loan and advances of Nabil

The correlation and coefficient of determination of Nabil is presented in the table 4.10

Table 4.10

Correlation coefficient between deposit and loan and advances of Nabil

Correlation Coefficient	Coefficient of determination	Probable error	6 P.E
0.9891	0.9783	0.0065	0.0392

(See Annex no.3.2)

The table 4.10 shows the correlation coefficient deposit and loan and advances are 0.9891. There is significant positive correlation between loan and advances and deposit collection. It means

there is significant relationship between deposit and loan granted. The coefficient of determination is 0.9783, which depicts that 97.83% of loan has been explained by the deposit collection. It shows that increase in deposit leads to increase in loan and advances. In accordance to increase in deposit Nabil's loan and advances is in increasing trend.

The correlation is statistically significant. Whether it is or not probable error has been calculated too. Probable error of the correlation coefficient denoted by P.E. is the measure of testing the reliability of the calculated value of 'r'. Here, 'r' is greater than 6 P.E. then there is evidence of significant correlation between loan and deposit. That reveals there is significant relationship between loan and advances and deposit. It indicates that credit manager of the bank considers deposit collection to determine the lending.

4.4.3 Correlation coefficient between non-performing loan and loan and advances of NBL

The table 4.11 shows the correlation coefficient between NPL and loan and advances

Table 4.11

Correlation coefficient between non-performing loan and loan and advances of NBL

Correlation Coefficient	Coefficient of determination	Probable error	6 P.E
0.2016	0.0406	0.2893	1.7358

(See Annex no.3.3)

Table 4.11 shows that correlation coefficient between the non-performing loan is 0.2016. There is insignificant positive correlation between NPL and loan. That indicates the both NPL and loan decreasing simultaneously. The coefficient of determination is 0.0406. Here "r" is less than 6 times value P.E., meaning that the correlation coefficient is insignificant.

4.4.4 Correlation coefficient between non-performing loan and loan and advance of Nabil

The correlation and coefficient of determination of NPL and loan of Nabil is presented in table 4.12

Table 4.12

Correlation coefficient between non-performing loan and loan and advances of Nabil

Correlation coefficient	Coefficient of determination	Probable error	6 P.E
0.3061	0.0937	0.2734	1.6403

(See Annex no.3.4)

The table 4.12 explains the relationship between non-performing loan and loan and advances of Nabil. The correlation coefficient of Nabil is highly positive. It shows that there is positive relation between loan and NPL. Coefficient of determination is 0.0937. Here correlation coefficient is less than 6 times value, it is statistically insignificant.

4.4.5 Correlation coefficient between loan loss provision (LLP) and loan and advances of NBL and Nabil

The table 4.13 indicates the correlation and coefficient of determination of LLP and loan of NBL and Nabil.

Table 4.13

Correlation coefficient between loan loss provision (LLP) and loan and advances of NBL and Nabil

Banks	Correlation Coefficient	Coefficient of determination	Probable error	6 P.E
NBL	0.2778	0.0772	0.2783	1.6698
Nabil	0.9451	0.8932	0.0322	0.1933

(See Annex no. 3.5 and 3.6)

Table 4.13 shows the correlation coefficient between loan loss provision and loan and advances of NBL and Nabil. Here correlation coefficient of NBL is 0.2778 i.e insignificant positive relations between loan loss provision and loan and advance. Correlation coefficient is lesser than 6 times value of P.E., the correlation coefficient is insignificant. The correlation coefficient of Nabil is 0.9451 and 6 times value of P.E. is 0.1933. There is highly positive relation between

loan loss provision and loan of Nabil. Here “r” is greater than 6 times value of P.E. the relationship is significant. It seems that Nabil has lower volume of LLP; this indicates it has lower volume of NPL.

4.4.6 Multiple correlation analysis between profit, loan and deposits of NBL and Nabil

Table 4.14

Multiple correlation of NBL	Multiple correlation of Nabil
0.5630	0.9695

(See Annex no.3.7 and 3.8)

For multiple correlation analysis we assume profit is dependent variable and loan and deposits are independent variables. From table 4.14 we show that the correlation of coefficient of NBL’s profit with loan and deposits is high positive profit. And the correlation coefficient of Nabil’s profit with loan and deposits is significantly positive. Both banks have positive correlation on profits with loan and deposits.

4.6 Major finding

The major findings of the study are as follows:

- In terms of the ratio of priority sector to loan and advances, Nabil has maintained higher PSL to total loan and advance ratio as compare NBL. Therefore, Nabil is more conscious about priority sector investment for the economic development of the country. It seems that both banks reduced their investment in priority sector in year by year. (table 4.1)
- The deposit collected of both banks during the five years period is increasing and fluctuating trend. The lending deposit ratio of NBL is in increasing trend in 2010 and started to decreased in 2012; ratio of Nabil is fluctuating since it is decreased in 2010 and started to increase but again it decreased in 2012. Its seems that Nabil has utilized the most of its collected funds in the year 2011. (table 4.2)

- Nabil seems to be efficient in mobilizing its total deposit in the form of loan and advances. Nabil seems to be the best performer in utilizing its collected fund in the form of loan and advances efficiently where as NBL has not more utilized its collected funds.
- The ratio of nonperforming loan to loan and advances of Nepal bank ltd is higher than that of Nabil bank ltd. NBL was able to decrease the ratio of NPL except the year 2011, In 2008/09 it has 0.0895. NPL out of the total loan but in 2010 it is only 0.0487. after this, it silently grows up to 0.0574 in 2011 but again decreased in 2012. After the privatization of management, NPL of Nepal bank has decreased. The result showed banking sector is seriously affected by the non-performing loan. (table 4.3)
- While analyzing of total profit to loan and advance ratio, NBL profit ratio is highly fluctuating all over the five years. Similarly, the Nabil's profit is nearly the constant in the research period. (table 4.4)
- While analyzing the priority sector lending, Insured PSL is high over the research period of NBL and Nabil has higher volume of uninsured PSL. NBL invest high volume in insured priority sector and Nabil invest high volume in uninsured priority sector. Uninsured priority sector investment reduces profit because it requires full loan loss provisioning. So, NBL performed well while making investment in PLS. (table 4.5 and 4.6)
- The analysis of non-performing loan shows that NBL has high volume of bad loan in every year of the study period and Nabil has higher bad loan in the year 2009/10 and 2010/12. NBL has higher volume of non-performing loan and it has higher bad loan than NABIL. Higher bad loan indicates that the poor performance and ineffective credit policy of the bank. Higher the bad and doubtful loan higher volume of loan loss provision. In comparison Nabil performs good while making credit policy. From the above analysis, it shows that Nabil has effective recovery system than the NBL.(table 4.7 and 4.8)

- The correlation coefficient of deposit and loan and advances of NBL and Nabil are 0.0891 and 0.9891 respectively. There is high positive correlation between loan and advances and deposit collection of NBL. Nabil has highly positive correlation between loan and advances and deposit collection. After the correlation analysis, both banks show that increase in deposit does lead to increase in loan and advances. (table 4.9 and 4.10)
- The correlation coefficient between the non-performing loan and loan advances of NBL and Nabil 0.2016 and 0.3061 respectively. The correlation coefficient of Nabil highly positive and NBL has low positive between NPL and loan. This mean both NPL and loan of advance of NBL is in decreasing trend. (table 4.11 and 4.12)
- Correlation between loan loss provision and loan and advances of NBL and Nabil are 0.2778 and 0.9451 respectively. There is highly positive relation between loan loss provision and loan of Nabil. This mean Nabil has lower volume of NPL and loan and advances. (table 4.13)
- Multiple correlation of coefficient of NBL profit with loan and deposits is high positive profit. And the correlation coefficient of Nabil profit with loan and deposits is significantly positive. Both banks have positive correlation of profits with loan and deposits. (table 4.14)

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Banks & financial institutions are the backbone of the economic development of a country. They have promoted industrialization & economic development by channeling the public deposit into industrial as well as agricultural sector. Commercial banks play an important role in the economic development of the country as they provide capital for the development of industry, trade as well as agriculture by disbursing the savings collected as deposits from the people. Commercial banks investment strongly support for the economic condition of the country. Loan granted to small sector and agricultural sector support to increment of per capital income of the rural people. Bank's loans help the growth of trade and commerce, energy sector as well as agriculture and empower the economic activities of the country.

The research is about the lending management of commercial banks with reference to NBL and Nabil. The first chapter of the study deals about basic assumption. Basically it highlighted the concept, problems, significance, objectives of the study. Second chapter helps the researcher to provide the knowledge about the conceptual review and national and international researches review. Third chapter deals with various methodology used for the study such as sources of data, population and sample of data, data collection technique and procedure and tools used.

Fourth chapter deals with data presentation and analysis. In this chapter financial condition, nonperforming loan, correlation and regression are analyzed. The analysis is conducted with the data collected from various sectors. The cursory looking for the two banks in terms of lending deposit ratio Nabil seems dominant. Out of total deposit collection Nabil has disbursed more than 77% as loan where as NBL has disbursed around 53% of its deposit collection as a loan in the year 2011/12. It seems that Nabil is the best performer while utilizing its collected fund. NBL is hugely suffering from the high NPL. This would be the one reason of least ratio of lending to deposit. In the first year of the study period, about 91% of loan out of total was nonperforming loan of NBL. But in second year NBL decreased its NPL continuously for two years. It is the positive signal of its lending policy. In comparison, Nabil has lower ratio of the

NPL. Political crisis of the nation, trade deficit and owner worker worse relationship for industry failure are the main causes for the increment of the NPL.

From analyzing PSL to lending ratio Nabil is more conscious about the development of small industrial sector because it has more lending ratio in priority sector. In the analysis of profitability ratio Nabil is the straight income trend generator than NBL.

The correlation coefficient of deposit and loan and advances of NBL is 0.0891. There is high positive correlation between loan and advances and deposit collection. The correlation coefficient of deposit and loan and advances of Nabil is 0.9891. The correlation coefficient between the non-performing loan and total loan is 0.2016 of NBL. The correlation coefficient of Nabil is highly positive 0.3061. Correlation between loan loss provision and loan and advances of NBL and Nabil are 0.2778 and 0.9451 respectively. From the correlation analysis Nabil manage its lending effectively and efficiently. Multiple correlation of coefficient of NBL and Nabil profit with loan and deposits is 0.5630 and 0.9695 respectively. Both banks have positive correlation of profits with loan and deposits.

An overall analysis shows Nabil bank manages its lending effectively and efficiently and it recovers its bad loan taking necessary action in time. NBL is not managing its lending properly and suffered from the high volume of nonperforming loan.

5.2 Conclusion

Banks & financial institutions in Nepal will have to benchmark themselves against some of the best ones in the world, for a strong and resilient banking and financial system. Therefore, banks need to go beyond peripheral issues and tackle significant issues like improvements in profitability, efficiency and technology, while achieving economics of scale through available cost effective solutions. These are some of the major issues that need to be addressed by banks in recent scenario, for their success and not just for survival, in the changing milieu.

Lending function is considered by the banking industry as the most important function for the utilization of funds. Since, banks earn their highest gross profits from loans; the administration of loan portfolios seriously affects the profitability of banks. Indeed, the large number of non-performing loan is the main cause of bank failure. Non-performing loan seems to be major problems for Nepalese commercial banks. Banks are learning to review their risk portfolios.

Lending is the major income generating sources for Nepalese commercial bank but there is risk inherent in bank's lending portfolio. In order to cover the risk inherent in the lending portfolio, banks have to make loan loss provision by categorizing the loans into different category as per the NRB directives.

It has been found that NBL has high portion of non-performing loan that needs higher provision results in lower profit. Out of total NPL, NBL has more volume of loss loan. Analysis of variance indicated that all indicators are not found significant difference at 0.1 level of significance of NBL. From these indicators it can be said that to preserve its position as a successful and dominant commercial bank NBL has to give attention on its lending and recovery device. It can be concluded that NBL is not able to manage lending efficiently. After conducting this study, Nabil performs better in managing lending.

5.3 Recommendation

The high portion of non-performing loan accompanied by provision of these banks has reduced the profitably and competency of the bank in this competitive environment. NPL of NBL is higher in the ratio and recommended to take remedial actions for recovering bad loans. To reduce the NPL they are also recommended to take following actions while granting the loan.

- The banks analyze the borrower's strategies and organizational architecture to be the most important determinants of firm profitability and the firm's ability to repay the banking loan. So, banks have constructed a comprehensive analytical framework that will improve the accuracy of analyzing a borrower's capacity and condition.
- The banks should provide more training program in business strategy and organizational management to the employees in the lending department. Training is the most important for the employees to make them efficient and professional in credit appraisal, monitoring and proper risk management.
- The efficient employees properly evaluate proposal of borrower and monitor his capacity and condition. So it is recommended for the banks to evaluate the job performance of employees of lending department.
- Banks should measure internal performance. The major benefit of using an internal measure to monitor the output quality of the employees in a lending department is a

reduction in the likelihood of employee moral hazard behaviors. To effectively use local decision rights to teams might effectively prevent individual fraud. The final decision for a loan should be made through consensus or some type of voting mechanism among any team members who have participated in the evaluation process for the loan. To reduce the individual fraud, team decision is more effective. So, it is recommended that team decision should be followed while the loan is disbursed.

Following the directives of NRB will also reduce credit risks. Hence both banks are recommended to adhere to the directives and they are also suggested to come up with a stronger internal audit department to ensure that the directives are properly implemented.

Portfolios are composition of investments in various sectors which in turn are composed of expected risk and return of their component investment. It helps an investor to make optimal investment decision minimizing overall risk and maximizing overall return. So, both banks are suggested to make optimal lending portfolio to reduce its bad loan risk, maximizing profit and development of economy of the nation.

NBL's contribution to loan and advance is relatively low. Entire economy is largely dependent upon the proper execution of lending function by commercial banks. Low level of lending means, low level of investment resulting to low level of productivity, which may ultimately affect negatively on the national economy. Loan and advance on one hand is the highest income generating assets and on the other hand it also helps to upgrade the economic position of the country. Hence, NBL should increase its lending in productive sector in the form of loan and advance. Since, NPL seems high in comparison of Nabil from the point of every indicators, it is noticed that NBL has poor performance than NABIL. So, it is recommended that the privatization along with government ownership will be the best for the economic development and the overall development of country.

Nabil is concentrating its operation in urban areas. Most of the people who live in rural areas are not benefited from it. Making investment in agricultural sector is needed for the economic growth of the nation. So, Nabil needs strengthen its branches in rural areas. Financial support from the bank helps to improve the financial condition of the rural people. To help poverty alleviation, banks are advised to expand their branches in rural areas.

The government has to encourage the upcoming new entrepreneurs, encourage the small-scale industries, give priority to export business and encourage foreign investors. The bank in turn should extend support from their side in every possible way.

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ANNEX

Financial ratios

Annex: 1.1

Priority sector lending (PSL) to total loan and advances ratio

Rs in million

Year	PSL		Total Loan		Ratio	
	NBL	Nabil	NBL	Nabil	NBL	Nabil
2007/08	500.54	918.64	15770.7	21759.46	0.0317	0.0422
2008/09	302.84	1032.62	19560.09	27999.01	0.0155	0.0368
2009/10	254.57	1161.55	25052.35	33030.10	0.0101	0.0352
2010/11	304.60	1241.64	26705.88	38905.49	0.0114	0.0319
2011/12	439.04	1467.55	29698.86	42867.83	0.0147	0.0342
Total	1801.59	5822	116787.89	164561.83		

Source: Annual Report and concerning department of respective banks

Annex: 1.2

Total loan and advances to total deposit ratio

Rs. in million

Year	Total loan		Total deposit		Ratio	
	NBL	Nabil	NBL	Nabil	NBL	Nabil
2007/08	15770.7	21759.46	41451.7	31915	0.3805	0.6818
2008/09	19560.10	27999.01	45194.23	37348.30	0.4328	0.7496
2009/10	25052.35	33030.10	42882.04	46410.70	0.5842	0.7116
2010/11	26705.88	38905.49	46808.43	49696.11	0.5705	0.7829
2011/12	29698.86	42867.77	56052.37	55023.70	0.5298	0.7791
Total	116787.89	164561.83	232388.77	220393.81		

Source: Annual Report and concerning department of respective banks

Annex: 1.3

Total nonperforming loan (NPL) to total loan and advances ratio

Rs in million

Year	Total NPL		Total Loan		Ratio	
	NBL	Nabil	NBL	Nabil	NBL	Nabil
2007/08	1410.8	161.09	15770.7	21759.46	0.0895	0.0074
2008/09	966.72	224.81	19560.09	27999.01	0.0494	0.0080
2009/10	1219.67	487.54	25052.35	33030.10	0.0487	0.0147
2010/11	1534.85	689.85	26705.88	38905.49	0.0574	0.0177
2011/12	1657.53	1000.00	29698.86	42867.77	0.0558	0.0233
Total	6789.57	2563.29	116787.89	164561.83		

Source: Annual Report and concerning department of respective banks

Annex: 1.4

Total profit to total loan and advances ratio

Rs in millions

Year	Total Profit/Loss		Total Loan		Ratio (R)	
	NBL	Nabil	NBL	Nabil	NBL	Nabil
2007/08	345.93	1197.89	15770.7	21759.46	0.0219	0.0550
2008/09	1044.57	1626.54	19560.09	27999.01	0.0534	0.0580
2009/10	279.54	1787.70	25052.35	33030.10	0.0111	0.0541
2010/11	321.01	2098.42	26705.88	38905.49	0.0120	0.0539
2011/12	173.83	2658.02	29698.86	42867.83	0.0058	0.0620
Total	2164.88	9368.57	116787.89	164561.83		

Source: Annual Report and concerning department of respective banks

Correlation

Correlation coefficient between deposit and loan and advances of Nepal Bank Ltd

Annex: 3.1

Rs in million

Year	Deposit (X)	Loan (Y)	X ²	Y ²	XY
2007/08	41,451.70	15,770.70	1718243433	248714978.5	653722325.2
2008/09	45,194.23	19,560.09	2042518425	382597120.8	884003206.3
2009/10	42,882.04	25,052.35	1838869355	627620240.5	1074295875
2010/11	46,808.43	26,705.88	2191029119	713204026.6	1250060315
2011/12	56,052.37	29,698.86	3141868183	882022285.3	1664691489
Total	232388.77	116787.89	10932528520	2854158652	5526773211

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

$$\frac{5 \times 5526773211 - 232388.77 \times 116787.89}{\sqrt{5 \times 10932528520 - (232388.77)^2} \sqrt{5 \times 2854158652 - (116787.89)^2}}$$

$$= 0.0891$$

$$\text{Coefficient of determination (r}^2\text{)} = (0.0891)^2 = 0.0079$$

$$\begin{aligned} \text{Probable Error (P.E)} &= 0.6745 \frac{1-r^2}{\sqrt{n}} \\ &= 0.2992 \end{aligned}$$

$$6 \text{ P.E.} = 6 \times 0.2992 = 1.7952$$

Annex: 3.2

Correlation coefficient between deposit and loan and advances of Nabil

Rs. In Million

Year	Deposit (X)	Loan (Y)	X²	Y²	XY
2007/08	31,915.00	21,759.46	1018567225	473474099.5	694453165.9
2008/09	37,348.30	27,999.01	1394892525	783944561	1045714305
2009/10	46,410.7	33,030.97	2153953074	1091044979	1532990439
2010/11	49,696.11	38,905.49	2469703349	1513637152	1933451511
2011/12	55,023.7	42,867.77	3027607562	1837645705	2358743316
Total	220383.77	164562.7	10064723735	5699746496	7565352737

Correlation (r) = 0.9891

Coefficient of determination (r²) = (0.9891)² = 0.9783

Probable Error (P.E) = 0 .0065

6 P.E. = 0.0392

Correlation coefficient between loan and advances and NPL of NBL

Annex: 3.3

Year	Loan (X)	NPL (Y)	X²	Y²	XY
2007/08	15,770.70	1,410.80	248714978.5	1990356.64	22249303.56
2008/09	19,560.09	966.72	382597120.8	934547.55	18909130.2
2009/10	25,052.35	1,219.67	627620240.5	1487594.91	30555599.72
2010/11	26,705.88	1,534.85	713204026.6	2355764.52	40989519.92
2011/12	29,698.86	1,657.53	882022285.3	274705.70	49226751.42
Total	116787.88	6789.56	2854158652	7042969.32	161930304.8

Correlation (r) = 0.2016

Coefficient of determination (r²) = (0.2016)² = 0.0406

Probable Error (P.E) = 0 .2893

6 P.E. = 1.7358

Annex: 3.4
Correlation between loan and advance and NPL of Nabil

Year	Loan (X)	NPL (Y)	X²	Y²	XY
2007/08	21,759.46	161.09	473474099.5	25949.99	3505231
2008/09	27,999.01	224.81	783944561	50539.54	6294457.44
2009/10	33,030.10	487.54	1090987506	237695.25	16103494.95
2010/11	38,905.49	689.65	1513637152	475893.02	26838952.28
2011/12	42,867.77	1000	183764705	1000000	42867770
Total	164561.83	2563.29	5699689024	1790077.8	95609906.08

Correlation (r) = 0.3061

Coefficient of determination (r²) = (0.3061)² = 0.0937

Probable Error (P.E) = 0 .2734

6 P.E. = 1.6403

Annex: 3.5
Correlation between LLP and loan and advances of NBL

Year	Loan (X)	LLP (Y)	X²	Y²	XY
2007/08	15,770.70	2,513.01	248714978.5	6315219.26	39,631,926.81
2008/09	19,560.09	1,945.19	382597120.8	3783764.13	37,896,677.88
2009/10	25,052.35	1,491.39	627620240.5	2224244.13	37362824.27
2010/11	26,705.88	2,034.60	713204026.6	4139597.16	54335783.45
2011/12	29,698.86	2,028.02	882022285.3	4112865.12	60229882.06
Total	116787.88	10012.21	2854158652	14891992.46	229608508.1

Correlation (r) = 0.2778

Coefficient of determination (r²) = (0.2778)² = 0.0772

Probable Error (P.E) = 0 .2783

6 P.E. = 1.6698

Annex: 3.6
Correlation between LLP and loan and advances of Nabil

Year	Loan (X)	LLP (Y)	X ²	Y ²	XY
2007/08	21,759.46	394.40	473474099.5	155551.36	8581931.02
2008/09	27,999.01	409.07	783944561	167338.26	11453555.02
2009/10	33,030.10	762.10	1090987506	580796.41	25172239.21
2010/11	38,905.49	871.39	1513637152	759320.53	33901854.93
2011/12	42,867.77	1,262.08	1837645705	1592845.93	54102555.16
Total	164561.83	3699.04	569968024	3255852.49	133212135.3

Correlation (r) = 0.9451

Coefficient of determination (r²) = (0.9451)² = 0.8932

Probable Error (P.E) = 0 .0322

6 P.E. = 0.1933

Annex: 3.7

Multiple correlation coefficients of Loan, Deposits and Profit of NBL

Where Profit is dependent variable and loan and deposits are independent variable

Year	Deposits (X)	Loan (Y)	Profit (Z)	d ₁ =X- \bar{X}	d ₂ =Y- \bar{Y}	d ₃ =Z- \bar{Z}
2007/08	41,451.70	15,770.70	345.93	-5026.05	-7586.88	-87.05
2008/09	45,194.23	19,560.09	1,044.57	-1283.52	-3797.49	611.59
2009/10	42,882.04	25,052.35	279.55	-3595.71	1694.77	-153.43
2010/11	46,808.43	26,705.88	321.02	330.68	3348.3	-111.96
2011/12	56,052.37	29,698.86	173.84	9574.62	6341.28	-259.14
Total	232388.77	116787.88	2164.91	0.000	0.000	0.000

d ₁₂	d ₁₃	d ₂₃	d ₁ d ₂	d ₁ d ₃	d ₂ d ₃
25261178.6	57560748.19	7577.70	38132038.22	437517.65	660437.91
1647423.59	14420930.3	374042.33	4874154.36	-784987.99	-2322506.91
12929130.4	2872245.35	23540.76	-6093901.44	551689.78	-260028.56
109349.26	11211112.89	12535.04	1107215.84	-37022.93	-374875.67
91673348.14	40211832.04	67153.54	60715346.31	-2481167.03	-1643279.30
131620430	126276868.7	48489.37	98734853.30	-2313970.52	-3940252.53

$$\text{Mean of Deposits } (\bar{X}) = \frac{\sum X}{n}$$

$$\text{Mean Of Loan } (\bar{Y}) = \frac{\sum Y}{n}$$

$$\text{Mean Of Profit } (\bar{Z}) = \frac{\sum Z}{n}$$

$$\text{Correlation } (r_{xy}) = \frac{n \sum d_1 d_2 - \sum d_1 \times \sum d_2}{\sqrt{n \sum d_1^2 - (\sum d_1)^2} \sqrt{n \sum d_2^2 - (\sum d_2)^2}}$$

$$\text{Correlation between Loan and Deposits } (r_{xy}) = 0.0766$$

$$\text{Correlation between Loan and Profit } (r_{xz}) = -0.5036$$

$$\text{Correlation between Deposits and Profit } (r_{yz}) = -0.2897$$

$$\text{Correlation of profit with Loan and Deposits } (R_{zxy}) = \sqrt{\frac{r_{xz}^2 + r_{yz}^2 - 2 r_{xz} r_{xy} r_{yz}}{1 - r_{xy}^2}}$$

$$= 0.5630$$

Annex: 3.8

Multiple correlation coefficients of Loan, Deposits and Profit of Nabil

Where Profit is dependent variable and loan and deposits are independent variable

Year	Deposits (X)	Loan (Y)	Profit (Z)	d ₁ =X- \bar{X}	d ₂ =Y- \bar{Y}	d ₃ =Z- \bar{Z}
2007/08	31915.00	21759.46	1197.89	-	-	-
				12163.75	11152.91	-675.82
2008/09	37,348.26	27,999.01	1,626.53	-6730.49	-4913.36	-247.18
2009/10	46,410.11	33,030.10	1,787.70	2331.95	117.73	-86.01
2010/11	49,696.11	38,905.49	2,098.42	5617.36	5993.12	224.71
2011/12	55,023.70	42,867.77	2,658.02	10944.95	9955.4	784.31
Total	220393.77	164561.83	9368.56	0.000	0.000	0.000

d_{12}	d_{13}	d_{23}	d_1d_2	d_1d_3	D_2d_3
147956814.1	124387401.5	456732.67	135661209	8220505.52	7537359.63
45299495.64	24141106.49	61097.95	33069320.35	1663642.51	1214484.32
5437990.80	13860.35	7397.72	274540.47	-200571.02	-10125.95
31554733.37	35917487.33	50494.58	33665512.56	1262276.96	1346714
119791930.5	99109989.16	615142.17	108961355.20	8584233.73	7808119.77
350040964.4	283569844.80	1190865.05	311631937.60	19530087.71	17896551.77

Correlation between Loan and Deposits $r_{xy}=0.9891$

Correlation between Loan and Profit $r_{xz}= 0.9565$

Correlation between Deposits and Profit $r_{yz}=0.9739$

Correlation of profit with Loan and Deposits $R_{zxy}=0.9695$

