

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

A Banker is one, who in the ordinary course of his business receives money which he pays by honoring cheque of persons from whom or whose account he receives it. Bank is the major part of financing. Bank involves in a process of collecting scattered money and to help its mobilization in different sectors according to the need of customers. Generally Banks are those financial institutions which offer the widest range of financial services especially credit, savings, payment service and perform the financial function in any business.

Normally, an institution established by law, which deals with money and credit, is called bank. On the other side an institution involved in monetary transactions is also called bank. The business providing financial services to consumers and financial institution is also known as bank. It also provides loan, accept deposits, exchange money, transfer the money and checks account, which can be used like, money to make payments and purchases and give services. Without the growth of financial field, there is no chance to develop business and without the growth of business, the country cannot develop at any costs. So banking sector plays vital role in the economic development of the country. Banks came into existence mainly with the objective of collecting the idle funds, mobilizing them into productive sector causing an overall economic development. The bankers have the responsibility of safeguarding the interest of the depositors, the shareholders and the society they are serving.

The functions of modern banking system are multifarious in nature and owing to the shift in emphasis of the functions of bank a different stage of development; different economists have defined banking in different ways.

—Bank is an institution whose debts are widely accepted in settlement of other people's debts to each other.¶ - **Prof. R. S. Sayers**

—Bank is an establishment which makes to individual such as advances of money as may be required and safely made to and to which individuals entrust money when not required by them for use.‖ - **Prof. Kinley**

—A banker is one who in the ordinary course of his business, receives money which he pays by honoring cheques of persons from whom account he receives.‖ - **Dr. H. L. Hart**

A bank is a dealer in capital or more properly a dealer in money; he is intermediate party between the borrower and the lender. - **Gilbert**

— Banks made a wide variety of loans to a wide variety of customers for many different purposes from purchasing automobiles and buying new furniture, taking dream vacations or pursuing college education, to constructing home and office buildings. Loans may be divided as: real estate loans, financial institutional loans, agricultural loans, commercial and industrial loans, loans to individual, miscellaneous loans, lease financing receivables etc. - **Peter S. Rose**

Banking has crossed the various phases to come to the modern form. Traditional forms of banking were traced during civilization of Greek, Rome, and Mesopotamia. Merchants, Goldsmith and Moneylender are said to be ancestors of modern banking. Merchants started the system of banking by trading in letters than the physical money because in remitting money from one place to another is very cumbersome. For this they issued different documents as the near substitute of the money, called draft in modern days. Goldsmith is used to keep valuable good in his custody and used to charge certain commission for keeping valuable goods in his custody and return back the valuable on demand. They also issued the receipt to the depositors which could to be transferred to any person that the depositors wished. This receipt gives birth to the bank note. Moneylender used to give loan to the needy public and they used to keep fraction of total deposit in the form of cash and rest was lent. This gives birth to the basic fractional reserve principle of modern banking. It is very difficult to say that exactly from where the word —Bank‖ is originated. The word bank was developed from Latin word —Bancus‖, Italian word —Bancal‖ or French word —Banque‖, all meaning a bench. Bank of Venice is the first bank set up in 1157 A.D. in Italy. Subsequently, Bank of Barcelona (1401) and

Bank of Genoa (1407) were established. Introduction of Banking Act-1833 in United Kingdom accelerates the growth of banks as well as it provides the freedom to open joint stock company banks. Like other abolish in 1933 B.S. during the period of Rana Prime Minister Ranodip Singh. It was the first step toward institutional development of banking in Nepal. It provides the loan to the public and its employees against securities, but it does not take any deposit. Nepal Bank Limited was the first bank in Nepal which was established in Kartik 30, 1994 B.S. Nepal Rastra Bank was set up in 14 Baishak 2013 B.S. under Nepal Rastra Bank Act 2012 B.S and it is the central bank of Nepal. Subsequently, government set up Rastriya Banijya Bank in 10th Magh, 2022 B.S. as fully owned commercial bank. Industrial Development Bank was established in 2013 B.S. In 2018 B.S. IDC was converted to Nepal Industrial Development Corporation. Agriculture Development was set up in 2024 B.S. After eighty's decade, government adopted liberal economic policy. Then various joint venture and other banks were launched in the country. Under which government initiated foreigners to make investment in Nepal. Today, bank has become an important part of the society and it is considered as the backbone of the country. Banking business is itself seems to be helpful on capital formation. We cannot imagine the development of the economic condition of the country without banking. Banking has been played a vital role for the overall development economic condition of the country. Modern Banks refers to commercial Banks. Commercial Banks are one of the vital aspects of this sector which, deals in the process of canalizing the available resources in the needed sector. It is the intermediary between the deficit and surplus of financial resources. Financial system contains two components via; depository and non-depository financial institutions and Commercial Banks come under financial institutions. These institutions act as an intermediary between the individuals who lend and who borrow. Commercial Banks are the major component in the financial system. They work as the intermediary between depositors and lenders and facilitate in overall development of the economy, with major thrust in industrial development. Commercial Banks came into existence mainly with the objectives of collecting the idle funds, mobilizing them into productive sector and causing and overall economic development. The banks have the responsibility of safeguarding the interest of

the depositors, the shareholders and the society they are serving. A sound banking system is important because of the key roles it plays in the economy; intermediation, maturity transformation, facilitating payments flows, credit allocation and maintaining financial discipline among borrowers. Banks are the gatherers of saving, allocates of resources providers of liquidity and payment services. In the year 1934 AD, the establishment of Nepal Bank Ltd. with the Imperial Bank of India came into existence under —Nepal Bank Act, 1937 as the first commercial bank of Nepal, inaugurated on November 1937. Rastriya Baniya Bank, the second commercial bank was established in the year 1965. RBB being the largest commercial bank plays a major role in the economy. On the long run Commercial Bank Act was felt, accordingly it was established in 1974 AD. According to section 2 (a) of Commercial Bank Act 1974, the commercial bank are the heart of economic system it exchanges money, accepts deposits, grants loan and operates commercial transaction. They make funds available through their lending and investing activities to the borrowers, individuals, business firms and government. The activities of the commercial banks and financial institution are governed by the bank and financial institution related act 2063.

1.2 Profile of Kumari Bank Limited:

Kumari Bank Limited, came into existence as the fifteenth commercial bank of Nepal by starting its banking operations from Chaitra 21, 2057 B.S (April 03, 2001) with an objective of providing competitive and modern banking services in the Nepalese financial market. The bank has paid up capital of Rs. 1,603,800,000.00 of which 70% is contributed from promoters and remaining from public.

Kumari Bank Ltd has been providing wide - range of modern banking services through 28 points of representations located in various urban and semi urban part of the country, 19 outside and 9 inside the valley. The bank is pioneer in providing some of the latest / lucrative banking services like E-Banking and SMS Banking services in Nepal. The bank always focus on building sound technology driven internal system to cater the changing needs of the customers that enhance high comfort and value. The adoption of modern

Globus Software, developed by Temenos NV, Switzerland and arrangement of centralized data base system enables customer to make highly secured transactions in any branch regardless of having account with particular branch. Similarly the bank has been providing 365 days banking facilities, extended banking hours till 7 PM in the evening, Utility Bill Payment Services, Inward and Outward Remittance services, Online remit Services and various other banking services.

Visa Electron Debit Card, which is accessible in entire VISA linked ATMs (including 30 own ATMs) and POS (Point of Sale) terminals both in Nepal and India, has also added convenience to the customers. The bank has been able to get recognition as an innovative and fast growing institution striving to enhance customer value and satisfaction by backing transparent business practice, professional management, corporate governance and total quality management as the organizational mission.

The key focus of the bank is always center on serving unfulfilled needs of all classes of customers located in various parts of the country by offering modern and competitive banking products and services in their door step. The bank always prioritizes the priorities of the valued customers. (Source: www.kumaribak.com)

1.3 Credit Policy

The Credit policy is the primary means by which senior management and the board guide lending activities. Although the policy primarily imposes standards, it also is a statement of the bank's basic credit philosophy. It provides a framework for achieving asset quality and earnings objectives, sets risk tolerance levels, and guides the bank's lending activities in a manner consistent with the bank's strategic direction. Credit policy sets standards for portfolio composition, individual credit decisions, fair lending, and compliance management. Credit policy should provide a realistic description of where the bank wants to position itself on the risk/reward spectrum. It needs to provide sufficient latitude for a bank to respond to good business opportunities while concurrently controlling credit risk. In normal circumstances, a bank should be able to achieve portfolio objectives and respond to changing market conditions without triggering a limit. Limits should not be so

conservative that insignificant changes breach them, nor should they be so liberal that they have no practical effect. For the policy to be an effective risk management tool, it must clearly establish the responsibilities of those involved in the lending process. Policies should be periodically reviewed and revised to accommodate changes in the bank's strategic direction, risk tolerance, or market conditions. Policy review should consider the organizational structure, breadth and complexity of lending activities, capabilities and skills of lending personnel, and strategic portfolio quality and earnings objectives. Changes in regulations and business conditions also need to be considered. In addition to providing an opportunity for change, the review should evaluate how well the policy has guided lending decisions. For example, a high volume of exceptions indicates that many loan decisions are being made outside the policy. This could mean that the bank is assuming more risk than is desirable or that the policy is too restrictive. If the bank's policy is too restrictive, easing it could increase business opportunities without unduly increasing risk. Conversely, the absence of exceptions may indicate that the policy is too vague, and a tightening of the policy could strengthen the controls on loan quality. All policy reviews should include the organizational unit responsible for assessing compliance with policy.

1.4 Statement of the problem

Today as we know that banking industry is one of the fast growing businesses in Nepal. After the liberalization policy was adopted by government, the banking sector has been growing dramatically. However due to political instability, government couldn't be able to pay sufficient attention in this sector. Regulation, supervision, and monitoring by government have been weekend in banking sector as like other sectors and also other types of non-business practices might have been occurred in this sector.

Due to such type of non-business practices will hamper on this sector. Ultimately it effects on its activities of this sector. Commercial banks in Nepal have been facing various challenges and problems specially in lending. The problem in lending is rising due to an economic condition of the country, variation in government policies and due to the default borrowers. However the country had stepped in liberal economy and world

trade organization, but still banking sectors are not able to grab the opportunities or advantages from them. In context of Nepal, many banks are facing huge loss by lending in a huge project or industry. Still there is the trend of giving consortium loan for a big project so to minimize risk. Bank confidently can give only housing loan, hire purchase loan or Overdraft of certain limit to an individual, but still it gets feared to invest in a big project solely. This study highly focused on credit management related to above problems.

1.5 Objectives of the study

The objectives of the study are to examine the credit policy. The objectives of the study are listed below:

- a. To analyzes the lending process of commercial banks
- b. To analyze the deposit utilization towards lending.
- c. To examine the impact of credit policy on liquidity.
- d. To examine the non-performing assets and loan loss provision.
- e. To give suggestion for appropriate credit management.

1.6 Need of the Study:

The basic need of the study is partial fulfillment of the requirement for the degree of Master of Business Studies. The study will be beneficial to the borrower or the customer of the bank; management team of bank; researchers, general interested public and other people and organization.

1.7 Focus of the Study:

As we know that credit itself is a quite difficult job and is highly riskier as well as sensitive too. The main focus of this study is to know about the effective credit policy and effort used to manage them as well as credit functioning and controlling in the commercial banks.

1.8 Significance of the study:

Credit is the major sources of income of every commercial bank. There is no doubt that the profit earned by any bank depends on the volume of the good lending. Study on commercial bank's lending practice carry a great significance to shareholders, professionals, bankers themselves and the student eager to know about lending practices and their management. This study is based on measuring the efficiency of Kumari Bank Ltd. in the practices of lending. This study no doubt will have importance to various groups of people but in particular it is directed to certain group of people which are:

- Importance to shareholders.
- Importance to management team of the bank.
- Importance to customers
- Importance to financial institution and stock exchange.
- Importance to government bodies and policy makers.
- Importance to outside parties: investors, customers, competitors, stockbrokers, dealers and market makers.

1.9 Limitations of the Study:

The benefits and limitations are the two faces of a same coin. Each and every research work has more or less limitations. To make this study precise, meaningful and valuable some limitations are made so that the objective of this study is achieved within limited time, resource and information.

Some major limitations of this study are listed below:

- a) The study mainly focuses on the factors relating to credit practices.
- b) The study is based on secondary data such as annual report, financial statement etc. Inaccessibility of information which could have helped to analyze other aspects of credit functioning as well.
- c) The study is based on Kumari Bank Limited.
- d) Thus, overall financial position of the bank cannot be judged by this report and this study is only helpful for credit operation.

1.10 Organization of the study:

The study has been organized into five chapters each devoted to study of Credit operation and its management. The chapters one to five consists of introduction, review of literature, research and methodology, presentation and analysis and summary, conclusion and recommendation. The rationale behind this kind of organization is to follow a simple research methodology approach. The contents of each of the chapter of this study are briefly mentioned here.

Chapter 1: Introduction

Chapter one contains the introduction to the study. It deals with introduction of the main topic of the study like background of the study, profile of Kumari Bank Ltd, and credit policy, statement of the problem, Research methodology, objective of the study, focus of the study, limitation of the study and organization of the study.

Chapter 2: Review of Literature

Chapter two includes a discussion on the conceptual frame work and review of the major empirical works. The conceptual consideration and review of related literature conducted in this chapter provide a framework, with the help of which the study has been accomplished.

Chapter 3: Research methodology

Chapter three describes the research methodology applied in the study. This chapter deals with research design, nature and sources of the data, method of data collection and analysis.

Chapter 4: Data Presentation and analysis

Chapter four consists of presentation and analysis of data, which describes with the empirical analysis of the study. In this chapter all collected relevant data are analyzed and interpreted and will explain the major findings of the study.

Chapter 5: Summary, Conclusion and recommendation

Chapter five consists of summary of the study, conclusion and recommendation and on the basis of the study. This chapter presents the major findings of the study. Recommendations are made to the commercial bank regarding to credit management.

CHAPTER TWO

REVIEW OF LITERATURE

Review of literature is a decisive part of all studies. It helps to find out already discovered things. Past studies are also the basis for the research so it cannot be ignored. They provide foundation to the present study. Literature Review is needed to develop a new research frame work which is based on past knowledge and experience. The primary purpose of literature review is to identify:

- What research has been done in the subject?
- What others have written about the topic?
- What theories have been advanced?
- The approach taken by other researchers:

Thus the purpose for reviewing literature is to learn, analyze, and find out what research studies have been done in the same subject, and finding what they had left in that subject. For the purpose researcher uses different books, reports, journals and research studies published by various institutions, unpublished dissertations submitted by master level students have been reviewed.

2.1. Conceptual Review - "Credit Management":

"Lending is the principal business activity for most commercial banks. The loan is typically the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. Whether due to lax credit standards, poor portfolio risk management, or weakness in the economy, loan diversified problems have historically been the major cause of bank losses and failures. Effective management of the loan and the credit function is fundamental to a bank's safety and soundness.

Credit management is the process by which risks that are inherent in the credit process are managed and controlled. Because review of the credit management process is so important, it is a primary supervisory activity. Assessing credit management involves evaluating the steps of bank management takes to identify and control risk throughout the credit process. The assessment focuses on what management does to identify issues before they become problems. This booklet, written for the benefit of both examiners and bankers, discusses the elements of an effective credit management process. It emphasizes that the identification and management of risk among groups of loans may be at least as important as the risk inherent in individual loans. For decades,

good loan managers have concentrated most of their effort on prudently approving loans and carefully monitoring loan performance. Although these activities continue to be mainstays of loan management, analysis of past credit problems, such as those associated with oil and gas lending, agricultural lending, and commercial real estate lending in the 1980s, has made it clear that credit managers should do more. Traditional practices rely too much on trailing indicators of credit quality such as delinquency, nonaccrual, and risk rating trends. Banks have found that these indicators do not provide sufficient lead time for corrective action when there is a systemic increase in risk.

Effective credit management begins with oversight of the risk in individual loans. Prudent risk selection is vital to maintaining favorable loan quality. Therefore, the historical emphasis on controlling the quality of individual loan approvals and managing the performance of loans continues to be essential. But better technology and information systems have opened the door to better management methods. A credit manager can now obtain early indications of increasing risk by taking a more comprehensive view of the loan scenario. To manage their risks, bankers must understand not only the risk posed by each credit but also how the risks of individual loans and portfolios on loan are interrelated. These interrelationships can multiply risk many times beyond what it would be if the risks were not related. Until recently, few banks used modern portfolio management concepts to control credit risk. Now, many banks view the loan portfolio in its segments and as a whole and consider the relationships among portfolio segments as well as among loans. These practices provide management with a more complete picture of the bank's credit risk profile and with more tools to analyze and control the risk. Credit management is like a portfolio management since banks are lending in various aspects. Their purpose may be the same that is to make huge profit but their way in lending in various aspects has made a portfolio. Thus credit management can be also called a loan portfolio management" (*Comptroller of Currency Administrator of National Bank, 1998:1-2*)

2.1.1. Various types of Credit:

Loan portfolio management deals with managing all types of credit. There are many types of credit that commercial banks provide. This lending can be categorized as:

Loan and advances based on their nature: Loan and advances based on their nature can be categorized as

- **Secured loan Advances**
- **Unsecured loan and Advances**

A secured loan and advances may be called to those loan and advances which are granted upon taking the higher value of security as compare to the loan granted amount. In other words, if the Distress value of security is higher than the loan granted amount, then this loan is called secured loan and advances. The distress value of the security that the bank put in must be more than 167% of the loan limit. An unsecured loan and advances is the one which is granted by the bank without any collateral, or granted only upon the personal guarantee of any customers or upon corporate guarantee. Again if the bank grant loan and advances by putting in with lower value of the security as compare to loan amount, then this types of loan is also referred as unsecured loan and advances. Loan and advances based on the involvement of the fund. Based on the involvement of the fund, loan and advances can be classified as

- Fund based loan and advances

- Non Funded Based loan and advances.

Fund Based loan and Advances:

Fund based loan and advances are the direct lending of funds to the customers. In Funded based loan and advances, loan is granted directly to customer either by cash or by manager's cheque. It is called funded since it involves to cash. Funded based loan and advances are as follows:

a. Overdraft:

Overdraft is a short term credit given for meeting the working capital of the borrower. Overdraft is given only for one year. If the borrower is genuine and if their interests are not accrued or if it is really doing a good transaction, then upon its request, it can be renewed for further one year period. Over draft is given only to meet the working capital requirement in any business and the business unit should possess a current account for the purpose. In this facility, certain limit is given to a customer or borrower and interest is charged only on used amount from the limit. Amount can be overdrawn up to the granted limit.

b. Cash Credit:

Cash credit is a drawing account against credit granted by the bank. It is also operated in the same way as in overdraft. A borrower is required to open a cash credit account with the bank and bank issued separate cheque for cash credit account. Bank permits customers to borrow fund up to fixed limit. Cash credit is allowed against the security of tangible assets. They may be hypothecation of stock, plant and machinery along with its insurance policy favoring to bank, and other current assets.

c. Demand Loan:

Demand loan is also a short term loan granted to meet borrower's fixed working capital requirement. Installment is required to pay on periodically installment or on lump-sum basis. For this a customer is required to open separate Demand loan account. If demand loan once is repaid in full or in part, then it can't be withdrawn again by the customer.

d. Bridge loan:

Bridge loan is another short term loan granted to meet immediate requirement of fund specially for any project. It is basically a loan meant for bridging the fund. Like in Demand loan, if once bridge gap loan is credited, the borrower is not allowed to withdraw the loan.

e. Pledge loan:

Pledge loan is the bailment of the goods as security for payment of a debt or performance of a promise. Bailment is the delivery of the goods by one person to another for some purpose upon a contract. After the purpose is completed those goods are to be return to the delivering person. A pledge may be in form of goods, stocks or any movable property.

f. Hire Purchase Loan:

Hire purchase loan means financing on vehicles to the customers by the bank. It is a credit facility introduced to finance the customer durables like motor vehicles or contractor equipments. In this facility customers or borrowers are required to pay some portion of amount and the remaining shall be financed by the bank. Generally upon receiving the pro-forma invoice and marking to the cost as per pro forma invoice, bank shall finance up to some cost considering the borrower's repayment capacity and remaining should be borne by a customer. The financed vehicle will be in the name of bank. The financed vehicle should be insured by the customer favoring to the bank.

g. Housing Loan:

Housing loan is granted for the construction of house, purchase of house, purchase of land, extension of the house, repair and maintenance of the house for the borrower. A certain cost required for above purposes is sketched by an engineers or an engineering consultancy. Making base to that sketched figure, bank will finance portion of amount seeing the borrower's repayment capacity. Borrowers should insure the proposed house favoring to the bank.

h. Personal Loan:

Personal loan is granted to the individuals or borrower to meet their cash requirement for social function and rituals and personal cash management. This loan is borrowed to those borrowers who has good income sources and can repay it timely.

i. Term loan:

Term loan is given for financing capital/fixed expenses on the project, on going and up coming projects. Term loan is provided to purchase or import of plant, machinery, furniture, equipments etc. Term loan are relatively granted for relatively longer period and are repayable on installment basis.

j. Consortium Loan:

Consortium loan is participation finance. If one bank will not be able to grant higher amount of loan either due to Single Obligor Limit or due to cash crisis, then participating with other banks, or financing mutually with other bank refer to consortium loan. More than one bank mutually agrees to grant loan to a borrower involves consortium credit or consortium financing. This type of loan is given to airlines, big industries or hydro project. Under the consortium agreement, the participating banks acquire common interest and share the advances and securities on predetermined proportion.

k. Loan against Fixed Deposit Receipt:

If any customer has fixed deposit in bank and that is not matured, then that customer can enjoy loan against Fixed Deposit Receipt when he needed fund urgently. Bank is bound to advance credit against same receipts.

l. Loan against share:

Some bank may provide loan against lien of share certificate. The share should be in listing in Stock Exchange.

m. Loan against gold:

Some bank grant loan against gold by taking gold as a security. If the borrower is seeking lesser amount of fund, then some bank grant them loan upon submission of their gold as collateral.

Non Funded Based loan and advances:

There are some such advances which do not involve the fund in their grant. These kinds of advances are called non funded advances. In such advances bank only make commitment that in case of borrowers default, the bank will make well the loss as per the terms made in contract. If the borrower defaults on this advanced, it will convert to fund based advances.

Non funded loan and advances are as follows:

a. Bank Guarantee:

Bank gives guarantee to third part or beneficiary on behalf of their customers. Bank guarantee is a written letter of undertaking issued by a bank, committing to make the losses good to the third party in case of non compliance of the terms of the contract. In bank guarantee, three parties are involved.

- The principal debtors on behalf of whom the guarantee is issued
- Beneficiary on favor of who guarantee is issued - Guarantor who issue bank guarantee.

Bank Guarantee is of following types:

i) Bid Bond Guarantee:

Bid bond guarantee is issued by a bank favoring the beneficiary on behalf of it's customer for bidding the tender.

ii) Performance Bond Guarantee:

Performance Bond Guarantee is issued by a bank favoring the beneficiary on behalf of it's customer to whom the tender is awarded.

iii) Advance Payment Guarantee:

Advance Payment Guarantee is issued by a bank to beneficiary on behalf of it's customer for receiving the mobilization fund from beneficiary as per the contract.

iv) Maintenance Guarantee:

Maintenance Guarantee assures the beneficiary of financial compensation to the extent of maintenance guarantee in case of non maintenance by the debtor.

v) Retention Guarantee:

Retention Guarantee assures the creditors of financial compensation to the extent of retained money if some defects are noticed in job accomplished by the debtors till a specific period.

vi) Custom Guarantee:

Custom Guarantee assures the customs financial compensation to the amount of guarantee if goods are not taken out of the country by a specified time.

vii) Judicial Guarantee:

Through judicial guarantee, the bank assures the court that the money will be available on the first demand of the court if the decision goes against the accused on whose behalf the guarantee is issued.

b. Letter of Credit:

Letter of Credit; also know as Documentary Credit is a credit letter issued by a bank. It is a bank's conditional undertaking of payment. It is an instrument for making payment against

documents. It is a document which ensures payment importer or buyer and exporter or seller. It is an undertaking by the importer's bank that if the exporter exports the goods and produces document as stipulated in Documentary credit, the bank would make payment to the exporter.

2.1.2 Importance of Credit Management:

"Any analysis of a bank's ability to reduce or cut existing commitments must consider more than its legal obligation to lend. It should also consider reputation risk and the potential for lender-liability actions. The withdrawal or reduction of commitments can have significant ramifications for a bank. From a strategic perspective, any tightening of commitments may adversely affect a bank's ability to maintain or grow a customer base if it is perceived as an unreliable lender in tight credit markets. A bank's reputation may also suffer if it is perceived as unwilling to support community credit needs. Given these additional risks, bank management must carefully assess the implications of curtailing lending lines.

a) Transaction Risk:

In the lending area, transaction risk is present primarily in the loan disbursement and credit administration processes. The level of transaction risk depends on the adequacy of information systems and controls, the quality of operating procedures, and the capability and integrity of employees. Significant losses in loan management have resulted from inadequate information systems, procedures, and controls. For example, banks have incurred increased credit risk when information systems failed to provide adequate information to identify concentrations, expired facilities, or stale financial statements. At times, banks have incurred losses because they failed to perfect or renew collateral liens; to obtain proper signatures on loan documents; or to disburse loan proceeds as required by the loan documents.

b) Compliance Risk:

Lending activities encompass a broad range of compliance responsibilities and risks. By law, a bank must observe limits on its loans to a single borrower, to insiders, and to affiliates; limits on interest rates; and the array of consumer protection. Lending activities may expose it to liability for the cleanup of environmental hazards. A bank may also become the subject of borrower-initiated —lender liability lawsuits for damages attributed to its lending or collection practices. Supervisory activities should include the review of the bank's internal compliance process to ensure that examiners identify and investigate compliance issues.

c) Strategic Risk:

A primary objective of loan management is to control the strategic risk associated with a bank's lending activities. Inappropriate strategic or tactical decisions about underwriting standards, loan portfolio growth, new loan products, or geographic and demographic markets can compromise a bank's future. Examiners should be particularly attentive to new business and product ventures. These ventures require significant planning and careful oversight to ensure the risks are appropriately identified and managed. For example, many banks are extending their consumer loan activities to —sub prime borrowers. The product may be familiar, but the borrowers' behavior may differ considerably from the banks' typical customer both bankers and examiners need to decide whether the opportunities outweigh the strategic risks. If a bank is considering growing a loan product or business in a market saturated with that product or business, it should make sure that it is not overlooking other lending opportunities with more promise. During their evaluation of the loan management process, examiners should ensure that bankers are realistically assessing strategic risk.

d) Reputation Risk:

When a bank experiences credit problems, its reputation with investors, the community, and even individual customers usually suffers. Inefficient loan delivery systems, failure to adequately meet the credit needs of the community, and lender-liability lawsuits are also examples of how a bank's reputation can be tarnished because of problems within its lending division. Reputation risk can damage a bank's business in many ways. The value of the bank's stock falls, customers and community support is lost, and business opportunities evaporate. To protect their reputations, banks often feel that they must do more than is legally required.

e) Credit Culture and Risk Profile:

Understanding the credit culture and the risk profile of the bank is central to successful credit management. Because of the significance of a bank's lending activities, the influence of the credit culture frequently extends to other bank activities. Staff members throughout the bank should understand the bank's credit culture and risk profile. The credit culture exerts a strong influence on a bank's lending and credit risk management. Values and behaviors that are rewarded become the standards and will take precedence over written policies and procedures.

A bank's risk profile is more measurable than its credit culture. A risk profile describes the various levels and types of risk in the portfolio. The profile evolves from the credit culture, strategic planning, and the day-to-day activities of making and collecting loans. Developing a risk profile is no simple matter. The risk profile will change over time as portfolio composition and internal and external conditions change. Credit culture varies from bank to bank. Some banks approach credit very conservatively, lending only to financially strong, well-established borrowers. Growth oriented banks may approach lending more aggressively, lending to borrowers who pose a higher repayment risk. These cultural differences are grounded in a bank's objectives for asset quality, growth, and earnings. Emphasizing one of these objectives over another does not, in and of itself, preclude achieving satisfactory performance in all three. However, the emphasis will influence how lending activities are conducted and may prompt changes in credit policies and risk control systems. They have cultural values, credit policies, and processes that reinforce each other and that are clearly communicated, well understood, and carefully followed. The culture, risk profile, and credit practices of a bank should be linked. If the credit practices and risk-taking activities of a bank are inconsistent with the desired culture and policies, management should find out why and initiate change to bring them back in balance" (*Comptroller of Currency Administrator of National Bank, 1998:9-11*)

2.1.3 Objectives of Credit Management:

Loan portfolio objectives establish specific, measurable goals for the portfolio. They are an outgrowth of the credit culture and risk profile. The board of directors must ensure that loans are made with the following three basic objectives in mind:

- To grant loans on a sound and collectible basis.
- To invest the bank's funds profitably for the benefit of shareholders and the protection of depositors.
- To serve the legitimate credit needs of their communities.

For most banks, meeting these three objectives will require that senior management and the board of directors develop medium- and long-term strategic plans and objectives for the loan portfolio. These strategies should be consistent with the strategic direction and risk tolerance of the institution. They should be developed with a clear understanding of their risk/reward consequences. They also should be reviewed periodically and modified as appropriate. In drawing up strategic objectives, management and the board should consider establishing:

- What proportion of the balance sheet the amount of credit should comprises?
- Goals for loan quality.
- Goals for portfolio diversification.
- How much the loan amount should contribute to the bank's financial objectives?

Business plans or budgets detailing the financial goals for the loan amount are the next step in the strategic planning and goal setting process. Business plans should set realistic financial goals that are consistent with strategic goals and risk tolerance levels. Bankers and examiners should be alert to aggressive financial goals because they generally require high growth and increased risk-taking. Banks typically assess their financial performance using measurements such as earnings, return on equity, and return on assets. Financial performance measures should also consider the relationship between risk and return. In addition to establishing strategic objectives for the credit management, senior management and the board are responsible for setting risk limits on the bank's lending activities. Risk limits should take into consideration the bank's historical loss experience, its ability to absorb future losses, and the bank's desired level of return. Limits should be based on the interrelationship of risk and reward and on the risk to capital, earnings, or both. The bank should have a system in place to ensure that exposures approaching risk limits are brought to the attention of senior management and the board. Both on- and off balance- sheet exposure should be included in the risk limit measurement system. Exceeding or modifying established risk limits should require their explicit approval. In addition, any proposed changes to the bank's underwriting standards should be evaluated to determine how the change will affect overall credit management"

2.1.4 Principle of Good Lending:

All loan and Advances extended to the borrower shall be returned back after maturity as per the terms and conditions stipulated at the time of approval. All lending officer must study the ability of the borrower to repay the loan. Borrowers may not be able to repay the loan or they are not willing to repay the loan. So, for this purposes, bank should undertake the borrower's security to safeguard the loan. Banks extends credit facilities based under certain principles such principles are regarded as credit policy. The major principles of good lending are:

Safety:

"Safety First" is most important principle of good lending. When a bank lends, then the bank should confirm on their lending whether they are safe or not. The bank shall ensure that the advances when granted to the right customers and is utilized in such a way that the advances are safe for all time.

Liquidity:

It is not enough that the loan will come back; it is also important that the advances granted to the customer must come on demand or in accordance with the agreed terms of repayment. The source of repayment must be definite.

Profitability:

The main goal of bank is to earn profit. For this, the bank is required to increase its investment without letting the fund remain idle. The bank should try to invest only on those projects from which it can ensure goods and timely interest income. But bank never should forget its own liquidity condition while lending huge number of loans. Secured and long term loan can give good income.

Security:

No matter how attractive the interest or rate is but there is always possibility of loan being default if it is unsecured. Security means adequate collateral having good value which can easily sold if required. Besides security, the bank should also integrate upon the financial position and status of borrower while lending loan.

Diversification:

The bank should not concentrate on only one sector while extending the loan. It should try to diversify its investment. It should mobilize its resources on various collateral, various assets, different business and different individuals and organization. This will help to reduce the banks risk in greater extent.

National Interest:

Even when an advance satisfies, all the above principles it might not be suitable if it does not take into account the national interest. Banks are required to grant advances on those sectors, which are priorities by the government on time to time in meeting the national requirements. The bank should invest on such sectors as per the government or Nepal Rastra Bank

2.1.5 General Procedure in granting loan and advances:

Most of bank loan to individuals arises from a direct request from the customer. The customer approach to a member of bank's staff and asks to fill a loan application. On granting loan and advances, the following general procedures are required to follow:

a) Interviews with customer:

Once a customer decides to request a loan, an interview with a loan officer usually follow right way, giving the customer an opportunity to explain their credit needs. After identifying their credit needs, a loan officer must conduct an in-depth interview of the applicant, focusing on 5'Cs.

- Character
- Capacity
- Capital
- Collateral
- Condition

If the loan officer satisfied on above focal points, the officer shall ask the customer to fill up the standard loan application form, designed by the bank and provide the document as mentioned in the application itself.

b) Documentation:

If the customer is a business firm or is engaged in a business activity, then loan officer must ask for the Business Registration form, PAN number, shareholder's details and their citizenship, audited financial report, and the property valuation report of the collateral. If the customer is an individual, then loan officer must ask for their citizenship, verified income source, KYC firm, Property valuation report of the collateral being put in etc. The customer must submit several crucial documents in demand of bank when needed. If all documents seem viable, then the loan can be further forwarded.

c) Site Visit:

For any kind of loan that has been applied in the bank, then the officer must visit the customer's residential location. This is done to identify whether the customer is either rented or he is residing in his own house. This will more clarify on his living address whether he is current resident or permanent resident of that locality. If a business or mortgage loan is applied for an officer of a bank, he usually makes a site visit to access the customer's location and the condition

of the property and his business. After site visiting, the officer should make collateral inspection report and if there is business involved, again business inspection report must be made.

d) CIB Report:

For every new and old customer, bank will be unable to identify directly their relation with other financial institution. CIB report is the commonly used approach to identify the customer whether they are enjoying credit facility with other financial institution or not or either they are in the name of black listed. An officer must send CIB report to concerned institution mentioning the client's family details writing his/her father and grandfather name and their address. If the CIB report is positive, then the loan qualifies for further processing.

e) Credit Appraisal Memo:

After all above process is completed, then loan officer must write a credit appraisal memorandum to sanction loan amount to the borrower. In the memo, applicant's proper information including his background must be written. In the memo, the client present request, collateral that the client is offering, CIB information, and recommendation with terms and conditions must be mentioned. This memo should be forwarded for approval.

LOAN APPROVAL PROCESS:

The loan approval process is the first step towards good portfolio quality. When individual credits are underwritten with sound credit principles; the credit quality of the portfolio is much more likely to be sound. Although good loans sometimes go bad, a loan that starts out bad is likely to stay that way. The foremost means to control loan quality is a solid loan approval process.

After a loan is approved, Loan officer should forward offer letter to the customers mentioning all terms and conditions of the facilities offered. Upon execution of all documents, by preparing a checklist of the executed legal documents, Disbursement of loan shall have to be done to the borrower. The legal documents required for disbursement of loan are as below:

- Loan Deed
- Mortgage Deed
- Personal Guarantee Bond
- Letter of Installment, where applicable

- Letter of Disbursement, where applicable
- Demand Promissory note
- Insurance policy issued by insurance company favoring to bank.
- General Indemnity form
- Authority to Debit account.

2.2 Review of NRB Directives:

NRB is the bank of all banks. It regulates, supervises and controls the functions of commercial banks and other financial institutions. Concerned to these activities, NRB has issue various directives to supervise commercial banks. For managing credit NRB has given following directives.

Directives No. 2. Loan Classification and Provisioning

Classification of Loan and Advances shall be on the basis of aging of outstanding principal amount of loan and advances.

Pass (performing)

- All loans and Advances not over due and overdue up to 3 months.
- Provisioning requirement is 1%.

Sub-Standard

- Loans and Advances overdue from 3-6 months.
- Provisioning requirement is 25%.

Doubtful

- Loans and advances overdue from 6 months to 1 Year.
- Provisioning requirement is 50%.

Loss

- Loans and Advances overdue for more than 1 Year.
- Least probability of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future.
- Provisioning requirement is 100%
- Substandard, Doubtful and loss assets are to be classified as Non Performing Assets.
- Assets classification and Loan Loss Provision has to be done in each quarter and the report to be submitted to Nepal Rastra Bank with in one month of the quarter end.

Additional Provision for pass loan:

Loan and Advances against gold and silver, FD receipts, HMG bonds be classified as pass loans. However, if FD and NSB bonds are used to secure loans for other purposes, classification as mentioned above is to be applied.

Additional Provision for Loss loan:

Loans and Advances under following conditions have to be categorized under loss loan although they are not overdue.

- No security at all or securities is not in line in the agreement with the bank
- If the borrower has been declared bankrupt.
- If the borrower is absconding or can't be found.
- If the purchased or discounted bills not realized within 90 days from date due.
- If the non funded facilities like letter of credit and guarantee converted into funded facilities.
- If the loans and Advances are not utilized from the borrowed purpose.
- If initiation as auctioning of the collateral has passed six months and if recovery process is under litigation.
- If the loans and Advances are granted to the blacklisted borrower.
- If project or business is not in condition to operate or not in operation.
- If credit card loan is not written off within 90 days from due date.

Additional provision for term loan:

On the entire amount of outstanding loan on the basis of past due period of overdue installment i.e. if single installment is not paid within stipulated time, all the remaining outstanding installments have to be considered for provisioning.

Provision for Off-Balance Sheet items:

If the Off- Balance Sheet items are converted into On- Balance sheet liability of the bank, then classification will have to done as per overdue period as mentioned above.

Provision for realization of Principal and interest:

- Not allowed by overdrawing current account or by extending the limit on an overdraft facilities.
 - Where a system in a bank exists as to recovery of principal and interest by debiting the customers' account and recovery is made as such resulting in overdraft, which is not settled within one month, such overdrawn principal amount shall also be liable to be included under the outstanding loan and such loan shall be downgraded by one step from its current classification.
- Interest income should be recognized as per Directive no 4.

Additional Provision for loan granted against personal guarantee:

- For loan against personal guarantee, details of free assets (not mortgaged/hypothecated to other banks or financial institution) equal to amount of advances granted must be taken.
- If the said loan falls under category of standard, sub-standard and doubtful assets, then additional 20% of original provisioning is required. Similarly, classification of such loan and advances shall be prepared separately.

Directives No. 3. Single Obligor Limit, Same Group and Single Sector

Existing Provision and Time Frame to meet new Regulation Time Frame Fund Based Non Fund Based From Ashad 2060 25% of core capital 50% of Core Capital

Relaxion on Single Obligor Limit

- Loans and Advances granted against the security of FDR, other deposit, NSB Bonds and unconditional Guarantee provided by World Bank, ADB, International Finance Corporation including other multilateral organization and against unconditional guarantee issued by Internationally Rated Banks having rating of at least A+ by reputed rating agency or bank specified as first class bank by NRB.
- Loans and Advances granted by A class licensed institution to following public sector undertaking for import of following goods.
 - i) Nepal Oil Corporation
 - ii) Nepal Food Corporation

Definition of Group Related Borrowers

- Where a company holds 25% or more share in other company, then the both companies.
- A person, firm, directors of a company, shareholders of a private company, partners of partnership firm, proprietor and spouse , spouse daughter, adopted son and daughters, parents, step mother, brother and sister who have supported by such director, shareholders, partners, proprietor residing jointly in same house or separately.
- The company in which the person mentioned under above individually or jointly holds 25% or more shares.
- The director, shareholders or other relatives as mentioned above individually or jointly holds less than 25% share of other company but the management of the another company is controlled by such person in either of following ways:
 - i) By being the chair person of BOD

- ii) By being the chief Executive of the company
- iii) By appointing more than 25% of the directors.

-Cross Guarantee provided by one customer/company to other customer/company, then both the customer/company should be considered as one.

- Firms, companies stated to be associated as a group or members of such group.

Returns:

Half yearly returns of customers fall under one group to BFI Regulation Department and Bank Supervision Department of NRB.

Not considered as single group:

All companies fully owned by the government or in which the government has majority ownership (more than 50%) be treated as separate entity.

Single Sector

Means Sum total of loans and advance, guarantee and commitments and letter of credit granted to the customers of one sector of the economy. If the loans and advances granted by banks are concentrated into single sector, then NRB can direct to provide/raise additional capital as above.

Provision for monitoring of credit concentration: Bank has to monitor the loans and advances granted to single sector by segregating the following two categories:

- i) Category 1: For loans and advances aggregating to 50% to 100% of core capital granted to single sector, quarterly monitoring shall be done by bank itself.
- ii) Loans and advances granted to single sector exceeding 100% of core capital should be endorsed by BOD and the same decision of BOD shall be intimated to Banking Operation and inspection and supervision department of NRB.

Directives No. 7. Timeframe for Implementation of regulatory directives.

Directives no. 7 deals with timeframe for implementation of regulatory directives. This directives deals with the timeframe of reply for On Site Inspection Report, Loan Loss Provisioning, Loan Portfolio Improvement Program, Capital Adequacy, Management of Assets and Liabilities, Internal Audit and Control, Implementation of Plan, Policies and Procedures and Quarterly Progress Report . For Effective Credit Management, bank should reply for On Site Inspection Report within 30 days, Loan Loss Provisioning immediately on receipt of the instruction from NRB and Loan Portfolio Improvement Program with in 30 days.

Directives No. 11. Consortium Lending:

Consortium Lending means loans and facilities provided to any customers, firm, company or project on the basis of mutual understanding by two or more financial institutions.

- Only the financial institution licensed by NRB is eligible to participate to such financing.
- Lead institution selected by consortium group.

Directives No. 12. Credit Information and Black Listing:

- Credit Information Centre has been established under the company act.
- Report has to be provided to the Centre relating to the borrowers.
- Credit facilities approved for RS 2.5 million and above have to be submitted within 15 days after the end of each month.
- Banks prior to extension or renewal, restructuring or rescheduling of loans of Rs 1 million or more credit information about the borrower shall Compulsorily be obtained.

Procedure for Black-Listing

CIC shall include the borrowers in blacklisting within 15 days after confirmation. Classification of borrower

- a) Willful Defaulters
- b) Non-willful Defaulters

Bank shall not extend new loans/facilities, give additional loan facilities, renew loan facilities or release of balance of installment credit or to accept guarantees of the individual, firm, company or organized institution included in black list.

Directives No. 15. Interest Rates:

- Banks are free to fix interest rates for both deposits and lending.
- Interest rate on deposit and lending shall be published on quarterly basis and should be submitted to NRB within 7 days of each quarter ending.

2.3. Review on NRB Act:

As per the provisions of the NRB act, 2012, Rastra Bank may issue directives from time to time to commercial banks regarding banking, currency and credit. It shall be the duty of commercial banks to comply with the following directives:

1. Development of Banking System and Supply of Credit to commercial Banks:

- a) The NRB shall make all possible efforts to develop and regulate the banking system in the kingdom of Nepal.
- b) With the consideration to the monetary situation, the NRB may provide loan or refinancing facilities on the condition prescribed by it against collateral or guarantee, to any commercial bank, which supply agricultural or industrial credit.

2. Determination of Rates of Interest:

NRB can determine the rates of interest to be charged or paid by commercial bank on loans or deposits. But in the current circumstances, where NRB has not prescribed any rate of interest under sub-section (1), it has given authority to commercial banks itself for fixing interest rate in lending and borrowing. Commercial Bank vary interest rate offered from the published rate to all kinds of deposits by 0.5% on the deposit amount net exceeding Rs 200 million and by 1% on such amount above Rs. 200 million on the basis of understanding with the depositors. The interest rate charges on all types of loan may vary up to maximum of 0.5% on the basis of understanding with the customers.

3. Liquidity:

Commercial banks shall maintain liquid assets (also called "cash reserve") in such proportion of their domestic deposit liabilities as the NRB may prescribe. The Cash Reserve Ratio requirement, after the amendment of NRB policy on 10th April, 1998, is fixed at 6% of fixed deposits and 8% of other deposits, which should be balanced with NRB, along with 3% of total Local Currency deposits as the vault cash requirement.

4. Fund to be maintained with NRB:

Commercial banks must maintain fund in NRB according to the Percentage of total deposits liabilities prescribed by NRB. "Total Deposits liabilities" refers to the liabilities of amounts covered by them the term —Deposits" defined in the 2031, Commercial Bank Acts".

5. Loan to be supplied to the prescribed sectors:

The NRB has prescribed the priority and deprived sectors, for commercial banks to advance 3% of its total loan and advances to these sectors, in order to flow the credit in rural area of the countries.

2.4 Review of Related Studies:

—The effectiveness of the bank’s LPM (Loan Portfolio Management or Credit Management) process heavily depends on the quality of management information systems (MIS). Indeed, many of the advancements of contemporary portfolio management are the direct result of the more robust MIS that is available today. At the same time, many banks are frustrated in their efforts to expand portfolio risk management by the limitations of their MIS. Loan portfolio managers and examiners should be active proponents of the continued improvement of credit-related MIS. While a bank’s systems or technology often impedes MIS improvement, lack of understanding or poor communications between credit management and systems personnel can also do so. Credit-related MIS helps management and the board to fulfill their respective oversight roles. Therefore, when assessing MIS-produced credit reports, the examiner should determine whether the users are receiving the right kind of information at the right time. Reports to senior management and the board must be more than a presentation of numbers; they must be analytical in nature and allow the users to draw independent conclusions. For example, a report presenting the level of classified assets has limited value; however, if the report contains historical information and shows the classified asset position relative to capital, it becomes more useful. Similarly, reports on numbers of exceptions to policy are not very useful, but reports on aggregate exceptions as a percentage of industry or specialized lending portfolios may signal a change in risk assumption. Summary data presented in a concise format generally satisfies management’s needs. A report should not give management or the board more information than it can understand in the time it has to devote to the topic.

Line lending managers have different requirements than senior management and the board. In order to properly inform such different user groups, a bank requires good systems architecture. An ideal system would enable a banker to query, track, and aggregate in all loan data fields; prepare a standard array of reports; Bank management and examiners should assess the adequacy and accuracy of the bank’s MIS based on the size and scope of lending activities and any planned changes in the portfolio. The best technology can be next to worthless if the data are not accurate. Only if data are updated periodically and out-of-date loan information purged can MIS reports remain accurate and useful. Preserving the reliability of MIS can be especially difficult in banks that are expanding rapidly. Common data integrity problems include incorrect industry codes, failure to report delinquency, incomplete or outdated information on loan participations, failure to archive note origination dates and amounts at renewal or modification, inaccurate underwriting

exception capture, lack of clear reports and reporting lines, incorrect risk ratings or failure to archive risk ratings when a change occurs, and omission of off-balance-sheet exposure. Loan review, credit administration, and audit play a vital role in ensuring that data are accurate. When MIS deficiencies or restrict credit risk management practices, examiners will need to identify the root cause and initiate corrective action" (*Comptroller of Currency Administrator of National Bank, 1998:33-34*).

—Credit administration involves the creation and management of risk assets. The process of lending takes into consideration about the people and system required for the evaluation and approval of loan request, negotiation of terms, documentation, disbursement, administration of outstanding loans and work outs, Knowledge of the process and awareness of its strength and weaknesses and important in setting objectives and goals for lending activities and for allocating available funds to various lending functions such as commercial, installment and mortgage portfolios" (*Johnson Et. Al., 1940: 132*).

—Banks are expected to support their local community with an adequate supply of credit for all legitimate business and consumer financial needs and to price that credit reasonably in line with competitively determined interest rates. How well a bank performs its lending function has a great deal to do with the economic health of its region because banks loan support the growth of new business and jobs with in the bank's trade territory and promote economic vitality. Moreover, bank loans often seem to convey positive information to the market place about a borrower's credit, quality enabling a borrower to obtain more and perhaps some what cheaper funds from other source. Banks make a variety of loans to a wide variety of customers for many different purposes – from purchasing automobiles and buying new furniture taking dream vacation, or pursuing college education or constructing homes or buildings"(*Scott D., 1992: 140*)

—Commercial banks act as intermediately-accepting deposits and providing credits to the needy area. The main source of commercial bank is current deposit, so they give more important to liquidity of investment and as such they specialized in satisfying the short term credit needs of business other than long term. Commercial banks are restricted to invest their fund in corporate securities. Their business is confined to financing the short term needs of trade and industries such as working capital financing. They cannot finance in fixed assets. They grant credits in the form of cash credit and overdraft. Apart from financing, they also render services like collection

of bills and cheques, safe keeping of valuables, financial advising etc. to their customers" (*Vaidya S., 1999: 29*)

In the post report titled '**Loan loss provision rises notably' published in the Kathmandu post**, the reporter had made an endeavor to highlight some facts and figures regarding loan loss provision of commercial banks.' The banking sector is witnessing a huge surge in loan provision reserve lately. The increment is primarily a result of directive issued by Nepal Rastra Bank (NRB) in 2001 that introduced stringent loan provisioning criteria for commercial banks. As per data recently released by the central Banks, the total loan loss provision in the country's banking sector increased from around Rs.8.73 Billion in mid-April 2001 to Rs. 13.18 billion in mid-April 2003. The increment is over 51%. As per latest NRB figures, a remarkable surge has seen in loan provision of Nepal bank Ltd. (NBL). Against the provision of Rs.1.7million in Mid-April 2002, The loan provision amount surged to whopping Rs. 7033billion in a year" The reporter further states that apart from the two technically insolvent government-invested banks, loan provision of other joint venture private banks has also risen significantly and the notable increments seen in the loan loss provisioning amounts is due to the eight-point prudential directives that the central bank issued in the mid-to all commercial banks. The reporter concludes, the directives laid down stringent guidelines relating to loan loss provisioning to ensure a good health of the over all banking system. The directives require loans to be provisioned to the extent of cent percent if payment is defaulted for one year. Like wise, the directives require loans top be provisioned to extend of 25% if payment is defaulted for over 3 months and 50% if the period of default extends beyond, but allowed maximum of 3yrs, unlike the present system of just year, for loans to be provisioned to extent of cent percent"

2.5 Review of Dissertation:

Prior to this thesis, various students have carried out several thesis works on the related topic. Some of them are relevant for these study propose, which are presented below.

Ghimire, R. (2008) had conducted a research on a topic of "financial performance of commercial banks: A comparative case study of NBBL, HBL and EBL". His major objectives are to examine the various ratios of the banks and to examine the overall performance of the selected banks. His major findings are EBL and NBBL have increased their performance assuming benchmark to the HBL and EBL, HBL and NBBL had maintained current Ratio of 1.75, 1.35 and 1.42 respectively.

Gupta, D.R. (2009) had conducted a research on a topic “Financial performance Analysis of Everest Bank Ltd”. His major objectives are to examining the financial performance of bank such as liquidity, Profitability, activity and capital structure analysis. His major findings are Liquidity position is below the normal standard and also inconsistency in liquidity policy. The banks did not do a lot of exercise in more credit creation and reducing the interest rate for loan and advances for more competitiveness. The EPS of NB Bank and EBL had been increasing trend but the EPS of HBL had been rapidly decreasing over the period.

Tuladhar, M. (2010) had undertaken a study entitled “A comparative study of working capital management of NABIL and standard chartered Bank Nepal Limited”. His major objectives are to study the current assets and current liabilities and their impact on liquidity and profitability. To analyze the liquidity, assets utilization, long -term solvency and profitability position of those two banks. His major findings are NABIL and SCBNL had maintained current Ratio of 1.55 and 1.31 respectively. The average quick ratio of NABIL and SCBNL were 0.64 and 0.75 respectively. Liquidity of SCBNL was always better than NABIL during the study period. SCBNL had more short term and less costly resources of fund than NABIL. NABIL had better investment efficiency on loans and Advances. Both banks follow conservative working capital policy. Profitability position of SCBNL is better than NABIL.

Shrestha, K. (2011) had undertaken a study entitled “Liquidity and credit management of commercial banks in Nepal” His major objectives are to examine the liquidity position of the banks and to examine the credit management of the selected banks. His major findings are The credit management of the banks was not satisfactory. The bank is unable to create more credit and reducing the interest rate for loan and advances for more competitiveness.

2.6 Research Gap:

The research carried out by the previous researchers in the subject of Credit Management in Nepalese Commercial banks are practically useful and appreciated by various related persons including academicians, bankers, shareholders and general public. Those researchers have been successful in highlighting the strength and weakness of the credit policies in Nepalese Commercial banks. The recommendation and suggestion given by them to improve the quality of credit have of course provided many guidelines in decision making.

All of the previous works are concentrated in improving the credit policy or credit management of the banks. They have over sighted to fulfill the current challenges to be faced by commercial banks such as:

- To accumulate the resources from the competitive environment
- To invest for the returns
- To minimize the shareholders wealth by protecting the assets of the depositors through complying strict directives issued by NRB,
- To run the branches in the rural communities to improve their living standard by providing banking services in order to promote the economic situation of the country,
- To deliver efficient services to the common people by enhancing efficiency of the staff and improving the management style of the bank,
- To give special attention towards loan recovery as the outstanding loan amount is increasing because of incapacity of the borrower in servicing the interest and loan due to economic recession to over the world
- To help the government for poverty alleviation and access to increased flow of credit and investment in the economic activities of direct to maximum number of low income people through micro and medium size loan.

Lending must be managed in such a way that every financed business or project turns to be good. Because financial institution never aims to send any individual to the street rather aims the individual to rise from the street. This research includes the latest information and data regarding commercial bank and will be able to deliver some of the present issues regarding loan management of commercial banks in the most presentable and effective way.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research design:

The first step in this research is to design the framework of the research. The task begins with the collection of necessary data and information concerning the study. The data and information collected must be studied carefully and presented them systematically and get them analyzed so as to meet the objectives of this assignment. The research design for this thesis is shown below:

First of all the necessary data related with Kumari Bank were collected from Kumari Bank Ltd. Collection of data consists of compiling data of only that useful information to quantity and analyzes how the data helps and assists the study of the research. Then a thorough study of all the data collected was made. After that, necessary data were sorted and analyzed in a systematic manner.

Procedure

For the preparation of this research, following procedure is followed.

Conception

Definition

Planning

Implementation

Termination

a. Conception phase:

For the appropriate topic, various interaction with friends, college library visit, net surfing was done. After making this effort the topic "Credit Management" was chosen.

b. Definition Process:

In the definition phase, certain vision to be carried out for research was developed, the description of the problems the research topic were analyzed. After that, the aim of the research was listed out.

c. Planning phase

Planning is very important phase. In this phase, the methodology to gather information was developed, reference books and reports were collected and the overall work schedule was prepared. Appropriate bank for the topic was selected.

d. Implementation phase

The real work started in this phase. The bank —Kumari Bank Ltd" was visited. Various types of credit that Kumari Bank is financing are scrutinized. The concept on types of credit, the documentation process in lending, and the factor to be considered while lending was acknowledged from verbal interaction with the staff members. The effort made by the staff in managing credit was observed. Finally, the annual financial report of the bank was collected.

e. Termination phase

The final assignment report was edited, printed and bided with a copy of collected information and then was submitted to the college.

3.2. Sources of data:

Data is very reliable and effective source for research. Data is a foundation of all fieldwork projects. Data may be obtained from several sources. It also depends on the objectives and necessity of the research. The research design of this report was based mostly on the exploratory design method. Thus, the sources of data collection were based on secondary resources. The source of data can be better explained as following:

a. Secondary Data

Secondary sources of data refer to the readymade data and report, which is already published by the concerned organization, or data that has been compiled by others. Secondary data is thus defined as the data collected earlier for a purpose other than one currently being pursued. Secondary data are the brochures, annual reports, published reports and statements, published official documents, etc. Secondary data have been collected from following sources:

- Annual Report of Nepal Credit & Commerce Bank Ltd.
- Nepal Rastra Bank Directives.
- Economic Survey (Published by Ministry of Finance)
- Banking and Financial Statistics.

- Books and Articles.
- Previous Dissertations.
- Website related to Credit Management.

3.3 Methods of Analysis

3.3.1. Theoretical Analysis:

Theoretical analysis is the process of identifying the theoretical concepts they have been adopted by the firm for some specific purposes. For assessing Credit Management, the elements, plans, procedures and strategies applied by Kumari Bank Ltd. for managing credit has been defined.

3.3.2 Financial Analysis:

Financial analysis is the way of noticing the financial strength and weakness of the firm by establishing some relationship to the items found in profit and loss account and Balance sheet. Many ratios reflecting to the term —**credit**" is assessed to illustrate the result that has been resulted after managing or controlling credit. The ratios used for assessing credit are categorized into two categories.

A. Credit Practice Ratios.

B. Credit Efficiency Ratios.

A. Credit Practices Ratios:

Following ratios have been made to analysis the credit practices of Kumari Bank Ltd.

i. Total Loans to 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 loans and advances for profit generating activities. Greater ratio indicates the better utilization of total deposits.

ii. Interest Income to Loans & Advances:

Interest income is one of the major sources of income for a commercial Banks. The high volume of interest income is an indicator of good performance of lending activities.

iii. Loans and Advances to Total Assets Ratio:

Loans & advances is the major part of total assets for the bank. This ratio indicates the volume of loans & advances out of the total Assets. A high degree of the ratio indicates that the bank has been able to mobilize its fund through lending function. However lending always carries a certain risk of default. Therefore a high ratio represents low liquidity and low ratio represents low productivity with high degree for safety in terms of liquidity.

iv. Loan and Advances to Current Assets Ratio:

Loans & advances is the major component in total Assets, which indicates the ability of banks to analyze its deposit in the form of loan & advances to earn high return. If sufficient loan and advances cannot be granted, it should pay interest on those utilized deposit funds and may lose earnings. So commercial banks provide loan & advances in appropriate level to find out portion of current assets, which is granted as loan & advances.

v. Interest Income to Total Income Ratio:

This ratio measures the volume of interest income in total income. The high ratio indicates the high contribution made by lending and investment whereas low ratio indicates low contribution made by lending & investment and high contribution by other fee based activities in total income.

vi. Total Loan & Advances to Total Capital & Liabilities:

This ratio measures the assets parts of banks in terms of lending with the total capital and liabilities. It identifies how much portion of its capital and liabilities are mobilized in lending process.

vii. Net Interest income to Net Profit:

Credit is the major sources of earning in every financial institution. Net interest income is the income earned from lending after providing the interest to the depositors. It is the difference of Interest income and interest Expenses. This ratio measures the portion of profit earned from Net Interest Income.

B. Credit efficiency Ratio:

Following ratios have been made to analysis the credit efficiency of Kumari Bank Ltd.

i. Non-Performing Loans to Total Loan and Advances Ratio:

NRB has directed all the commercial banks to create loan loss provision against the doubtful and bad debts. This ratio helps in minimizing the non performing loans and helps to control the Credit.

ii. Loan Loss Provision to Total Loan and Advances Ratio:

The provision for loan loss reflects the increasing probability of non-performing loan. Increase in loan loss provision decreases its profit and result to decrease in dividends. But its positive impact is to strengthen the financial conditions of banks by controlling the credit risk and reduced the risks related to deposits. The low ratio indicates the good quality of assets in total volume of loan & advances. High ratio indicates more risky assets in total volume of loan & advances.

iii. Loan Loss Provision to Non Performing Loan:

Loan loss provision is the compulsion factor in lending practices and Non Performing Loan is the evil factor in banks. If they are high then they will decrease the amount of profit which the banks target to receive. This ratio measures the portion of provisioned loan with non performing Loan. Since, all loan are needed to made provision, it is the compulsion part. Rather the difference part as compare to Non Performing loan is not so good to result a sound profit.

3.3.3. Risk Weighted Assets:

Various assets of a bank are exposed to varying degree of risk. For e.g. Cash balance are not susceptible to any risk whereas advances are susceptible to credit risk. Even with in the advances, the risk of loss arising from failure of the customers to settle his/her obligation fully. Similarly, different Off-Balance Sheet items also involve varying degree of risks. Therefore NRB has assigned different risk weight to different categories of assets. The Risk-Weighted value of category of assets is determined by multiplying the nominal value of the category as per the balance sheet with the Risk Weight assigned there.

3.3.4 Capital Adequacy Ratio:

Capital Adequacy is used to describe the adequacy of capital resources of the bank in relation to the risk associated with its operations. Adequacy of capital of bank has been the subject matter of consideration by banking authorities around the world for several decades. NRB issued a circular regarding the capital adequacy to be maintained by the commercial banks with effect from March 22, 1991. The commercial banks are required to maintain 11% of Capital Adequacy in form of 5.5% in core Capital and 5.5% in supplementary Capital.

Capital Adequacy is to be maintained in each quarter.

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

3.3.5 Single Obligor Limit (Single Borrowers Limit):

In order to minimize the risk of lending with the borrowers, certain limit is fixed for extending the amount to the person or the companies within the same group. Commercial banks are not allowed to establish the exposures with a borrower up to a certain rates of its Core Capital. NRB has prescribed maximum amount of credit (fund based and non-fund based) for as single borrower or to the companies within the same group.

Existing Provision and Time Frame to meet new Regulation

Time Frame Fund Based Non Fund Based

From Ashad 25% of core capital 50% of Core Capital

3.4. Statistical tools

Statistic is a book of methods of obtaining and analyzing data in order to base decision on them. It is the branch of scientific method used in dealing with phenomena that can be described numerically either by counts or by measurements. Thus the word statistics refer it a method of dealing with quantities information. Webster defined statistics as 'the classified facts which can be stated in numbers or in tables of number or in any tabular or classical arrangement.' Statistical tools like graphical presentations are used to measure the efficiency of Credit. For supporting the study, statistical tool such as Mean, Standard Deviation, Coefficient of Variation, Correlation, Trend Analysis, Hypothesis and Diagrammatic tools have been used under it.

CHAPTER FOUR

PRESENTATION AND ANALYSIS OF DATA

This chapter represents the data collected from various sources and also presents and analyzes them to measure the various dimensions of the problems of the study.

4.1 Measuring the Lending Portfolio (Assets/Liability Management Ratio)

The lending portfolios of a bank are measured in relative measures on this section. The relationship between various assets and liabilities of the balance sheet has been established to show the relative strengths of lending of the bank comparatively. An attempt is made to determine the strength of lending portfolio in absolute figure of the bank, regarding to the volume of deposit, loans and advances and other variable.

4.1.1 Measuring the Lending Portfolio in Relative Term

4.1.1.1 Loans and Advances to Total Assets Ratio

Loans and advances of any commercial bank represent the major portion in the volume of total assets. The ratio of loans and advances to total assets measures the volume of loans and advances in the structure of total assets. The high degree of this ratio indicates the good performance of the banks in mobilizing in the funds by way of lending function. However, in its reserve side, the high degree of this ratio is representative of low liquidity. Granting the loan and advances always carries the certain amount of risk. Thus, these assets of banking business are regarded as risk assets. This ratio measures the management attitudes toward risk assets. The low ratio is indicative of low productively and high degree of safety in liquidity and vice versa. The interaction between risk and return determines this ratio.

Table 4.1: Loans and Advances to Total Asset Ratio

Rs. In million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Loan & Advance	10370	12579	16477.8	16157	17321
Total Asset	12324	15619	19265.1	21500	21903
Ratio	0.84	0.81	0.86	0.75	0.79

Source : www.kumaribank.com

From the above table, the ratio of loans and advances to total assets ratio has not been constant. The fiscal year 2008/09 is highest then the other years. And the fiscal year 2009/10 is lowest. According to the ration best performance of the bank was in the year 2008/09. However the the bank performance of last year 2010/2012 is satisfactory. It has improved the ration then fiscal year 2009/10.

The bank has increased its loans and advances on an average basis since the past 5 years. This indicates that the bank has been following average lending policy. At the same time the assets of the bank has also increased in the five years time period. Hence there is no significant different in the ratio during last five years period.

4.1.1.2 Loans and Advances to Shareholders' Equity Ratio

Shareholders' equity consists of share capital, share premium, reserves and retained earnings. The ratio between loans and advances to shareholders' equity provides the measures regarding how far the shareholders' equity has been able to generate assets to multiply its wealth. The shareholders' equity refers to the net shareholders' intake in the business. Thus, this ratio measures the size of the business and its success in converting liabilities into assets.

Table 4.2: Loans and Advances to Shareholder Equity Ratio

Rs. In million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Loan & Advance	10370	12579	16477.8	16157	17321
Share Holder Equity	750	1470	1186	1306	1485
Ratio	13.83	8.56	13.89	12.37	11.66

Source : www.kumaribank.com

The loan and advances to shareholders' equity ratio of the bank ranges from 8.56, the lowest, in the year 2007/08 to then other fiscal years, 13.83 the highest in the year 2006/07. The decreasing trend reveals that the bank is unable to meet the increasing trend of equity by increasing its lending portfolio. This may be because the banks are compelled to increase their capital every year as per central bank's rule.

4.1.1.3 Priority Sector Loans to Total Loans and Advances Ratio

Earlier, NRB had directed all the commercial banks to flow 12.5% of their total outstanding credit to priority sector loans. The loan provided to agriculture cottage industries, deprived

sector, other sector of national priority, hydroelectricity and minimum power sector is deemed as the priority sector loans. The ratio of priority sector to total loans and advances refers to the portion of the total outstanding loans and advances that is out flowed in the priority sector. Now, NRB, through its monetary policy for fiscal year 2062/63, has relieved banks from its earlier compulsion to provide loan to priority sector loan.

Table 4.3: Priority Sector Loans to Total Loans and Advances Ratio

Rs. In million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11	Average
Priority Sector Loans	171.06	306.03	421	470.9	467.9	367.378
Loan and Advances	10370	12579	16477.8	16157	17321	14581
Ratio	0.02	0.02	0.03	0.03	0.03	0.03

Source: www.kumaribank.com

According to the above table, the average amount lent to the priority sector over the past five years is Rs.367.38 out of total loan and advance. The table represents that the bank has not been able to maintain the NRB directives of lending out at least 12% of its total lending to the priority sector. The tabulated value shows that the bank has increased its lending tin the priority sector from 2006/07 to 2010/11. However it would be not enough to maintain the NRB directives. So the KBL has to social responsibility to fulfill the requirement of priority sector.

4.1.2 Measuring the Lending Portfolio in Absolute Term

Under this topic, the various variables in their absolute value are measured. Unlike ratio analysis, different variables are measured individually. The volume of variable and its variability are measured. The value of individual variables enables to measure the gross contribution of the bank in the respective years. Though the ratio analysis solely describes the ratio between the two variables, it does not tell about the absolute value of those variables. Therefore, in this chapter, some of the important individual variables in their absolute value of mean and standard deviation are examined. At the same time, to measure the relative measure of variability of data; the coefficient of variation is also measured. The absolute value of bank for different years is compared to judge its contribution and its practices.

4.1.2.1 Net Worth

Net Worth of a firm refers to capacity of the organization. This figure measures shareholders' wealth in a firm. Higher the amount, higher will be the volume of business and vice versa.

Table 4.4: Net worth and Percentage Changes

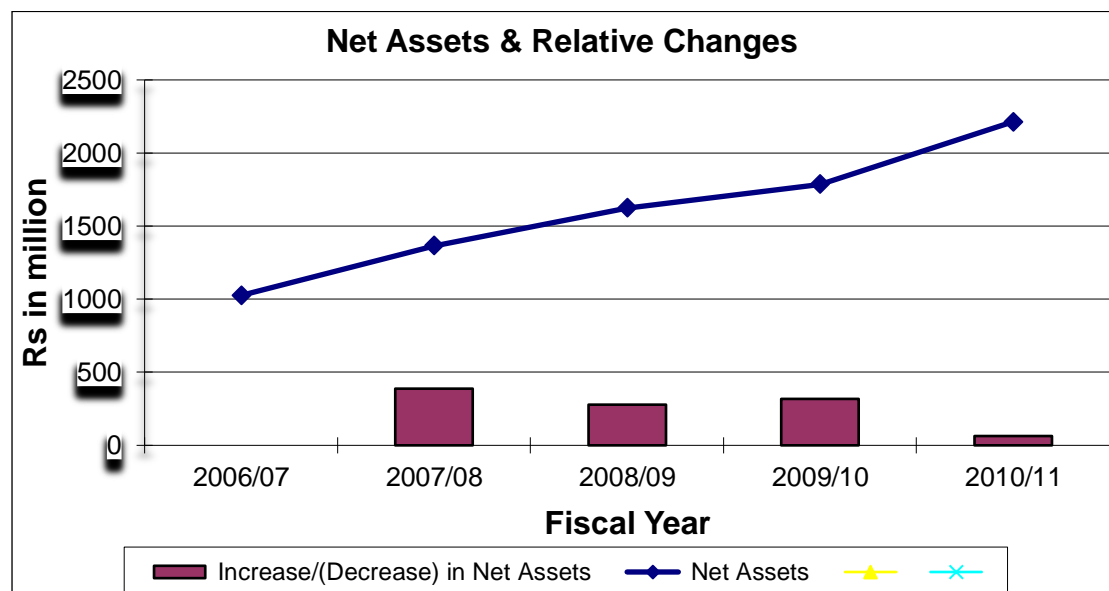
Rs in million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Net Worth	1025.63	1364.89	1624.95	1785.75	2213.83
Increase/(Decrease) in Net worth	-	339.26	260.06	160.80	428.08
Percentage Change	-	33.08	19.05	9.90	23.97
Average Growth Per Annum in percentage:	17.20				

Source: www.kumaribank.com

Table 4.4 reflects the net worth of KBL in the past five years. The net worth of the bank has increased drastically from Rs. 1025.63 m to Rs. 2213.83 m which average growth per annum has 17.20%. This indicates that the bank has been effectively initiating the shareholders' wealth to mobilize loans and also has been able to increase the volume of its business.

Figure 4.1



The graphic indicates the net worth of the bank. By the graphic it can be seen that the net worth has increased since the five years and the bank saw a rapid increase in the year 2007/08, where, the line indicating the net worth has become steeper. During this period alone, bank saw an increase by Rs. 2213.83 million its net worth. However, the graph represent that the lowest

increase in the net worth was during the year 2009/10, this was resulted due to the burden of outsider's liability that is the bank has owed a relatively larger amount to the outsiders in proportion to other years. A conclusion can be derived from herein that the banks capability to meet the shareholders' demands in the near future would be satisfactory, i.e. the bank will be able to meet the stakeholders' expectation in the time to the come.

Mean, Standard Deviation (SD) and Coefficient of Variation (CV) of Net Worth

The mean, standard deviation and the coefficient and the variation of net assets have been calculated to evaluate the dispersion of the net worth for the given years.

Table 4.5: Mean, SD and CV of Net Worth for five years

Rs in million

Mean	Standard Deviation	Coefficient of Variation
1,603.01	446.39	27.85%

Source: Appendix 2

The mean measured for net worth of the bank hold at Rs. 1603.01 million, which shows that an average the bank must have net worth Rs. 1603.01 million every year, with the increasing trend of the net worth the standard deviation for the bank is Rs. 446.39 million, it means that the banks manages to keep its net worth intact with a dispersion of Rs. 446.39 million. The flexibility of deficit or surplus is limited by the aforementioned amount. Another important measure of depression, the coefficient of variation, measured at 27.85 %, indicates that the bank has some extent of variability in its net worth with the moderate value. The overall trend of net worth is increasing. Thus, the volume of net worth of KBL permits it to expand its business in higher degree.

4.1.2.2 Loans and Advances

Commercial bank's main function is to create credit from its borrowed fund. The bank doing so converts its liability into assets, loans and advances are the assets coming from such activities. The high volume of loans and advances is indicative of good performance in credit sector. Since the survival of banking business is depended on good performance of its lending function. The high volume of well performing loans and advances in economy is a symbol of healthily banking business.

Table 4.6: Total Loans and Advances and percentage changes

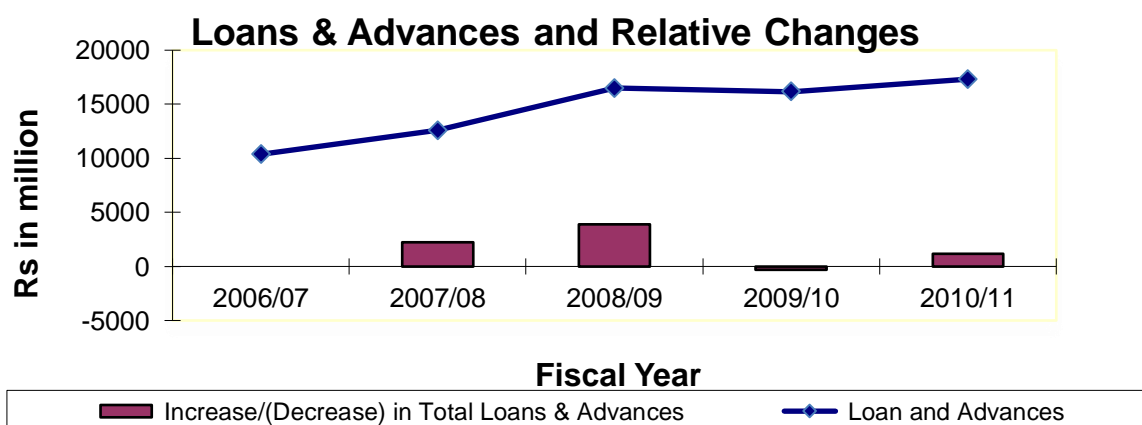
Rs in million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Loan and Advances	10370	12579	16477.8	16157	17321
Increase/(Decrease) in Total Loans & Advances		2209.00	3898.80	-320.80	1164.00
Percentage Change	-	21.30	30.99	(1.95)	7.20
Average Growth Per Annum in percentage:	11.51				

Source: www.kumaribank.com

The above table shows the total loans and advances made during the five years. It has been observed that the bank has been able to increase its lending activity by since 2006/07. It is evident that as a commercial bank, KBL has been performing its lending activity, by increasing the loans and advances since the last five years except of fiscal year 2009/10. A major increase in the amount of the loan was during the years 2008/09, where the percentage increase in the total loans and advances increased by 30.99%, from Rs. 10370 million in the year 2006/07 to Rs. 16477.80 million in the year 2008/09. Loans and advances made during the year 2009/10 were decreased to other years. The hindering part for the bank during that period was that even though the loans and advances for the past years were increasing, the bank could not continue and steady growth of loans and advances. However, there is average growth of 11.51 percent over past five years.

Figure 4.2



The graphical representation of the loans and advances show that there has not been constant of the loans and advances of the bank. The bank has rapidly growth in year 2006/07 to 2008/09. Then after that it has decreased. The graph shows that bank has not in steady growth over loan flow. It is considered that bank is trying to maintain in stable.

4.1.2.3 Interest Income

Volume of interest income measures the bank's ability to generate income from lending and investment activities. The high volume is indicative of favorable contribution of lending and investment activities. Interest income for a bank is one of the major sources of income. Interest income relates to those interests that are charged by the bank on the loan it provides.

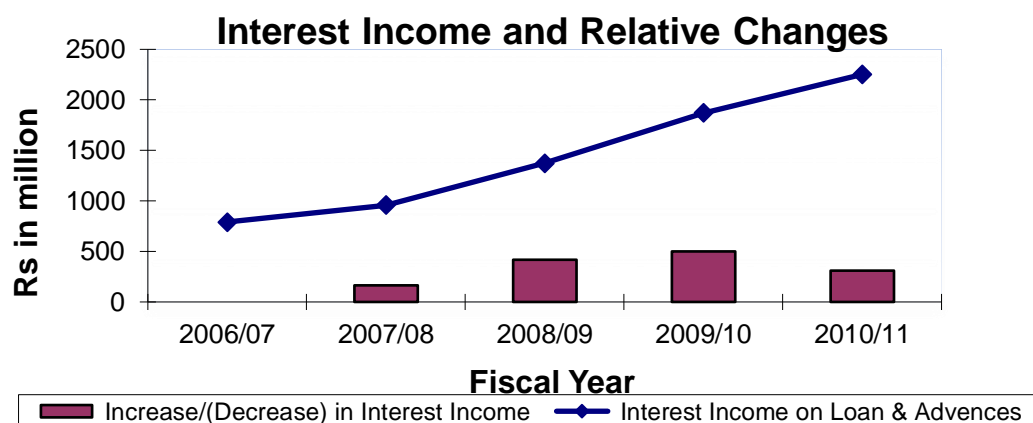
Table 4.7: Interest Income and Changes for Respective Years

Rs in million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Interest Income on Loan & Advances	791.28	957.25	1374.25	1871.07	2251.79
Increase/(Decrease) in Interest Income	-	165.97	417.00	496.82	380.72
Percentage Change	-	20.97	43.56	36.15	20.35
Average Growth Per Annum in percentage:			24.21		

The above table represents the interest that have been earned from loans and advances given out as well as the interests from the investments made by the bank. The interest earned was on increased in upto 2008/09, but in 2009/10 it has been decreased its income of interest earning. During this year, there was significant growth in lending and investment of the bank and market was on the track of reducing effective interest rates. This has caused downward impact in the income of KBL. However, KBL has shown very good growths, which average growth is 24.21% 7.30%, 15.67% and 8.94% respectively. This growth is also due to increased loans.

Figure 4.3



The figure explains the interest income from loans and investments over five years and level of its increment/decrement. However, trend line and bars shows increase in income for a year, there is steady growth on the succeeding years. According to the figure, the bank had earned a maximum interest during the fiscal year 2008/09, where as the highest level of increment is during the year 2008/09. The reason for the overall increase in the interest income lies in the fact

that the lower interest earned through investment has been offset by the higher interest earned through loans and advances and vice versa. But the graph indicates that the increase in the interest income is radical. One other major factor contributing to the fluctuating rate of collection of interest could be because of the uncollected interest during yearly closing, which is counted towards expenses or receivables. Bank suffers through a high credit risk, which could have hampered the collection of the interest from the clients. However, an average growth of 24.21% looks excellence in term of earning.

4.1.2.4 Net Interest Income

Net interest income is the overall interest income of bank after deduction of all interest expenses on deposits. Following table shows the exposure of KBL in term of Net Interest Income.

Table 4.8: Net Interest Income and Changes for Respective Years

Rs in million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Net Interest Income	394.23	458.52	558.05	682.15	685.24
Increase/(Decrease) in NII	-	64.29	99.53	124.10	3.09
Percentage Change	-	16.31	21.71	22.24	0.45
Average Growth Per Annum in percentage:	12.14				

Source: Appendix 2

Table 4.14 figures the net interest income of KBL during last five years period. There was increasing trend of net interest income of KBL from 2006/07 to 2009/10 but there is decrease in 2010/11. However it should be taken positively because the bank has been able to maintain income-expense ratio of interest to the positive side. Steady growth of 16.31%, 21.71%, 22.24 and 0.45% seen in every year from 2007/08 to 2010/11 respectively.

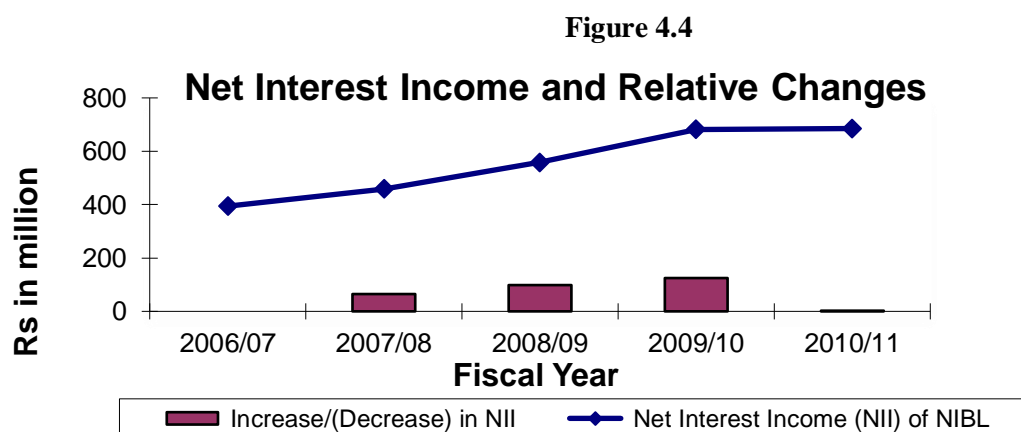


Figure shows NII and its respective growth over last five years. The highest growth rate is reported in 200/10 and lowest is in 2010/11. The bank has an average growth in NII by 12.14% per annum.

4.1.2.5 Net Profit

Net profit after all types of deductions such as bonus to employees, taxes and provisions have been used in this analysis. The volume of net profit measures the success of a firm in every aspect of its operation and strategy.

Table 4.9: Net Profit and Changes for Respective Years

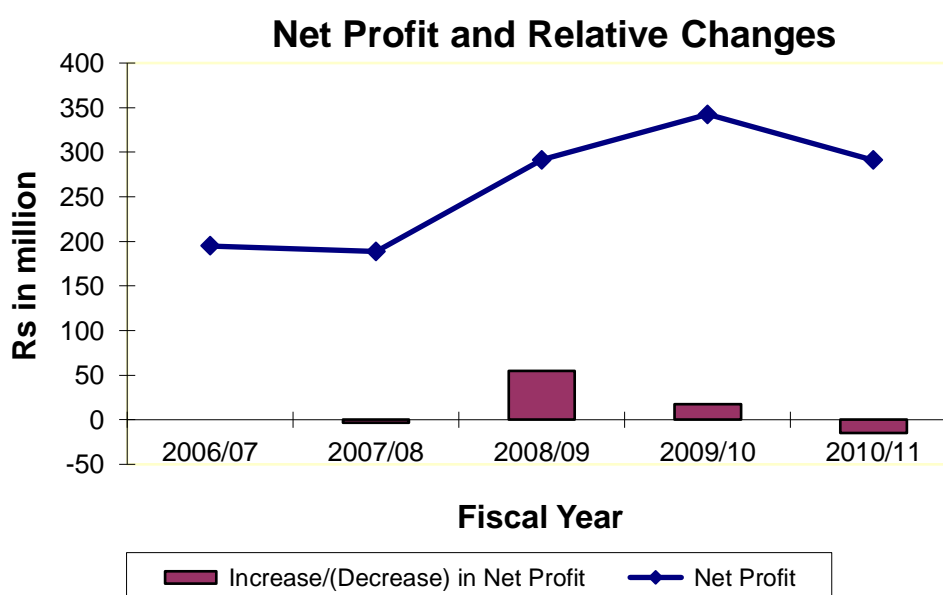
Rs in million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Net Profit	194.95	188.68	291.65	342.53	291
Increase/(Decrease) in Net Profit	-	(6.27)	102.97	50.88	(51.53)
Percentage Change	-	(3.22)	54.57	17.45	(15.04)
Average Growth Per Annum in percentage:			10.75		

Source: www.kmariabank.com

The pattern of net profit of the bank has not constant all over the years. During 2007/08 & 2010/11 there was decreased by 3.22 % and 15.04 in the net profit whereas fiscal year 2008/09 and 2009/10 was significantly increased in net profit. However, the average growth of KBL is 10.75% which is moderate, if we consider other factors constant and observe in term of net profit only. There is a regular increment over all the years.

Figure 4.5



The graph represents the net profit of KBL. It reveals the highest net profit in the year 2009/10

and the lowest in the year 2010/11. As represented by the graph, the net profit increased in tremendously in 2009/10. The bank has been able to take up its net profit level from Rs 194.95 million in 2006/07 to Rs. 342.53 million in 2009/10 reporting average growth per annum almost 10.75% over past five years of study. The bank, increment in the total deposits with lesser cost and increment in fees and commissions because of the increment in the loan and advances made the reason there was an increase in the net profit of the bank.

4.2 Activity Ratio

In this section the lending efficiency in term of quality and turnover is measured. For this purpose, the relationship of different variables of balance sheet and profit and loss account is established.

4.2.1 Provision for Loan Loss to Loans & Advances Ratio

This ratio of provision for loan loss to loans and advances describes the quality of assets that a bank is holding. NRB has directed the commercial banks to classify its loans and advances into the category of pass, substandard, doubtful and loss and to make the provision of 1% for pass category, 25% for substandard category, 50% for doubtful category and 100% for loss category. NRB has classified the pass loan as performing loans and all the other types of loans as non-performing loans. The provision created against the pass loan is called general loan loss provision and the provision against all other category is called the special loan loss provision. Provision for loan loss in the balance sheet represents the profitability from total loan of banks. Provision for loan loss, on the other hand, signifies the cushion against future contingencies created by default of borrowers. The low rate signifies the good quality of assets in the total volume of loans and advances. The high ratio signifies the relatively more risky assets in the volume of loans and advances.

Table 4.10: Provision for Loans and Advances to Loan & Advances Ratio

Rs in million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Provision for Loan loss	24.95	64.02	57.4	13.07	113.78
Loan and Advances	10370	12578.84	16477.81	16157.16	17321.46
Ratio in %	0.24	0.52	0.34	0.08	0.66

Source: www.kumaribank.com.np

Above table explains the provision for loan loss of KBL over past five years. As per NRB directives, provisions against all type of loans should be done and booked under separate accounts. This type of regulations has been imposed by NRB in order to minimize the risk of loan and advances flowed by the banks. In case of KBL, we can see that some loans have been crossed the rating of good loan. Good loans are those loans, which do not default for repayment and account conduct is found satisfactory. Thus, from the table we can say that KBL has made investment in secure loan. It has loan is not more risky that mean bank have good loan policy.

4.2.2 Non-performing Loans (NPL) to Total Loans and Advances Ratio

NRB has directed all commercial banks to formulate a special loan loss provision against the substandard, doubtful and bad loans. But most of the commercial banks do not willingly provide data on non-performing loans. Few of the banks do not even show the figure of specific reserve made on doubtful and bad debts in their profit and loss account. All banks show the total provision amount in the balance sheet. As per NRB's prescribed format of report, banks publish category wise loans and advances.

Table 4.11: Non-Performing Loans to Total Loans & Advances Ratio

Rs in million

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Non performing Loans	75.7	166.04	72.5	86.6	194
Loan and Advances	10370	12578.84	16477.81	16157.16	17321.46
Ratio in %	0.73	1.32	0.45	0.54	1.12

Source: www.kumaribank.com.np

Table 4.11 exhibits that in total volume of loans and advances and the non-performing loans. There has been fluctuated percentage of the non-performing loan of the bank. However, increase in the non-performing loans decreases the profit of the bank. The bank was able to decrease non performing loan in year 2008/09 and 2009/10 with comparison to previous and year 2010/11, which indicates the improving performance of the bank in 2008 to 2010 and year 2010/11 indicates that the bank should take action according to previous.

4.2.3 Interest Income to Total Income Ratio

This ratio measures the volume of interest income in total income. This ratio also helps to measure the bank's performance on other fee-based activities. The high ratio indicates the high contribution made by the lending and investment activities and vice versa.

Table 4.12: Interest Income to Total Income Ratio

Rs. in million

Fiscal Years	2006/07	2007/08	2008/09	2009/10	2010/11
Interest Income	791.28	957.25	1374.25	1871.07	2251.79
Total Income	994.13	1166.13	1763.3	2235.83	2844.57
Ratio	0.80	0.82	0.78	0.84	0.79
Average Ratio	0.80				

Source: www.kumaribank.com

The ratio for the interest income to total income ratio has somewhat been stable for KBL as indicated in Table 4.12. The highest ratio was in the year 2009/10 & 2007/08, and the lowest was in the year 2008/09 similar to 2010/11. The average ratio calculated is hovers around 0.81, which is close by to the year's entire ratio. The average ratio indicates that the ratios of the five years do not have a high degree of deviation from the mean of the bank. We can see that the overall trend of the ratio of the bank is not fixed. The overall trend of this ratio suggests shaken economy activity and stability of bank in fund based even due to its increasing risk elements.

4.2.4 Interest Income to Interest Expense Ratio

The ratio of interest income to interest expense measures the gap between interest rates offered and interest rate charged. Since NRB has restricted the gap between the interest offered and interest charged, in average, should not be more than 5% the difference in this ratio is mainly caused by the ratio of funds mobilized and the funds collected. The credit creation power of commercial banks has high impact on this ratio.

Table 4.13: Interest Income to Interest Expense Ratio*Rs. in million*

Fiscal Years	2006/07	2007/08	2008/09	2009/10	2010/11
Interest Income	791.28	957.25	1374.25	1871.07	2251.79
Interest Expense	397.05	498.73	816.2	1188.92	1566.55
Ratio	1.99	1.92	1.68	1.57	1.44
Average Ratio	1.72				

Source: www.kumaribank.com.np

The ratio indicates that there is a high degree of gap between the interest offered and the interest charged. The increased ratio as compared to the trend of loans and advances and deposits to total deposits, implies that KBL is charging high interests to the borrowers and offering low interest rate to the depositors. The low cost of deposit and a moderate volume non interest bearing deposits in the deposits mix of KBL has caused the gap between interest income and interest expense to higher. The average ratio of the bank is 1.72 which indicate that a rupee of expense in deposits has generated 1.72 rupees of interest income for the bank. But the last previous three year, The Gap between interest expense and income are gradually decreased. KBL should think about on old strategy.

4.3 Measurement of Profitability Ratios

4.3.1 Total Income to Total Assets Ratio

This ratio measures how efficiently the asset of a business is utilized to generate income. It also measures the quality of assets in income generation.

Table 4.14: Total Income to Total Assets Ratio*Rs in million*

Fiscal Years	2006/07	2007/08	2008/09	2009/10	2010/11
Total Income	994.13	1166.13	1763.3	2235.83	2844.57
Total Assets	12324.4	15619	19265.1	21499.7	21902.7
Ratio	0.08	0.07	0.09	0.10	0.13

Source: www.kumaribank.com

Above table explains that KBL's highest ratio was observed during 2010/11. The ratio has

gradually increased from year 2006/07 to 2010/11 which is 0.08 to 0.13 it implies that the efficiency of assets has been increased year by year. If the bank were to look for a boost in the performance through this ratio, the bank would be possible in a good position to do so. The increasing ratio trend shows the increasing in EPS and net profit to shareholder's equity.

4.3.2 Net Profit to Shareholders' Equity Ratio

This ratio measures the amount of profit that a rupee of shareholders' fund has received. The high ratio is indicative of high return to shareholder and vice versa.

Table 4.15: Net Profit to Shareholders' Equity Ratio

Rs in million

Fiscal Years	2006/07	2007/08	2008/09	2009/10	2010/11
Net Profit	194.95	188.68	291.65	342.53	291
Shareholder's Equity	750	1470	1186	1306	1485
Ratio	0.26	0.13	0.25	0.26	0.20
Average Ratio	0.22				

Source: www.kumaribank.com

Above table exhibits that the ratio of net profit to shareholder's equity is the highest and similar in the year 2006/07 and 2009/10, where the ratio was 0.26 % . But once again this ratio for the bank has not been stable throughout the period of five years. Even though there have been fluctuation from the high of 0.26 to the low of 0.13, the overall change from 2006/07 till 2010/11 was an average ratio of 0.22 , it relates that the shareholder's for every single rupee of equity shall receive 0.22% profits for that single rupee.

4.3.3 Earnings per Share

EPS refers to the net profit divided by the total number of shares outstanding. The amount of EPS measures the efficiency of a firm in relative terms. This figure is the indicative of the overall good or bad performance of the organization. How far an organization is able to use its resources to generate profit is determined by the profit it has earned. Thus the EPS determines the market value of a share, determines the attitude of outsiders and high amount of EPS increases the competition in the market by the entry of new organizations.

Table 4.16: Earning per Share (EPS)

In Rupees

Fiscal Years	2006/07	2007/08	2008/09	2009/10	2010/11
Earning per Share (EPS)	22.70	16.35	22.04	24.24	15.67
Increase/ Decrease in EPS		(6.35)	5.69	2.20	(8.57)
Mean EPS	20.20				

Source: www.kumaribank.com

Above table shows that the EPS of KBL was highest during 2009/10. During the years 2006/07 and 2010/11 the bank EPS was decreased by 6.35 % and 8.57% respectively .The EPS of the bank was not constant. The major reason behind this drop in the EPS was due to the increase in the number of shares outstanding. As EPS is calculated by dividing net profit by the number of shares outstanding. Hence increase in the denominator, which would always reduce the value obtained from there in.

Figure 4.6

Earning per Share (EPS) and Relative Changes

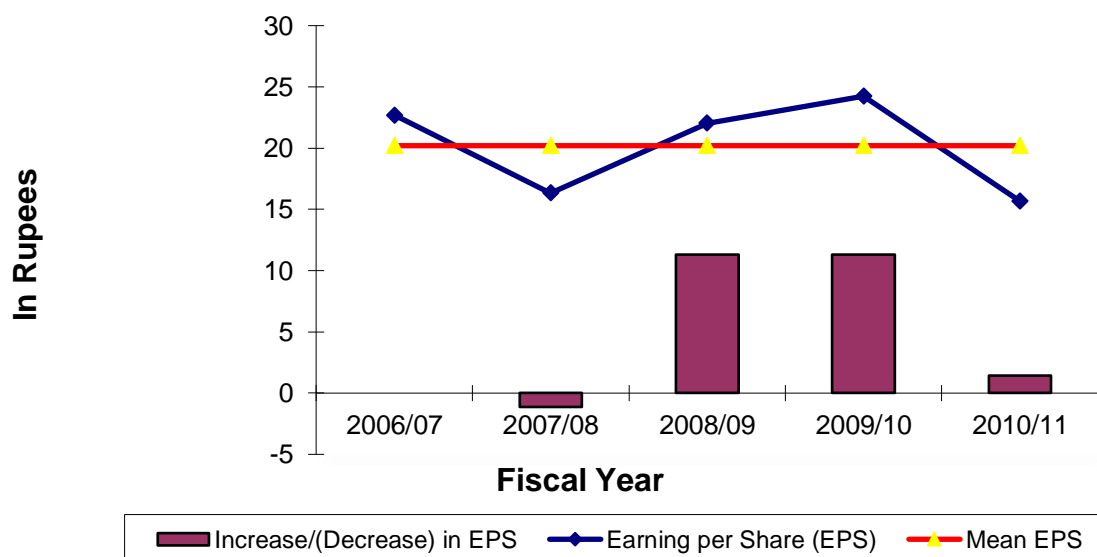


Figure 4.6 reflects the EPS of KBL and at the same time represents the mean EPS and also shows the change in the EPS during the period of five years. By the figure it is easily portrayed that the EPS of the bank had initially decreased and then went up during last year of the study. On the other hand, the mean EPS denotes that apart from 2006/07, the EPS for the different years haven't

deviated from the bank's average EPS. Though the deviation during 2008/09 and 2009/10 was positive and proved the increased efficiency of the bank, however, decrease in the EPS a year later, plummeted the change to a decreasing status. However, the performance of the bank on the part of the EPS is deemed as satisfactory as the mean EPS of KBL hovers around Rs. 20.20 and during 2010/11, the EPS of the bank was fell down the mean, which was Rs. 15.67 Further, it can be noted that EPS of KBL has gone down than the mean EPS..

4.4 Measuring Correlation between different Variables

4.4.1 Correlation between Deposits and Loans & Advances

The correlation between deposits and total loans & advances describes the degree of relationship between these two items. How a unit increase in deposits impact the volume of the loans and advances is measured by correlation. Here, deposit is the independent variable and the loan and advance is the dependent variable.

Table 4.17: Correlation, Coefficient of Determination and Probable Error between Total Deposit and Total Loans & Advances

<i>Evaluation Criteria</i>			
r	r²	P.Er.	6*P.Er.
0.9709	0.9426	0.0256	0.1536

Source: Appendix 3

Table describes the relationship between total deposits and total loans and advances. As prominent from the table, it can be seen that there is a high degree of positive correlation between the two variables. This indicates that loans and advances are highly dependable on the amount of deposits collected. Since the value of (r) in the bank is more than six times the P.Er., the correlation between these two variables is significant. As noted the value of coefficient of determination is 0.9426, it indicates that 94.26% of the variation in loans and advances is explained by deposit and the rest is due to other factors such as necessity of utilization of deposit to other sectors, which is essential and requirement for banking operation. Thus by the figures that have been obtained above, we can say that the bank is making its loans and advances form a major portion of its deposits, which means the bank is efficiently mobilizing its deposits.

4.4.2 Correlation between Shareholders' Equity and Loans and Advances

The correlation between shareholders' equity and loans and advances describes the degree of impact of the increase in shareholders' equity due to increase in loans and advances. The loans and advances is the independent variable and the shareholders' equity is considered as the dependent variable.

Table 4.18: Correlation, Coefficient of Determination and Probable Error between Shareholders' Equity and Total Loans & Advances

<i>Evaluation Criteria</i>			
r	r²	P.Er.	6*P.Er
0.6379	0.4069	0.02652	0.1591

Source: Appendix 4

Above table explains that there is high degree of positive correlation between shareholder's equity and loans and advances in the bank. Since the value of r is greater than four times the P.Er., the value of (r) is significant. We can see that coefficient of determination between the said variables is 0.4069; this infers that the increment in loans and advance of KBL increases the shareholder's equity. So, 40.69 % of the variation in the shareholders' equity has been resulted by the performance of loans and advances and rest are affecting by other variables.

4.4.3 Correlation between Total Income and Loans & Advances

The correlation between total income and loans and advances measures the degree of linear relationship between these two variables. Loans and advances is independent variable whereas total income is the dependent variable.

Table 4.19: Correlation, Coefficient of Determination and Probable Error between Total Income and Loans & Advances

<i>Evaluation Criteria</i>			
r	r²	P.Er.	6*P.Er
0.72	0.5184	0.2153	1.2918

Source: Appendix 5

According to above table, correlation between total income and loans and advances is high. The value or (r) is significant as the value of (r) is greater than six times P.Er. Both the variables are

positively correlated, so there will certainly be change in total income with changes in loans and advances. The coefficient of determination is also positive, which is 0.5184, which means that 51.84% of changes in total income is resulted by loan and advances and rest of is due to other factors, such as fee based income and other income of KBL.

4.4.4 Correlation between Provision for Loan Loss and Loans and Advances

The provision for loan loss and loans & advances are co-related. The former is the product of the latter. Therefore, correlation between provision for loan loss and loans & advances measure the degree of linear relationship between these two variables. By the nature of variables, as an independent variable the increase in loan and advances must increase the volume of the dependent variable i.e. Provision for loan loss.

Table 4.20: Correlation, Coefficient of Determination and Probable Error between Provision for Loan Loss and Loans & Advances

r	r²	P.Er.	6*P.Er
0.4444	0.1975	0.3589	2.1534

Source: Appendix 6

As predicted by the calculations, there is positive degree of correlation between two variables. So, changes in loans and advances will certainly result the changes in provision for loan loss. The value of (r) is greater lower 6 * P.Er. So the coefficient of correlation is significant. Similarly, coefficient of determination 0.1975 explains that 19.75% of total variation in provision for loan loss is explained by loans and advances leaving only rest which is result of other factors. Here, other factor is again loans and advances, but difference is that in this case loans should be categorized to the higher degree of risk (i.e. nonperforming loan).

4.4.5 Correlation between Interest Income and Net Profit

The interest income contributes the major portion of total volume of commercial bank's income. This correlation measures the degree of linear relationship between interest income and net profit. Here, the interest income is independent variable and net profit is dependent variable.

Table 4.21: Correlation, Coefficient of Determination and Probable Error between Interest Income

and Net Profit

<i>Evaluation Criteria</i>			
r	r^2	P.Er.	6*P.Er
0.8204	0.6731	0.01462	0.0877

Source: Appendix 7

Table 4.21 shows that the value of (r) for KBL is significant and the linear relationship between these two variables is also positive, as the value of (r) is greater than seven times the P. Er. In determining the correlation, we can say that the net profit is dependent with interest income but not totally because as shown by the result coefficient of variation is not 1. As shown in the table 82.04% of variation in net profit is a result of interest income and rest of other factors.

4.5 Measuring the Growth Rate, Propensity of Growth based on Trend Value

So far we have calculated various measures of relative financial tools and absolute measures of statistical tools. In this section we shall examine the trend analysis of loans and advances, and EPS. The measures of trend analysis exhibit the behavior of given variables in a series of time. The performance of any commercial bank does not carry consistency over all the period and several factors causes the increase or decrease in the volume of various items of bank operation. The trend of any variable and the slope of trend line relating with the compound interest discount factor measures the growth rate of that variable. Thus along with the analysis of trend line, the growth rate has also been measured.

4.5.1 Trend Analysis, Growth Rate and Propensity of Growth of Loans and Advances.

Loan and Advances are the backbone of commercial banks. Volume of loans and advances directly affects the performance of the bank and its profitability as well. The trend line is obtained for the next five years and is based on least square methods of time series.

Table 4.22: Trend Equation, Growth Rate and Propensity of Growth of Loans & Advances

Table 4.22 exhibits linear equation based on $Y = a + bX$ of the bank and the average growth of the bank along with the propensity of growth with respect to the loans and advances. The growth exhibited by the table represents 12.35% growth, where it is likely to growth by Rs 1748.12m in one year period. However, the trend shows the encouraging sign as the loans and advances of the bank are likely to increase vastly in the future.

Figure 4.7

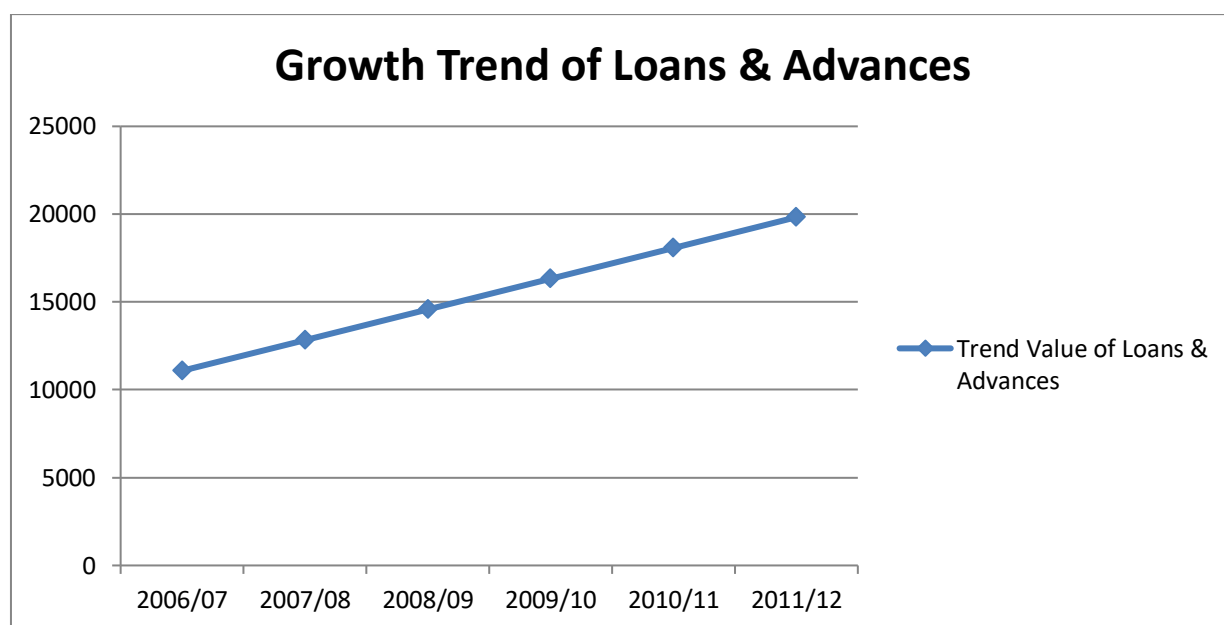


Figure 4.7 exhibits the trends lines representing the trend value performance of loans and advances of KBL. The trend line has been rising and representing that the bank has major focus on lending. The figure indicates that the bank will focus on lending as shown by the slope of the line. The slope of the line represents the high growth rate in its lending.

From this analysis, KBL can be concluded as a good performer in Loans and advances in the future. It has a good growth rate and the aspect of growing in loans in the future also looks good for the bank.

4.6 Major Findings of the Study

4.6.1 Findings from measurement of Lending Portfolio

1. Loans and advances to total assets ratio of the bank has been increasing. It shows that the bank has gradually increased its loans and advances almost since the past 5 years. This indicates that the bank has been following a policy of high lending. At the same time the assets of the bank has been increasing trend since the period. The ratio in the mean time also depicts that the bank has maintained a right mix of conducting other fee-based activity to move along with its loans and advances. However, the ratio cannot be deemed as outstanding but can be mentioned satisfactory.
2. The ratio of loans and advances to shareholders equity has gained significant importance in measuring the capital fund and corresponding contribution in loans and advances. There has been a good level of increment during the year 2006/07 and 2008/09; however this increase in the ratio is owed to the low volume of the entire component of shareholders' equity in the bank's capital mix and proportionately high volume of business. This has led KBL to be one of the best performers amongst the whole banking industry. Thus it can be concluded that the bank has been able to increase its loans and advances in proportion to the size of its capital.
3. Similarly, the absolute measures of lending strengths have revealed that the mean volume of net worth has a moderate variation. The average growth of the net worth throughout five years is measured at 17.20% indicating the bank has substantial success in maintaining the satisfaction to its shareholders and also has been able to increase the volume of its business. This reveals that the bank has been increasing its net worth by mean of loan and investment.
4. The volume contributed by KBL in case of loans and advances is highly appreciable. There is good level of increment in loan and advances. Loans and advances made during the year 2009/10 were somewhat lesser in comparison to other years because during that year the deposit were low and since deposit were low, proposed mobilization of funds could not be initiated. But the hindering part for the bank during that period was that even though the loans and advances for the past years were increasing, the bank could not continue and steady growth of loans and advances. However, there is excellent average growth of 11.51 percent over past five years.
5. One noted finding is that the bank is positive towards increasing its assets from the loans and advances. The performance of the bank is pointed to the right direction as it has cut out on its provision for loans and more important, the bank has made reductions in the non-performing loans of the bank. Thus, this concludes that the bank is stepping forward to efficiently

perform in the case of pace of development of the above variables.

6. The bank had earned a maximum interest during the fiscal year 2009/10, where as the highest level of increment is during the year 2008/09. The reason for the overall increase in the interest income lies in the fact that the lower interest earned through investment has been offset by the higher interest earned through loans and advances and vice versa. One other major factor contributing to the fluctuating rate of collection of interest could be because of the uncollected interest during yearly closing, which is counted towards expenses or receivables. Bank suffers through a high credit risk, which could have hampered the collection of the interest from the clients.
7. From the analysis of Loan Loss Provisioning of the bank it can be seen that it has been constant in the provisioning by the bank. Provisioning, if decreased is favorable to the bank as it decreases the liability of the bank, but on the other hand if the provisioning stays the same, that will be the result no additional business by the bank. Although, least increment of provisioning with an increase in the loans and advances of the bank is very good. Hence, the minimal increase in the provisioning of the loans and advances shows a positive effect on the bank's performance. Thus, we can predict that KBL either have been facing problem of risky assets (bad loans) or there is tremendous increase in loan and advances.
8. The figures of net profit reveal that KBL has good growth rate over last five years, which is good for goodwill of bank. From the calculation we can see that KBL has average growth rate of 15.75% in net profit over last five year's period.

4.6.2 Findings from analysis of Portfolio behavior of Loans and Advances

The portfolio analysis has revaluated that the flow of loan and advances in agriculture sector is the lowest contribution from the bank. The mean of 0.03% indicates very low contribution in this sector. The high operating cost, high degree of risk, small-scale loans etc. has made the commercial banks to flow low percentage of their credit in this sector. If the combined mean is taken as the standard percentage, then the performance of the bank in the manufacturing sector deserves a high degree of appreciations compared to other sectors. The contribution of the bank on the manufacturing sector is appreciable and the increase of credit in this sector is crucial for the national development also. However, bank should divert its lending to different sector because focusing to only one sector may create high risk for the bank's future. The lending in the commercial purpose has however, been efficient in the case of KBL. The contribution of the bank to this sector is given second priority from the data obtained. The service sector has been given importance by the bank. The bank has contributed 14% of its total credit to this sector.

4.6.3 Findings from Lending Efficiency & its Contribution in Total Profitability

1. The ratio of provision for loans and advances to loans and advances has a relatively lower degree of effect of KBL. There has been a variation on this ratio; however, a decline in this ratio has been noted in the earlier years and KBL has been able to maintain low level of ratio almost all the years. As per NRB directives, provisions against all type of loans should be done and booked under separate accounts. This type of regulations has been imposed by NRB in order to minimize the risk of loan and advances flowed by the banks. In case of KBL, we can see that some loans have been crossed the rating of good loan. Thus, from the analysis we can say that KBL has provisioned more than 1% for some of its loans, which shows that defaulters are present in KBL. However, ratio of five years predict that provisioned amount does not exceed 5% of total loan of KBL, which proves KBL has been putting its effort and is conscious to minimize the risky loans. Regarding NPL, KBL has to improve the category of its loan and try to minimize the bad loans, which fall under Non-performing Loan. Even though, the percentage of NPL of KBL is low, it will have to make a review of its lending policy to recover bad loans from its default clients, but certainly KBL has been putting efforts to reduce in Non Performing Loans (NPL) as we can see in the decrease in the amount of the NPL of KBL in the year 2008/09 and 2009/10 but after that gradually increase in year 2009/10 and 2010/11 that has affected performance of KBL.
2. The mean ratio of interest income to total income has concluded that the contribution of interest income to total income mixed of KBL has been just constant for the different years. The performance of KBL has been moderate and the average ratio indicates that the ratio 0.80 the five years do not have a high degree of deviation from the mean of the bank. This ratio indicates that the cost of funds in KBL is not so high and that it does have relatively less effect on this ratio. KBL, has advancement of technology and modern banking, thus, it has capitalized in collection funds in the cheapest possible price.

4.6.4 Findings from measurement of Profitability Ratios

1. Among the various measures of profitability ratios, the total income total assets ratio measures the earning power of each rupee employed by an organization irrespective of volume of expenditure incurred. The ratio of total income to total expense measures the earning capacity a rupees of expenses. The ratio indicates how much a rupee of expense would result in total income. Thus higher the ratio, better the productivity of expenditure. The productivity of expense in KBL is so good as it's a rupee expense is able to contribute 1.72

times the expenditure made. Regarding the performance of a bank, it is considered good to have a total income to total expense ratio of more than 2.

2. The EPS reflects the relative measures of profitability. The performance of KBL is relatively not so satisfactory. But the high volume of reserve and surplus in the capital mix of KBL has resulted in the bank to acquire a compromising position as compared to net profit to shareholders equity ratio. Although there is decrease in EPS of KBL over last one year, it is made somewhat the KBL should have to improve their business because it has not gone down from the mean EPS of KBL.

4.6.5 Findings from measurement of correlation between different variables

The correlation chapter has shown generally high degree of significant correlation between all the variables.

The bank has a high degree of correlation in respect of total deposits and total loans and advances, shareholder's equity and loans & advances, total income and loans and advances, which are indicative of good performance of KBL in generating profit through lending. This also concludes that increment in deposits is the most likely to increase the volume of loans and advances. As far as the lending function and its correlation with other variables are concerned, the correlation of KBL has shown the best contribution toward national economy. There is also a high degree of correlation between shareholders' equity and loans and advances and between total income and loans and advances, which predicts the return generated by lending of KBL has a great contribution towards bank's profitability.

4.6.6 Findings from Trend Analysis

1. Trend analysis has revealed the future performance of KBL in the case of loans & advances. The slope of the trend line is high in the bank. Especially, through the pattern of the recent times, KBL's efficiency in loans & advances is forecasted to increase. The measured growth, depending on the trend values, has projected the increasing performance of KBL's for next one year. The growth rates of loans & advances of KBL seem good. This added to the vital power of lending in KBL. The high degree of growth in loans and advances puts the bank in a good position in the lending functions for the future.
2. The propensity of growth measured by trend analysis also reveals KBL's forecasted good performance, not only in the percentage growth but also in the volume of growth.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

In this chapter we examine the processed data to come into summary, conclusions on the performance of the bank on an individual basis and put some recommendation for the subject bank in order to improve its weaknesses. This chapter is divided into summary, conclusions and recommendations.

5.1 Summary and Conclusion

The lending strengths of KBL in term of exposure of loans and advance is good. The ratio of loans & advances to total assets, loans & advances to shareholder's equity indicate a good performance of KBL in its lending activities. The bank has been able to upgrade the performance by increasing its loan portfolio. If KBL succeeds in collecting the cheap sources of fund in the future, the lending strengths of KBL would push its performance upward.

Viewing the productivity of loans and advances and its contribution in the national economy, the performance of KBL has been satisfactory. The contribution made by this bank in agricultural purpose, however, is lower; it has increased contribution to the manufacturing sector continuously. A considerable percentage of KBL's credit has been granted to unproductive sector of general use and social purpose; however such loans are also required in order to improve individual's social status and fulfillment of basic needs. But the overall slowdown in the economy, increasing failure of the industrial sector in generating profit, increasing tendency bad performance of industrial loan etc. has put KBL to the tough stage. Thus, element of credit risk in KBL has increased due to the failure of industrial sector in the economy. If the present economic conditions improved and the industrial performance turned to success, KBL would be the superior entity in the commercial banking groups in the future. Whatsoever the case, the contribution made by the bank in industrial sector of the economy is highly appreciable.

The propensity of growth of loans and advances is good but the opportunity in lending activities is limited, thus there is uncertainty to meet the expected growth. This however, decreases the bank's capability in making credits but if the economy takes the upward trend there would certainly be a strong position of KBL in terms of lending, which will help to generate more

profit. Looking at the asset management ratio, the performance of KBL seems good in the area of lending, productivity and impact on national economy. The activity ratio on the other hand, also reflects to the soaring performance of KBL. The decreasing loan loss provision ratio is the indicative of the bank's better performance in judging the good customers. The high growth rate, proportionately high volume of loans and advances, better contribution to the industrial sector and the increasing level of deposits mobilization, has put the bank into one of the most competitive banks in the industry. It has also been able to contract a good renowned position in the lending function as deemed by the national priority, and national development. However, better activity ratio of this bank, been a major contributor in managing the lending portfolio according to the demand of the profit oriented business. The high volume of lending activity of KBL has put this bank in the top position in absolute term. Thus, looking at the various summaries and findings, we can conclude that the bank has accelerated its performance in the year 2006/07 and has continued till 2009/10 and the bank has the potentiality to become a leading bank in Nepal.

5.2 Recommendation

Based on the findings in chapter four and above conclusions the following recommendations have been forwarded:

1. The rural economy has always been realizing the credit needs; the dominancy of non-organized moneylender in this area has been prevailing. To compromise between the liquidity and credit need of rural economy, the bank is highly recommended to expand its credit in this area. This helps minimizing idle fund in business and at the same time to contribute to the national economy.
2. The ratio between loans and advances and shareholders' equity shows that there is good growth rate over last five years. This implies that KBL is able to increase loans proportionately with the capital. So, Bank should continue to maintain or further increase this performance.
3. The provision on loan loss and relatively decreasing volume of non-performing loans in KBL does somewhat attention. The moderate volume of NPL in KBL may have caused a slight hassle in the performance of the bank. But the bank must get rid of its accumulated bad debts and show high efficiency.

Following the normal guidelines of NRB and acting upon this also reduces many of the credit risk arising from borrower's defaulter, lack of proper credit appraisals, black listed borrowers,

and willful defaulters. The over confidence in commercial banks regarding credit appraisal efficiency and negligence in taking information from Credit Information Bureau has caused many bad debts in the bank. Hence, the bank is recommended to follow the directives of NRB strictly and be more cautious and realistic while granting loans and advances. The major solution of reducing the risk is to avoid lending in the more risky area until the bank is fully satisfied regarding the future viability of the project. Although the government has established an office named 'Debt Recovery Tribunal' in order to help the banks for recovery of bad debts. An additional effort for establishment of 'Assets Management Company', which helps the banks in collecting their debts and improving their credit rating efficiency, should be initiated.

4. There is slightly change in Net worth of KBL in last year, which is good for banks image and shareholders' satisfaction. This type of change is due to increase in loans and advances over last year. Shareholders' satisfaction is one of the major factors for bank's status. Thus, the bank is recommended to increase sustainable banking practice to cope up with the future challenges in the coming days by continually increasing loans and advances.
5. As examined by interest income and interest expense ratio, the interest gap is highly favorable for the bank. This ratio has clearly indicated that the bank is able to maintain the maximum gap of 5% between interest collected and interested paid as permitted by NRB. Thus, bank is recommended to increase this gap especially by increasing interest rate on lending. Increasing interest rate on lending generates high return to the bank and helps in increasing the sustainable lending practice with proper analysis. This will also create room to solicit deposit in case of liquidity crunch by mean of offering higher interest rate. However, this type of changes should be implement with due care because there is high risk of losing existing business, so tiny analysis of market is required for this.
6. The actual status of any bank is explored by net profit of that bank. KBL's net profit shows a good sign of growth, so there is confidence in public towards KBL. So, KBL is recommended to continue the present growth rate over net profit in order to maintain its status by focusing on the strength of lending and giving emphasis to mobilize the collected deposit to the great extent.
7. The ratio contribution made by the bank in agriculture and priority sector does not look fulfilling. KBL's volume of agricultural and priority sector both is not satisfactory, though lending to agricultural is increasing. Since, the prosperity of national economy is highly dependent upon this sector, the bank is recommended to increase its volume of credit to these

sectors. So, as focused by KBL, contribution to industrial sectors only does not complete the responsibility of the banks to the national economy. So, KBL should put effort to lend out money to the prioritized sectors like tourism, hydro powers, information and technology, and small scale businesses.

8. The high volume of liquidity shows that the high degree of lending strengths has been prevailing in the bank. The lack of reliable lending opportunities and fear of losing the principal in case of lending in rural sector has been keeping the bank less oriented towards the lending function to rural sector. Hence, the government should take appropriate action to initiate the banks to attract to flow credit in the rural economy. Imposing the compulsion by directives does not create long term healthy lending practices unless the commercial banks are not self motivated to flow credit in this sector. But in view of the risk element in lending, the banks still prefer to have a negative outlook in handling lending proposals. This attitude requires to be changed among the banks and any proposal coming to them should be processed to conform to banking norms so that it can be sanctioned for fulfillment of national and social objectives.
9. Finally, however, performance of KBL seems to be good till date, there is still many opportunities for further growth of the bank. KBL is suggested to further improve current position of lending portfolio. The bank should concentrate on financial strengths, personal integrity and credibility of the borrower for loan disbursement. It should maintain high level of monitoring and control system over the disbursed loans and advances. To create opportunities of new business and attractive lending schemes should be launched to the public. KBL should be more responsive towards national economy and economic development. It should not neglect the deprived sector, as upliftment of this sector plays vital role for national economy. The bank should avoid credit concentration to a limited sector in order to maintain its performance. If there is recession to any specific sector, remaining sectors of economy may function well and there may not be severe impact on the whole lending portfolio of the bank. NRB also should be more concerned and active for proper monitoring and formulating or reviewing its policies and regulations to safeguard the interest of the banks.

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APPENDICES

Appendix 1

Main Financial and Economical Indicators of Kumari Bank Limited

(NRs. In Millions)

Particulars	2006/07	2007/08	2008/09	2009/10	2010/11
Total Assets /Total Liabilities	12,324.4	15,619	19,265.10	21,499.70	21,902.70
Net Worth	1,025.63	1,364.89	1,624.95	1,785.75	2,213.83
Loan and Advances	10,370.00	12,578.84	16,477.81	16,157.16	17,321.50
Shareholder Equity	750.00	1,470.00	1,186.00	1,306.00	1,485.00
Priority Sector loans	171.06	306.03	421.00	470.90	467.90
Total Income	994.13	1,166.13	1,763.30	2,235.83	2,844.57
Interest Income	791.28	957.25	1,374.25	1,871.07	2,251.79
Interest Expenses	397.05	498.73	816.20	1,188.92	1,566.55
Net Interest Income	394.23	458.52	558.05	682.15	685.24
Net Profit	194.95	188.68	291.65	342.53	291.00
Provision for Loan loss	24.95	64.02	57.40	13.07	113.78
Non-performing Loans	75.70	166.04	72.50	86.60	194.00
Earning per Share (EPS)	22.70	16.35	22.04	24.24	15.67
Total Deposit	10,560.00	12,781.00	15,860.60	17,408.50	16,986.30

Appendix 2

Mean Standard Deviation and Coefficient of Variation of Net Worth

Fiscal Year	Net Worth (X)	(X- \bar{X})	(X- \bar{X}) ²
2006/07	1,025.63	-577.38	333367.66
2007/08	1,364.89	-238.12	56701.13
2008/09	1,624.95	21.94	481.36
2009/10	1,785.75	182.74	33393.91
2010/11	2,213.83	610.82	373101.07
Total	8,015.05	0.00	797,045.14

$$\text{Mean } (\bar{x}) = \sum \frac{X}{n} = \sum \frac{8015.05}{5} = 1603.01$$

$$\text{S.D.}(\delta) = \sqrt{\frac{\sum(x-\bar{X})^2}{n-1}} = \sqrt{\frac{797045.14}{5-1}} = \sqrt{199261.29} = 446.39$$

$$\text{C.V.} = \frac{\delta}{\bar{x}} \times 100\% = \frac{446.39}{1603.01} \times 100\% = 27.85\%$$

Appendix 3

Correlation, Coefficient of Determination and Probable Error between Total Deposit and Total Loans & Advances

Fiscal Year	Total Deposit (X)	Total Loan and Advance (Y)	X ²	Y ²	XY
2006/07	10560	10370	111513600	107536900	109507200
2007/08	12781	12578.84	163353961	158227215.7	160770154
2008/09	15860.6	16477.81	251558632.4	271518222.4	261347953.3
2009/10	17408.5	16157.16	303055872.3	261053819.3	281271919.9
2010/11	16986.3	17321.5	288534387.7	300034362.3	294228195.5
Total	73596.4	72905.31	1118016453	1098370520	1107125423

$$\begin{aligned} \text{Correlation } (\rho) &= \frac{n \sum XY - \sum X \times \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}} \\ &= \frac{5 \times 1107125423 - 73596.4 \times 72905.31}{\sqrt{5 \times 1118016453 - 73596.4^2} \sqrt{5 \times 1098370520 - 72905.31^2}} \\ &= 0.9709 \end{aligned}$$

$$\text{Determination } (\rho^2) = (0.9709)^2 = 0.9426$$

$$\text{Probable Error} = 0.6745 \times \frac{1 - \rho^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.9426}{\sqrt{5}} = 0.0256$$

Appendix 4

Correlation, Coefficient of Determination and Probable Error between Shareholder's Equity and Total Loans & Advances

Fiscal Year	Shareholder's Equity (X)	Total Loan and Advance (Y)	X ²	Y ²	XY
2006/07	750.00	10,370.00	562,500.00	107,536,900.00	7,777,500.00
2007/08	1,470.00	12,578.84	2,160,900.00	158,227,215.75	18,490,894.80
2008/09	1,186.00	16,477.81	1,406,596.00	271,518,222.40	19,542,682.66
2009/10	1,306.00	16,157.16	1,705,636.00	261,053,819.27	21,101,250.96
2010/11	1,485.00	17,321.50	2,205,225.00	300,034,362.25	25,722,427.50
Total	6,197.00	72,905.31	8,040,857.00	1,098,370,519.66	92,634,755.92

$$\begin{aligned} \text{Correlation } (\rho) &= \frac{n \sum XY - \sum X \times \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}} \\ &= \frac{5 \times 92634755.92 - 6197 \times 72905.31}{\sqrt{5 \times 8040857 - 6197^2} \sqrt{5 \times 1098370519.66 - 72905.31^2}} \\ &= 0.6379 \end{aligned}$$

$$\text{Determination } (\rho^2) = (0.6379)^2 = 0.4069$$

$$\text{Probable Error} = 0.6745 \times \frac{1 - \rho^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.4069}{\sqrt{5}} = 0.02652$$

Appendix 5

Correlation, Coefficient of Determination and Probable Error between Total Income and Loans & Advances

Fiscal Year	Total Income (X)	Total Loan and Advance (Y)	X ²	Y ²	XY
2006/07	994.13	10,370.00	988,294.46	107,536,900.00	10,309,128.10
2007/08	1,763.30	12,578.84	3,109,226.89	158,227,215.75	22,180,268.57
2008/09	1,374.25	16,477.81	1,888,563.06	271,518,222.40	22,644,630.39
2009/10	2,235.83	16,157.16	4,998,935.79	261,053,819.27	36,124,663.04
2010/11	2,844.57	17,321.50	8,091,578.48	300,034,362.25	49,272,219.26
Total	9,212.08	72,905.31	19,076,598.68	1,098,370,519.66	140,530,909.36

$$\begin{aligned} \text{Correlation } (\rho) &= \frac{n \sum XY - \sum X \times \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}} \\ &= \frac{5 \times 140530909.36 - 9212.08 \times 72905.31}{\sqrt{5 \times 19076598.68 - 9212.08^2} \sqrt{5 \times 1098370519.66 - 72905.31^2}} \\ &= 0.72 \end{aligned}$$

$$\text{Determination } (\rho^2) = (0.72)^2 = 0.5184$$

$$\text{Probable Error} = 0.6745 \times \frac{1 - \rho^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.5184}{\sqrt{5}} = 0.2153$$

Appendix 6

Correlation, Coefficient of Determination and Probable Error between Provision for Loan Loss and Loans & Advances

Fiscal Year	Provision for Loan Loss (X)	Total Loan and Advance (Y)	X ²	Y ²	XY
2006/07	24.95	10,370.00	622.50	107,536,900.00	258,731.50
2007/08	64.02	12,578.84	4,098.56	158,227,215.75	805,297.34
2008/09	57.40	16,477.81	3,294.76	271,518,222.40	945,826.29
2009/10	13.07	16,157.16	170.82	261,053,819.27	211,174.08
2010/11	113.78	17,321.50	12,945.89	300,034,362.25	1,970,840.27
Total	273.22	72,905.31	21,132.54	1,098,370,519.66	4,191,869.48

$$\begin{aligned} \text{Correlation } (\rho) &= \frac{n \sum XY - \sum X \times \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}} \\ &= \frac{5 \times 4191869.48 - 273.32 \times 72905.31}{\sqrt{5 \times 21132.54 - 273.22^2} \sqrt{5 \times 1098370519.66 - 72905.31^2}} \\ &= 0.4444 \end{aligned}$$

$$\text{Determination } (\rho^2) = (0.4444)^2 = 0.1974$$

$$\text{Probable Error} = 0.6745 \times \frac{1 - \rho^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.1974}{\sqrt{5}} = 0.3589$$

Appendix 7

Correlation, Coefficient of Determination and Probable Error between Interest Income and Net Profit

Fiscal Year	Interest Income (X)	Net Profit (Y)	X ²	Y ²	XY
2006/07	791.28	194.95	626,124.04	38,005.50	154,260.04
2007/08	957.25	188.68	916,327.56	35,600.14	180,613.93
2008/09	1,374.25	291.65	1,888,563.06	85,059.72	400,800.01
2009/10	1,871.07	342.53	3,500,902.94	117,326.80	640,897.61
2010/11	2,251.79	291.00	5,070,558.20	84,681.00	655,270.89
Total	7,245.64	1,308.81	12,002,475.81	360,673.17	2,031,842.48

$$\begin{aligned} \text{Correlation } (\rho) &= \frac{n \sum XY - \sum X \times \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}} \\ &= \frac{5 \times 2031842.48 - 7245.64 \times 1308.81}{\sqrt{5 \times 12002475.81 - 7245.64^2} \sqrt{5 \times 360673.17 - 1308.81^2}} \\ &= 0.8204 \end{aligned}$$

$$\text{Determination } (\rho^2) = (0.8204)^2 = 0.6730$$

$$\text{Probable Error} = 0.6745 \times \frac{1 - \rho^2}{\sqrt{N}} = 0.6745 \times \frac{1 - 0.6730}{\sqrt{5}} = 0.01462$$