

LOAN MANAGEMENT OF COMMERCIAL BANKS
(A Comparative Study of NABIL and SCBNL Banks)

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March, 2010

RECOMMENDATION

This is to certify that the thesis

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Entitled

LOAN MANAGEMENT OF COMMERCIAL BANKS (A Comparative Study of NABIL and SCBNL Banks)

has been prepared as approved by this department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

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VIVA-VOCE SHEET

We have conducted the viva-voce examination of the thesis presented by
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LOAN MANAGEMENT OF COMMERCIAL BANKS

(A Comparative Study of NABIL and SCBNL Banks)

And found the thesis to be the original work of the student written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for Masters Degree in Business Studies (M.B.S).

Viva-Voce Committee

Head of Research Department :.....

Member (Thesis Supervisor) :.....

Member (External Expert) :.....

Date:.....

DECLARATION

I Hereby declare that the work reported this thesis entitled "**Loan Management of Commercial Banks (A comparative Study of NABIL and SCBNL)** ", submitted to Office of the Dean, Faculty of Management Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Master's Degree in Business Studies (M.B.S.) under the supervision of Associate Professor Pradeep Kumar Aryal, Central Department of Management.

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Binod Bista

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ABBREVIATIONS

BOK	: Bank of Katmandu
CBs	: Commercial Banks
FY	: Fiscal Year
GDP	: Gross Domestic Product
HBL	: Himalayan Bank limited
i.e.	: That is
LBL	: Lumbini Bank Limited
Ltd.	: Limited
NABIL	: Nepal Arab Bank Limited
NBBL	: Nepal Bangladesh Bank Limited
NBL	: Nepal Bank Limited
NCCBL	: Nepal Credit and Commerce Bank Limited
NEPSE	:Nepal Stock Exchange Limited
NIBL	: Nepal Investment Bank Limited
NICBL	: Nepal Industrial & Commercial Bank Limited
NRB	: Nepal Rastra Bank
NSBI	: Nepal SBI
NSBIBL	:Nepal State Bank of India Bank Limited
RBB	: Rastriya Banijya Bank Limited
Rs.	: Rupees
SCBNL	: Standard Chartered Bank Nepal Limited

CHAPTER-I

INTRODUCTION

1.1 Background of the Study

Loan management is the essence of the commercial banking consequently the formulation and implementation of lending policies are among the most important responsibilities of the directors and management. Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit. Loan management effects on the company's profitability and liquidity so it is one of the crucial decisions for the commercial banks. The banks take almost care in analyzing the creditworthiness of the borrowing customer to ensure that the interest and the principal amount on loans are timely recovered without much trouble and process for the recovery. A sound lending policy is essential for the good performances of the bank are further to attain economic objectives directed towards acceleration of the development. Lending policy should be carefully analyzed and the banks should be carefully while performing its credit creation effectively and to minimize the risk factor.

Lending is one of the most important functions of the commercial bank and the composition of the loans and advances directly affects the performance and profitability of the bank. There is intense competition in banking business with limited market and less investment opportunities available.

Due to loan management is not satisfactory and its being national issue and to contribute towards the topic through the study among the lot of topics, the loan management topic is selected. Thus study aims to focus on the comparative loan management of Nabil Bank Ltd and Standard Chartered Bank Ltd.

Commercial banks are major financial institutional, which occupy quite important place in the framework in every economy because they provide capital for the development for the industry. Commercial banks formulate

sound investment policies to make it effective, which eventually contribute to the economic growth of the country. The bound policies help commercial banks maximizing the quality and quantity of investment and hereby achieve the own objective if profit maximization and social welfare. Formulation of sound investment policies and co-ordinate and planned efforts pushed forward the forces of economic growth.

The need of financial resources in developing country like Nepal is essential for the economic development of country. The entire sector from industrial and economical to agriculture and infrastructure are in need of finding. Although the growth of industrial loans has not been encouraging in the recent years, there is sizable growth in commercial and other short term credits. Commercial banks are focusing loans on consumer loans like housing, vehicle, education loan etc. it is encouraging to explore to new sector for loan management but it should also be considered that industrial loan should be given prime importance as the economy largely depends on this sector.

Lending policies are not systematic and no clear cut vision of policy is available on lending aspect. In Nepal it has been found that on approval and lending decisions are made flexible to flavor the personnel networks. A new customer finds that loan providing process being very complicated and sometimes the documents submitted for loan sanctioning being fraudulent and for formality purpose only.

Loan management strongly recommends analyzing and managing the credit risks. Credit risk is defined as the possibility that the borrower will fail to meet its obligations in accordance with the agreed terms and conditions credit risk is not restricted to lending activities only but includes off balance sheet and inter-bank explores. The goal of the credit risk management is to maximize a bank's risk adjusted rate of return by maintaining the credit risk exposure within acceptable parameters. For most banks, loan are the largest and most obvious sources of credit risk, however other sources of credit risk exist through out the

activities of a bank, including in the banking book, and in the trading book, and both increasingly facing credit risk in various financial other than land, including acceptance, inter bank transactions and guarantees and the settlement of the transaction.

The loan management policy of a firm provides the framework to determine whether or not to extend credit and how much credit to extend. The loan management policy decision of a bank has two broad dimension; credit standard and credit analysis. A firm has to establish and use standards in making credit decisions, develop appropriate sources of credit information and methods of credit analysis.

The name and the year of the establishment of the commercial banks in have been listed below.

List of Commercial Banks in Nepal (Mid July 2009)

<u>S.N.</u>	<u>Name</u>	<u>Operation Date</u>
<u>(A.D.)</u> 1		Nepal Bank Limited
	(NBL) 1937/11/15	
2	Rastriya Banijya Bank (RBB)	1966/01/23
3	NABIL Bank Limited (NABIL)	1984/07/16
4	Nepal Investment Bank Limited (NIBL)	1986/02/27
5	Standard Chartered Bank Nepal Ltd. (SCBN)	1987/01/30
6	Himalayan Bank Limited (HBL)	1993/01/18
7	Nepal SBI Bank Limited (NSBI)	1993/07/07
8	Nepal Bangladesh Bank Limited (NBBL)	1993/06/05
9	Everest Bank Limited (EBL)	1994/10/18
10	Bank of Kathmandu Limited (BOK)	1995/03/12
11	Nepal Credit and Commerce Bank Ltd. (NCCBL)	1996/10/14
12	Lumbini Bank Limited (LBL)	1998/07/17
13	Nepal Industrial & Commercial Bank Ltd. (NIC)	1998/07/21
14	Machhapuchhre Bank Limited (MBL)	2000/10/03

15	Kumari Bank Limited (KBL)	2001/04/03
16	Laxmi Bank Limited (LXBL)	2002/04/03
17	Siddhartha Bank Limited (SBL)	2002/12/24
18	Agriculture Development Bank Limited	2006/03/16
19	Global Bank Limited	2007/01/02
20	Citizens Bank International Limited	2007/06/-21
21	Prime Bank Limited	2007/09/24
22	Sunrise Bank Limited	2007/10/12
23	Bank of Asia Nepal Limited (BOA)	2007/10/12
24	DCBL Bank Limited (DCBL)	2008/05/25
25	NMB Bank Limited (NMB)	2008/06/02
26	Kist Bank Limited	2009/05/07

Bank is defined as a financial intermediary that canalizes funds between deposits and entrepreneurs. It is a financial institution that accepts deposits and channels the money into lending activities. In a general sense, banks act as a financial intermediary. Intermediation is between deposits and entrepreneurs. A bank is an institution that deals with money by accepting deposits from the general public, corporate bodies and private organizations and deploys for profitable purpose in the form of loans and advances. Bank by accepting deposits takes up the role of custodian of public money. The transactions in the financial market heavily depend upon the banking system of the country. Without bank, it will be quite impossible for the industrialist and the entrepreneurs to go directly to general public for getting their saving or investments. So, the simplest definition is that, bank takes the savings of the public by providing them with certain rate of interest and loans it to needy customers charging them higher rate of interest and thus, earns some profit by doing these transactions. This is the broadest form of the banking, but at this age of time, their functions have increased manifold. Remitting of money, letter of credit, guarantee, issue of money, controlling monetary activities of country, etc. are also major functions of bank. For better understanding, an in depth

study of bank has been conducted. The term bank is mainly related to financial transactions to operate, run and facilitate various monetary activities.

According to Concise Oxford Dictionary, the term bank has been defined as “A bank is an establishment of the custody of money which it pays out on customers’ order.” In the word of Kent, “A bank is an organization whose principal operations are converted with the accumulation of the temporarily idle money of the general public for the purpose of advancing to other for expenditure.” A banker and a bank is a person or company carrying on the business of receiving moneys, and collecting drafts, for customers subject to the obligation of honoring cheques drawn upon them from time to time by the customers to the extent of the available on their current accounts.

Therefore bank can easily be defined as the custodians of deposits. Bank is an institution which deals with money by accepting various types of deposits, disbursing loans and rendering other financial services “A bank is a business organization that receives and hold deposits of funds from other, grants loans or extends credits and transfers funds by written orders of depositors”.

“The more developed financial system of the world characteristically falls into three parts: central bank, commercial banks and other financial institutions. The two banks selected for the study are joint venture commercial banks.

1.1.1. A Brief Profile of the Banks

Nabil Bank Ltd.

Nabil bank, 1st choice in Nepal. Nabil bank, the 1st foreign joint venture Bank set up in the nation with an objective to introduce modern banking services was registered under the Company Act, 1964, commenced its operations on 12th of July 1984 with Rs 28 million capitals and around 50 staff. Dubai Bank limited, Dubai was the foreign joint venture partner who extended Nabil a technical service agreement in the initial period the Bank, through its quality customer

service and innovative products. Has today attained a distinguished recognition in the banking industry of Nepal.

The Bank provides a complete range of consumer retail, SME and corporate banking service through its offices spread across the country. Nabil is the sole banker to a multitude of large corporate, international aid agencies, NGO's and embassies, it is the largest private bank in the country in terms of branch and ATM network. On the technological front, the Bank has earned a reputation in providing an array of card products and any branch banking service. Nabil Bank is committed to surge ahead to continue to be the bank.

Standard Chartered Bank Ltd.

Standard Chartered Bank Limited was registered under the Company Act, 1964 in 1987. Standard Chartered Bank Limited has been in operation in Nepal since 1987. The Bank is an integral part of Standard Chartered group having an ownership of 75% and the balance owned by the Nepalese public. The bank is the largest international bank currently operating in Nepal.

Standard Chartered has a history of over 150 years in banking and operates in many of the world's fastest-growing markets in over 70 countries. Standard Chartered employs almost 75,000 people, representing over 115 nationalities, worldwide. This diversity lies at the heart of the bank's values and supports the bank's growth as the world increasingly becomes one market with 16 points of representation, 17 ATM and more than 350 local staff, Standard Chartered Bank Nepal Limited is in a position to serve its customers through an extensive domestic network. In addition, the global network of Standard Chartered group gives the bank a unique opportunity to provide truly international banking service in Nepal. Standard Chartered Bank Nepal Limited offers a full range of banking products and services in wholesale and consumer banking, the bank has been the pioneer in introducing 'customer focused' products and services and

aspires to continue to be a leader in introducing new products in delivering superior services.

1.2 Focus of the Study

Banks have today gained paramount trust of the public. Banking industry offers a wide range of services addressing the needs of public in different walks of life. At present, a large number of banks are operating in Nepal. Naturally, they are rendering a wide range of services. They are trying to keep up pace with the changes taking place in the world. But quantity does not count for quality. The financial institution of all classes 'A' to 'D' are increased every year. In a small economy like Nepal, it is a question of great concern as to how so many banks are surviving and reaping profit. The concern is not only about these days but also the sustainability of the operating banks in future days also. Therefore the report will try to concentrate on two major private sector banks of Nepal, i.e. Nabil Bank Limited and Standard chartered Bank Limited. It will focus on the comparative loan management of these two banks regarding profitability, liquidity, leverage positions, cost minimization, etc.

1.3 Statement of the ~~problem~~ Problem

–Loan management is the essence of the commercial banking; consequently the formulating and second lending policies are among the most important responsibilities of directors and management. Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit. Loan management effects on the company's profitability and liquidity so it is one of the crucial decisions for the commercial banks.

The need of financial resources in a developing country like Nepal is essential for the economic development of country. The entire sector from industrial and economical to agriculture and infrastructure are in need of finding. Although the growth of industrial loans has not been encouraging in the recent years, there is sizable growth in commercial and other short term credits. Commercial

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banks are focusing loans on consumer loans like housing, vehicle, education loan etc. it is encouraging to explore to new sector for loan management but it should also be considered that industrial loan should be given prime importance as the economy largely depends on this sector.

Lending policies are not systematic and no clear cut vision of policy is available on lending aspect. In Nepal it has been found that on approval and lending decisions are made flexible to favors to personal networks also. A new customer finds that loan providing process being very complicated and sometimes the documents submitted the loan sanctioning being fraudulent and for formally purpose only. In this perspective the study deals with the following issues:

-) How effectively is the lending policy of selected sample bank is being followed?
-) Whether the trend of the deposit sand loans of the commercial banks are satisfactory?
-) How the sample banks measures the liquidity position and impact of deposit on liquidity?
-) What is the portion of lending between customer and industrial loan?
-) How the banks measure the lending between consumer and industrial loan?
-) How the banks measure the lending performance in quality, efficiency and contribution of profitability

1.51.4 Objective of the Study

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The main objective of the study is to analyze the loan management policy adopted by the sample banks. However the specific objectives are as follows:

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-) To analyze the effectiveness of lending policy of the selected sample banks.
-) To measure the performance in quality, efficiency and contribution of profitability.
-) To examine the trend of the deposit and loans of commercial bank.
-) To study the liquidity position, the impact of deposit in liquidity and its effect on lending performance.
-) To provide suggestions and recommendation for the proper loan system.

1.6.5 Significance of the ~~s~~Study

There are few researches done in loan management of commercial banks. Loan management is one of most important aspect of the bank. The study of analysis of loan management of the chosen selected banks would be beneficial to the shareholders, banking professionals, investors, teachers and students of banking management.

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This study is focuses in the qualitative measurement of the selected banks. Similarly, the finding of the study will equally important to other who is interested in knowing about this particular bank. Last but not the least, it will provide relevant and pertinent literature for the future research on the area of loan management of the banks.

1.6.7 Limitation of the ~~study~~ Study

Since, the study is focusing to fulfill the partial fulfillment for the requirement course of MBS of T.U. It has some limitation. We have limited resources and may be difficult to explore researcher to find out new aspect. Reliability of statistical tools used and lack of research experience are the major limitation and some other limitations can be enlisted as follows:

-) This research is limited to the lending aspect mainly with the loan and advanced only.
-) The secondary data is used to analyze and interpretation for result. So the accuracy of the finding depends on the reliability of available information.
-) In some extent, the data published on the website of related banks has been taken.
-) Due to time and resource factor only two commercial banks are taken for the study.
-) The study covers the time period of 2004/2005 to 2008/2009.
-) There could be many factors affecting loan management decision. However only those factors related with lending policy has been considered in this study.

1.8.7 Organization of the Study

This study has been organized into five chapters.

Chapter-I: Introduction

The first chapter deals with the subject matter consisting introduction, background of the study, statement of the problem, objective of the study, significance of the study, limitation of the study and organization of the study.

Chapter II: Review of Literature

-The second chapter is mainly focused with literature review that includes a discussion on the conceptual framework on loan management and review of major – studies relating with lending decision.

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Chapter 3III: Research and Methodology

The third chapter describes the research methodology used to conduct the present research. It deals with research design, sources of data, data processing procedures, population and sample; period of the study, method of analysis and financial and statistical tools.

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Chapter 4IV: Data Presentation and Analysis

The fourth chapter is concerned with analytical framework. It includes the analysis of financial indicators. Analysis of mean, correlation coefficient, regression analysis, trend analysis and financial analyses, the major findings are included are the end of the chapter.

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Chapter 5V: Summary, Conclusion and Recommendations

The fifth chapter includes the summary, conclusion and recommendations of the study which deals about the main theme of study and comparison of lending policy of the banks with recommended for improvement of loan management of the selected banks. The bibliography and annexes are also incorporated at the end of the study.

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CHAPTER-II

REVIEW OF LITERATURE

Review of literature mainly covers two parts. The first section of this chapter includes theoretical framework whereas second part is confined to review of the previous studies carried out by the various researchers. In this chapter, the overall concept and view of “financial performance” will be streamlined through the review of relevant literature related to this study. This chapter includes the conceptual framework, review of empirical studies, review of Nepalese study and research gap.

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2.1 Conceptual Framework

Bank is considered as the backbone in the development of the national economy. It is a financial institution, which acts as a transaction of money by accepting various types of deposit, disbursing loans and rendering other financial services. So, among the various function to provide loan to the environment of the investment and the bank and the bank has the major role in creating such an environment.

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Banks plays vital role in the economic development of a country. In fact, in the modern industrialized and service oriented era. The availability of the banks with competitive services is the measure of economic development of a country. While many people believe that banks play only a narrow role in the economy taking deposit and making loans the modern banking has had to adopt new roles in order to responsive to public needs. The principal role that a bank today play are:

The intermediate role:

▲ Transferring the saving received primarily from the households into credit (loans) for business firms and other in order to make investments in the new building, equipment and other capital goods.

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The Payment Role

▲ Carrying out payment for goods and services on behalf of their customer (such as by issuing and clearing cheque and dispersing currency and coins.)

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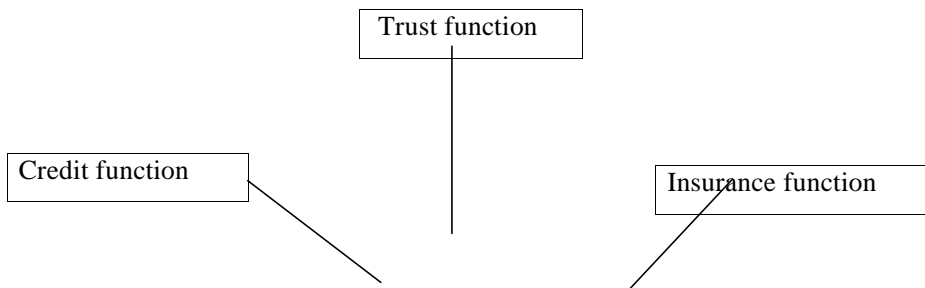
The Policy Role

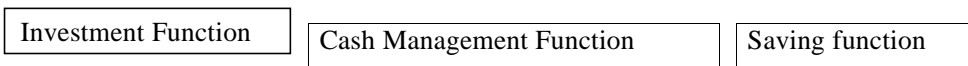
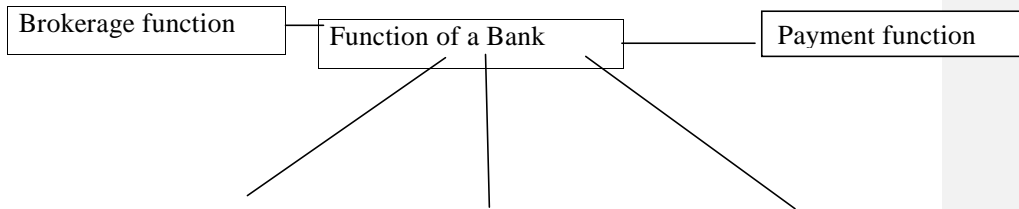
▲ Servicing as a conduct for government policy in attempting to regulate the growth of the economy and pursue social goal. Some of the vital functions performed by a full banking service institution today are summarized in the figure below.

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Figure 2.1
Functions of a Bank





The Guarantor Role:

Starting behind the customers to pay off the customers debt when those customers are unable to pay (such as by issuing letters of credit). Some of guarantees are big bond, performance bond etc.

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The Agency Role

Acting on behalf of the customers to manage and protect or issue and redeem their securities. During the last two and half decades the Nepalese Financial System has grown significantly. At the beginning of 1980s, there were only two commercial banks and two development banks in the country. After the adoption of economic liberalization policy, particularly the financial sector liberalization that paved the way for establishment of new banks and non-bank financial institutions into the country. Consequently, by the end of mid – January 2009, altogether 235 banks and non- bank financial institutions licensed by NRB are in operation. Out of them, 25 are “A” class commercial banks, 59 “B” class development banks, 78 “C” class finance companies, 12 “D” class micro-credit development banks, 16 saving and credit co-operatives and 45 NGOs.

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-) The number of commercial bank branches operating in the country increased to 617 in mid Jan 2009 from 555 in mid July 2008. Among the total bank branches, 48.95 percent bank branches are concentrated in the central region alone. By the end of mid Jan 2009, total 302 branches are being operating in this region. However, in the western, eastern, mid-western and far- western region are 19.45 percent (120), 19.29 percent (119), 7.78 percent (48) and 4.54 percent (28) respectively.
-) Entry of new banks in financial system along with increased in the business, the total assets i.e sources of fund of commercial banks went up by higher rate of 20.40 percent compared to 15.51 percent in the previous year. By the end of this fiscal year, the total assets of commercial banking sector reached to Rs. 682372.9 million from Rs 566736.0 million in the last year.
-) The share of loans and advances to total assets decreased to 49.99 percent in mid Jan 2009 from 53.45 percent in mid July 2008. Similarly, investment and liquid funds registered the 18.46 percent and 11.10 percent respectively. In the preceding year, the respective shares were 19.23 percent and 11.80 percent.
-) The composition of liabilities of commercial banks shows that, the deposit has occupied the dominant share of 70.32 percent followed by borrowing 3.16 percent and capital fund 2.42 percent in the mid Jan 2009. The respective shares of deposit, borrowing and capital fund in the previous year were 75.18 percent, 2.54 percent and 1.76 percent. Among the component of assets, loans and advances occupied the highest share of 49.99 percent followed by total investment 18.46 percent and liquid fund 11.10 percent in the same year.
-) In the mid Jan 2009, the loans and advances increased at lower rate of 12.62 percent compare to 32.30 percent in mid July 2008. By the end of mid Jan 2009, the total outstanding amount of loans and advances of

commercial banks reached to Rs. 341127.9 million. It was Rs. 302913.4 million in mid July 2008.

) The total investment of commercial banks in mid Jan 2009 increased by 15.65 percent and reached to Rs. 126002.1 million from Rs. 108954.8 million in mid July 2008. Similarly liquid fund increased by 13.25 percent and amounted to Rs. 75735.9 million.

) In the mid Jan 2009, total deposit of commercial bank increased by 12.62 percent compare to 26.25 percent growth in the mid July 2008. As of mid Jan 2009, it reached to Rs. 479864.2 million from Rs 426080.3 in the mid July 2008. Among the component of deposit, current deposit increased with rate of 8.71 percent compare to 24.56 percent in last year. Similarly, saving deposit and fixed deposit increased by 14.15 percent and 11.33 percent respectively.

) The saving deposit comprises the major share in total deposit followed by fixed deposit and current deposit. As of mid Jan 2009, the proportion of saving, fixed, and current deposits are 50.30 percent, 24.31 percent, and 12.71 percent respectively. In the last year the respective share of saving, fixed and current deposit were 49.63 percent, 24.59 percent and 13.16 percent.

) In the mid Jan 2009, the borrowing increased by higher rate of 49.58 percent compared to 13.00 percent in the previous year, By the end of mid Jan 2009, it reached to Rs. 21551.9 million from Rs. 14408.2 million in the mid July 2008.

) The entry of new banks as well as rise in the capital base by some of old banks attributed to change its Capital Fund. It is increased remarkable by 65.73 percent compared to previous year and reached to Rs. 16508.3 million in mid Jan 2009. It was Rs. 9960.7 million in mid July 2008.

) Out of the Rs. 344077.8 million outstanding credits in mid Jan 2009, the largest proportion of the loans and advances is occupied by manufacturing sector. The share of this sector is 23.43 percent followed by wholesale &

retailers' 17.32 percent, others 16.35 percent, construction 10.84 percent and finance, insurance & fixed assets by 8.88 percent. Similarly, service industries comprise 6.66 percent, transportation, communication & public services by 5.19 percent and agriculture by 4.15 percent in the same year.

) The outstanding of deprived sector credit of commercial banks in the mid Jan 2009 increased by higher rate of 99.62 percent compared to 12.41 percent in the mid July 2008. By the end of mid Jan 2009, it reached to Rs. 15353.60.million from Rs. 7691.40 million in mid July 2008. Sector credit to total outstanding loans and advances stood at 4.50 percent in the current fiscal period. Last year it was 2.82 percent.

) In mid Jan 2009, the credit to deposit ratio of the commercial banks remained same as of mid – July 2008. It was 71.09 percent as in mid July 2008. The ratio was 67.84 percent in mid July 2007.

) The non-performing loan of commercial banks declined significantly to 5.38 percent in mid Jan 2009 from 6.08 percent in the July 2008. The total amount of NPA remained to Rs. 18548.20 million from Rs. 18648.5 million in the July 2008.

Loans and advance

▲ The total loans and advances dispersed by the banking industry on Mid July 2008 rose by 36.14 percentages as compared to previous year and reached to Rs.274.16 billion. The loans and advances of the public banks have increased by 14.31% and private banks by 43.46%. The credit flow of the private commercial banks is growing in increasing trend. Though the credit growth of public sector bank is not consistent still their credit is also increasing.

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The Nepalese Banking system is riddled with a significant amount of Non Performing assets (NPA). The total volume of NPA as on Mid July 2008 was Rs.20.47 billion, which was Rs.25.56 billion in the previous year. The NPL ratio of public sector banks has come down to 15.01 percent from 55.13 percent of year 2003/04. Similarly, the NPL ratio of private sector banks combined has also come down to 2.55 percent from 5.82 percent of year 2003/04. It is clearly evident from the following picture that the volume of Non Performing assets is on the decline while the total loans (shown in above table) are continuously increasing, thus resulting in a favorable proportion of Non Performing With regard to quality of the loan portfolio of the individual banks, Nepal BangladeshBank (NPL-31.73%) followed by Rastriya Banijya Bank (21.43%), Nepal Credit & Commerce Bank (16.42%), Lumbini Bank Ltd. (14.92%), Nepal Bank Ltd. (12.38%), and Agriculture Development Bank (11.69%) hold double digit NPL. The volume of Non Performing assets, which was largely on account of the portfolio of the public banks last year, has switched to private banks in year 2007/08.

Non-Performing Loans of the Banks

Nepal Rastra Bank has prescribed a provision on all loan accounts of the banks, which escalates as the quality of the loan deteriorates. The banks are required to create loan loss provisions on the gross value of outstanding loans, rather than on the net loans, and they are not allowed the relaxation in terms of the value of the collaterals. The banks, thus, have to create provisions in accordance to the quality of their loan portfolios. So, the public banks with large volumes of Non Performing assets have large provisions in their balance sheets while the provisions of the private banks (except NBBL, NCCL, and LBL) are relatively lower. After the reform program was initiated in the public banks, the volume of NPA, both gross as well as net has come down, significantly. The loan loss provision being higher than non-performing assets indicates that the proportion

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of good loan is getting higher in the total credit portfolio and non-performing loans are getting lower.

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(Source: Annual Reports of 26 Commercial Banks '2008/09')

Sources of Major Problem in Credit Risk Management

Effective credit risk management allows a bank to reduce risks and potential NPLs. It also offers other benefit. Once banks understand their risk and their costs, they will be able to determine their most profitable business and thus j, credit-risk strategy supported by organizational changes, risk measurement technique and fresh credit process and systems. In the context of Nepal, the sources of major problems in credit risk management are as follows (Ramamurthy, 2004:3-5).

- (i) Financial statement (including audited) do not reflected a “true and fair view” of the business entity due to creative accounting. The audited financial statement as submitted by the customers do not reflect details relating to
-) Encumbrance’s change on the company’s current/ fixed assets plus to whom they are changed.
 -) Details of group company lending/borrowings
 -) Status of income assessment etc.
 -) Contingent liabilities.
 -) Accounting policies.
 -) Delegation of finding authority is based on seriously and not a complexes of the concerned officials.
 -) No exchange of credit information lack of transparency among the competition banks giving rise to multiple banking complicating to excessive shortfall etc.
 -) Absence of: Risk based pricing methodologiesCustomer risk rating methods Facility risk rating modelsPronounced name lending. Collateral

based lending instead of need based/ cash flow based lending. Over banked center contributing for severe competition and price cutting. Lack of corporate governance Permissive banking practice including names, lending, multiple banking etc. Macro level scenario of political inability slow growing economy, small domestic market. Ineffective judiciary Cross border risk disappearance of promoters Inadequacy of law to deal with crime like cheating, misfeasance.

2.2 Review of Books

Peter Rose (1999) in her book “Commercial Bank Management” states “Achieving superior profitability for a bank depends upon several crucial factors:

1. Careful use of financial leverage or the proportion of bank assets financed by debts as opposed by the shareholders equity capital.
2. Careful use of operating leverage from fixed assets or the proportions of fixed cost input the bank used to boost its operating earnings before taxes as bank output grows.
3. Careful control of operating expenses so that more dollars of sales revenue become net income.
4. Careful management of assets portfolio to meet liquidity needs while seeking the highest returns from any assets acquired.
5. Careful control of the bank’s exposure to risks so that the losses don’t overwhelm its income and equity capital”.

Michael R. Baye and Dennis W. Jensen (1996) through their book ‘Money, banking and financial market: an economic approach’ have tried to analyse the bank’s profitability under an economic approach. They state “to maximize profits, banks should attract deposits unto the point where the value of marginal producer of deposits equals the interest rate paid on deposits.”

Rose Kolari & Fraser (2002) in the book, 'Financial Institutions: Understanding and managing financial services' says the following:

"Banks earn interest on loans and investments; they pay interest to the depositors. When interest rates changes, there may be an effect on income if a bank holds rate sensitive assets and liabilities. If, for example, a bank holds more rate sensitive assets than liabilities when interest rate rise, profits will be improved because the bank will receive more in increased interest revenue than it will pay out in rising costs. The reverse would be true during a period of falling interest rates.

The interest gap is the difference between rate sensitive assets and liabilities; holding more rate sensitive assets than liabilities is called a positive gap and excess of rate sensitive liabilities over assets result in a negative gap" (Fraser & Ormiston, 2002: 32)

Emphasizing the bank's modern functions Meir Kohn (1999) writes in his book, 'Financial institutions and markets': "Banks now have steadily expanded their activities in payment related services, in delegation and trust services, in credit substitution and services, and in forward transactions. In doing so, they have pursued economies of scope, relatively unconstrained by regulations" (Kohn; 1999:12).

Analyzing the behaviour and future prospects for profitability of a financial institution is a complex task. Many factors affect each institution's profitability. Among the most important factors are the friskiness of loans and investments made; liquidity needs and the institution's provision for these needs; the effectiveness of tax management practices; the level of efficiency in utilizing human and non-human resources; and the ability of management to control expenses (particularly interest expenses and employee costs). Well conceived lending policies and lending practices are essential if a bank is to perform its creating function effectively and minimize the risk inherent in any extension of credit (Kolari & Fraser; 1993: 124-125).

Mr. Shiva Raj Shrestha (2059), deputy director of NRB gave the following criteria for the measurement of commercial banks performance stating that “The financial health and performance of commercial banks should be evaluated under the following perspectives:

1. Deposit transactions
2. Position of investments, loans advances and overdrafts
3. Cash and liquidity position
4. Foreign currency reserve
5. Qualitative factors of loans and advances
6. Capital fund
7. Reserve funds, contingency and other funds
8. Interest rate
9. Position of income
10. Customer base and volume
11. Sources and uses of finance
12. Extension of banking services
13. Off-balance sheet transactions
14. Earnings per share
15. Banking personnel” (Shrestha; 2059: 107-108).

2.3 Review of Previous Studies

2.3.1 Review of Articles

Kshetry (2057), in his article says “To strike balance between profitability and services to the community, commercial banks should force on activities that provide energy to speed up the productivity and diversify services in the community” (Kshetry; 2057: 142).

Pradhan (1991), published his article in which he pointed out some major issue in local commercial banks in comparison of recently established joint venture banks through his article “Nepal ma Banijya Bank: Upalabdhi Tatha Chunauti.” The study dealt with the whole commercial banking system of Nepal in respect of their performance and profitability. Some of his finding relevant to this study is summarized as:

1. The deposit collection rate of banks is very poor in comparison to joint venture banks.
2. The patterns of deposits are also different between these banks. The ratio of current deposit in local banks is 9.34% only where the same as the joint venture banks is 52.5%. But the fixed deposit ratio is very high in local banks” (Pradhan; 1991: 3).

Shrestha (2055), Deputy Chief Officer of Nepal Rastra Bank, Banking Operation Department, giving a short glimpse on the “Portfolio management in commercial bank, theory and practice” figured out the following.

Investors would like to select a best mix of investment assets subject to following aspects:

1. Certain capital gains
2. Good liquidity with adequate safety of investment
3. Maximum tax concession
4. Flexible investment
5. Economic, efficient and effective investment mix.

He suggested that the banks having international network can also offer access to global finance markets. He pointed out the requirements of skilled manpower, research and analysis team and proper management of information system (MIS) in any commercial bank. Mr. Shrestha concluded that:

-) The survival of the banks depends upon their own financial health and various activities.
-) The Nepalese banks having greater network and access to national and international capital markets have to go for portfolio management activities for the increment of their fee based income as well as to enrich the client base and contribute in national economy (Shrestha; 2055: 45).

Karki (2057), summarized some of the challenges of Nepalese financial sector through his article “Nepalese Financial Sector: Challenges and Some Solution” that:

“The liquidity position of the banking sector is rated as high as 24 percent, but the productive sector of the economy is starved by credit crunch. This has created a paradoxical situation in the banking sector. The financial institutions especially commercial banks have to identify new areas of investment to increase loans and advances to reduce the liquidity position.

With the rapid growth in the number of bank, deposit insurance scheme is a must for social justice rather than economic justification” (Karki; 2057: 26-30).

Sharma (2000), opined “Private commercial banks have mushroomed only in the urban areas where banking transactions in larger volume is possible. The rural and sub-urban areas mostly remain unattended to any of these kinds of opportunities. This is likely to prevail till competition takes its full pace and reign in the urban areas” (Sharma, 2000: 13).

2.3.2 Review of Thesis

Dhungana (2003) in his thesis entitled “A study on joint venture banks’ profitability” concluded that the profitability ratio of all the joint venture banks i.e., NABIL, NIBL and SCBNL were satisfactory, and their efficiency was also satisfactory in utilizing the deposits. However, they were found to mobilize savings from different parts of the country. The profit indicated in their financial

statement was an inflated one, fluctuation in the foreign currency being the main reason.

The basic objectives of the research were to appraise Joint Venture Banks appropriately for the application of profitability and other objectives were listed as below:

-) To highlight the current profit planning adopted and its effectiveness in Joint Venture Banks.
-) To observe Joint Ventures Bank Profit Planning on the basis of overall managerial budget developed by the bank.
-) To analyze the variance of budget and actual achievement.
-) To study the growth of the business of the Joint Venture banks over the Period.

Major Findings observed in his study are as follows:

-) Objectives of the joint venture bank are expressed in literary form and not specified clearly therefore there is higher danger of it being misinterpreted in the ways of one's benefit by the concern
-) Major concentration of resources mobilization of NB bank is at deposit mobilization. In this respect they are increasing higher cost towards deposit mobilization.
-) Deposit mobilization of Joint Ventures bank is found to be considerable growing every year. (Dhungana, 2003:78).

Another researcher Khadka (2005) in his thesis entitled "A study on investment policy of NABIL in comparison to other joint venture banks of Nepal" found that the liquidity position of NABIL was worse than that of SCBNL and NIBL. The basic objectives of the research were to study investment policy of banks and other objectives were listed as below:

-) To highlight the investment policy of sample banks and its effectiveness credit management.
-) To study the liquidity and profitability position of sample banks.
-) To study the growth of the deposit and investment of sample banks over the period.

The banks such as NCC and NBBL were found to be having the worst performance as compared to all other private sector commercial banks. NABIL had been found to have more current assets as loans & advances but fewer amounts as investment on government securities. NABIL was comparatively less successful in on-balance sheet operations as well as in off-balance sheet operations than that of any other joint venture commercial banks. Profitability position of NABIL was also not found to be so better as other commercial banks despite NCC and NBBL. NABIL was more successful in deposit mobilization but had lower performance to maintain high growth rate of profit as compared to SCBNL and NIBL. Mr. Khadka suggested the joint venture banks to be more careful in increasing profit in real sense to maintain the confidence of shareholders, depositors and customers. The banks were strongly recommended to utilize their risky assets and shareholders' funds to gain highest profit margin and reduce their expenses and collect cheaper funds for attaining more profitability. So the banks were recommended to invest their funds in different sectors of investment strategies and administer various deposit schemes to collect funds such as cumulative deposit scheme, prize bonds scheme, gift cheque scheme, house building deposit scheme, etc

Khadka has strongly recommended Nabil to utilize its risks assets and shareholders fund to gain highest profit margin and reduce its expenses and collect cheaper fund for more profitability. He has recommended investing its assets in different sectors of investment and administering various deposits schemes to collect cheaper fund such as cumulative deposit scheme, prize bonds, gift cheque, house building deposit scheme etc. (Khadka, 2005: 82).

Shrestha (2008) in his thesis entitled “Profitability Analysis of Standard Chartered Bank Nepal Limited and Nabil Bank Limited”. The basic objectives of the research were to study investment policy of banks and other objectives were listed as below:

-) To study the profitability position of banks and its effectiveness on overall performance of banks.
-) To study the liquidity position of sample banks.
-) To study the growth of the profit, deposit and investment of banks over the period.

The following are the major findings of the study:

-) SCBNL had more consistent operating efficiency ratio than Nabil bank limited during the study period.
-) Both of the banks data showed that more than 90% of their total liabilities paid interest. These banks showed that smaller portion of their interest bearing liabilities paid as interest expenses.
-) Both the banks’ weighted average cost of deposit ratio was found to be at decreasing rate.
-) Nabil bank had lower EPS than SCBNL, which indicated that the performance of SCBNL was better than Nabil.
-) SCBNL was paying more dividend than Nabil bank limited during the study period. The amount of dividend was almost double for SCBNL than Nabil. It meant that Nabil was in need of fund, so it was paying fewer dividends and adding more amounts under the head of retained earnings.
-) Among the total income, more than 75% of the income came from interest sector. That indicated the main source of income was interest for both the banks.

-) The operating expenses ratio over total expenses comprised of more than 40% for both the banks.
-) Nabil had fluctuating return on total assets than SCBNL. SCBNL had higher return on equity than Nabil. Return on equity of Nabil was more fluctuating than that of SCBNL. SCBNL had higher return on equity ratio than that of Nabil.
-) SCBNL had also higher interest earned to total asset ratio than Nabil.
-) The total interest income to total earning assets ratio of both the banks were found decreasing over the years, which indicates a negative sign to the bank's performance.
-) Nabil bank's net profit margin ratio was higher than that of SCBNL. Similarly, net interest margin of Nabil was also higher than that of SCBNL (Shrestha, 2008: 76-77).

Another researcher Shrestha (2008) in his study "Cost volume and profit analysis of commercial banks: A case study of HBL" concluded that:

-) CVP analysis had not been practiced yet.
-) There was no practice of segregating the total costs into fixed and variable components. The costs were roughly classified and the classification was not scientific and appropriate.
-) All levels of management were not found to involve in profit planning and decision making of the bank.
-) There was no complete and comprehensive budgeting system.
-) There was no use of conducting the SWOT analysis.
-) The bank was found to invest more than 90% of its investment fund in government debentures only.
-) The lending of the bank was at an increasing trend.

-) Income from interest was at decreasing trend in the later years of study.
-) Margin of safety was excessively higher than BEP sales. And therefore it indicated the well performance of the bank on an average.

Karki, (2008) has conducted a research on “A Study of Investment Policy in Nepal Arab Bank Limited”, in comparison other joint venture banks in Nepal.

His research objectives of the study are as follows:

- i) To measure the banks investment policy. The lending strength shall be measured in absolute to analyze the volume of contribution made by each bank.
- ii) To determine the liquidity position, the impact of deposit in liquidity and its effect on lending practices.
- iii) To analyze the portfolio behavior of lending and measuring the ratio and volume of loans and advances made in agriculture, priority and productive sector.
- iv) To measure the impact of investment in quality, efficiency and its contribution in total income.

Based on the above objectives of the study, his research findings of the study are as follows:

The steady and high volume of loans and advances throughout the years has resulted Nabil's ratio to be the highest. Nabil has deployed the highest proportion of its total deposits in earning activities and this ratio is significantly above the normal ratios. This is the indicative of that in fund mobilizing activities Nabil is significantly better. In that topic he had recommended that in order to become success in competitive banking environment, bank should be able to utilize depositor's money as loans and advances. Since the largest items in bank's asset side is loans and advances, negligence of administering this could be the main cause of a liquidity crisis in the bank and also one of the main reasons of bank failure.

Kafle, (2009) in his study entitled “Non-performing Loans of Nepalese commercial banks.”

The researcher’s main objectives of the study are:

- i) To know the problems of the non-performing loans and its effect in the ROA and ROE of the Nepalese commercial banks
- ii) To find out whether the Nepalese commercial banks are following the NRB directives regarding loan loss provision for non-performing loan or not.
- iii) To make necessary suggestions and recommendations.

The major findings of the study are:

Through the research he has found that the no banks have been following NRB’s directives regarding the loan loss provision. He also conclude that the return on assets (ROA) and return on equity (ROE) of the bank deposited upon the NPLs. The high degree of negative correlation between NPL and ROA and the NPL and ROE clearly indicates that there is inverse relation between them. He has recommended that for the smooth operation of the commercial banks, the NPLs should be controlled for this bank should provide necessary training regarding loan management to the manpower’s. In order to remove, the NPLs, banks should take enough collateral so that banks can recover its loan amount. For the loan loss provision as per the NRB directive and to reduce the NPL, the bank management should be effective and the NRB’s monitoring and regulation is necessary.

2.4 Research Gap

Financial scenario and effectiveness of the banks has been changed in due period of time because of increase of number of financial institution in Nepalese economy. And it is observed that it is essential to study effectiveness of loan management of commercial banks taking samples of two banks: Standard Chartered Bank Limited and Nabil Bank Limited to support in fulfilling research gap. The review of above relevant literature has contributed to enhance

the fundamental understanding and knowledge, which is required to make study meaningful and purposive. There has been lots of article published on field of investment policy. Loans and advances of commercial banks .there are various research available on investment analysis and policy of commercial banks,impact and implementation of Nepal Rastra Bank guideline I commercial banks but there are not sufficient researches available on lending aspect of commercial banks. In addition to this, mo one has done a study on “loan management” with reference to Standerd charterd Bank and Nabil Bank Limited. Therefore the research attempts to study in this area. To know the loan management of these two banks will probably be the first study in this subject matter. So, this study will be fruitful to those interested person parties scholars, professor, students, businessman and government for academically as well as policy perspect.

CHAPTER-III

RESEARCH METHODOLOGY

This chapter is related to research methodology in this study. Research methodology is a way to systematically solve the research problem. In other words, research methodology describes the methods and processes applied in the entire aspect of the study. It may be understood as a science of studying how research is done scientifically. It is necessary for the researcher to know not only the research methods but also the methodology. This chapter includes the research design, population, and sample.

3.1 Research Design

Research design serves as a framework for the study, guiding the research instruments to be utilized, and the sampling plan to be followed. In other words, research design describes the general plan for collecting, analyzing, and evaluating data. Research design is a planned structure and strategy of investigation conceived to obtain answers to research objectives through analysis of data. The study is based on primary as well as secondary data. So the descriptive and analytical research designs have been used.

3.2 Population and Sample

A small portion chosen from the population for studying its properties is called a sample, and the number of units in the sample is known as the sample size. The method of selecting for study a small portion of the population to draw conclusions about characteristics of the population is known as sampling. Sampling may be defined as the selection of part of the population on the basis of which a judgment or inference about the universe is made. Here only 2 sample joint venture commercial banks have been taken out of 26 commercial banks. All the commercial banks in Nepal are the population of the study. The sample taken from the commercial banks are as follows:

TOTAL BANKS	SAMPLE TAKEN
26 Commercial Banks	NABIL and SCBN

3.3 Nature and Sources of Data

The research is based on secondary source of data for research purpose; published financial statements of concerned banks were collected. Similarly, financial statement of commercial banks and various markets related information were collected and tabulated in spreadsheet. Such secondary information was gathered from the share department of the concerned banks and Security Board of Nepal. In addition, an answer on certain queries made to staffs of concerned organization personal enquires and discussions were also being conducted for clarification and verification of colleted data and for recommendation.

3.4 Analysis of Data

To meet the objectives of the study, the sources of secondary data of commercial bank are analyzed by using financial tools such as ratio analysis. Simple descriptive analysis tools such as frequency, Mean, standard deviations are used. The ratio analysis involves comparison for a useful interpretation of financial statements. The quantities judgment regarding loan management of a firm can be done with the help of rate analysis. For the analysis of the data the financial and statistical tools relevant to the topic are used. They are as follows:

3.4.1 Financial Tools

Ratio Analysis

A ratio analysis is simply the number expressed in terms of another and as such it expresses the quantities relationship between any two numbers. Ratio can be expressed in terms of percentage, proportion and as coefficient. The technique of ratio analysis is a part of the whole process of analysis of financial statements of any business of industrial concern especially to take output and

credit decision. Through this technique a comparative study can be made between different statistics concerning varied facts of a business different statistics concerning varied facts of business units. Just as the blood pressure, pulse and temperatures are the measure of the health of an individual, so the ratio analysis measures the economic financial health of a business concern. Thus, the technique of ratio analysis is of a considerable significance in studying the financial stability, liquidity profitability and the quality of the business and industrial concerns (Kothari, 1994:169).

For the study period following ratios are analyzed.

- 1) Current Ratio
- 2) Liquid fund to Total liabilities Ratio
- 3) Liquid funds to Total Deposit Ratio
- 4) Total Assets to Total liability Ratio
- 5) Loans and Advances to Total Assets Ratio
- 6) Loans and Advances and Investment to Total Deposit Ratio
- 7) Loans and Advances to Shareholders Equity
- 8) Interest Income to Total Income Ratio
- 9) Interest Expenses to Total Deposit Ratio
- 10) Interest Income to Interest Expenses Ratio
- 11) Growth Ratio of Total Deposit
- 12) Growth Ratio of Loans and Advances
- 13) Growth Ratio of Total Investment
- 14) Growth Ratio of Net Profit

1) Current Ratio: It establishes the relationship between current assets and current liabilities. It is

Computed by dividing current assets by current liabilities. It is calculated as follows :

$$\text{current ratio} \times \frac{\text{current asset}}{\text{current liabilities}}$$

2) Liquid fund to Total liabilities Ratio: It establishes the relationship between liquid fund and current liabilities. It is computed by dividing liquid fund to total liabilities. Its formula is :

$$\text{Liquid fund to Total liabilities Ratio} = \frac{\text{Liquid fund}}{\text{Total liabilities}}$$

3) Liquid funds to Total Deposit Ratio: it measures the position of the liquid fund on total deposit which is calculated by dividing to total deposit. Its formula is as follows:

$$\text{Liquid funds to Total Deposit Ratio} = \frac{\text{Liquid fund}}{\text{Total Deposit Ratio}}$$

4) Total Assets to Total liability Ratio: this ratio measures the relationship between total asset and total liabilities. It is computed by dividing total assets to total liabilities. Its formula is as follows:

$$\text{Total assets to total liability ratio} = \frac{\text{Total assets}}{\text{Total liabilities}}$$

5) Loans and Advances to Total Assets Ratio: this ratio judge the position of loan and advances on total assets. It is calculated by dividing loan and advances by total assets. Its formula is as follows:

$$\text{Loans and Advances to Total Assets Ratio} = \frac{\text{Loans and Advances}}{\text{Total assets}}$$

6) Loans and Advances and Investment to Total Deposit Ratio: This ratio measures the position of loan and advances and investment on total deposit. It is computed by dividing loan and advances and investment by total deposit. it is calculated as:

$$\text{Loans and Advances and Investment to Total Deposit Ratio} = \frac{\text{Loans \& Advances \& Investment}}{\text{Total deposit}}$$

7) Loans and Advances to Shareholders Equity: it is calculated by dividing loans and advances to shareholders equity. Its formula is as follows

$$\text{Loans and Advances to Shareholders Equity} = \frac{\text{Loans and Advances}}{\text{Shareholders Equity}}$$

8) Interest Income to Total Income Ratio: it is measured by dividing Interest Income to Total Income. Its formula is as follows:

$$\text{Loans and Advances to Shareholders Equity} \times \frac{\text{Interest income}}{\text{Total income}}$$

9) Interest Expenses to Total Deposit Ratio: it measures the position of the Interest expenses on total deposit. It is computed by dividing interest expenses to total deposit. Its formula is as.

$$\text{Interest Expenses to Total Deposit Ratio:} \quad \times \frac{\text{Interest expenses}}{\text{Total Deposit}}$$

10) Interest Income to Interest Expenses Ratio: it measures the position of interest income on interest expenses, which is computed by dividing interest income to interest expenses. Its formula is as follows:

$$\text{Interest Income to Interest Expenses Ratio:} \quad = \quad \frac{\text{Interest income}}{\text{Interest expenses}}$$

11) Growth Ratio of Total Deposit: it measures the growth ratio of the company or organization, which is compared by two years deposits i.e. current year deposit and previous year deposit. The calculation may be shows the increasing or decreasing rate of growth of the deposit. It is calculated by dividing current year deposit by previous year deposit. Its formula is as follows:

$$\text{Growth Ratio of Total Deposit:} = \frac{\text{current years deposit}}{\text{Previous year deposit}}$$

12) Growth Ratio of Loans and Advances: its measure the growth rate of loan and advances comparative by current years and last years. It is calculated by dividing current year's loan and advances by last year loans and advances. Its formula is as follows:

$$\text{growth ratio of loans and advances:} = \frac{\text{current years loan and deposit}}{\text{Previous years loan and advances}}$$

13) Growth Ratio of Total Investment : it usually measures the growth rate of total investment, which is computed by dividing current year's total investment and last year's investment. Its formula is as follows:

$$\text{Growth Ratio of Total Investment :} = \frac{\text{current years total investment}}{\text{Previous years total investment}}$$

14)Growth Ratio of Net Profit: it usually measures the growth rate of net profit, which is computed by dividing current year's net profit by previous year's net profit. Its formula is as follows:

$$\text{Growth Ratio of Net Profit} = \frac{\text{current years net profit}}{\text{Previous years net profit}}$$

3.4.2 Correlation Coefficient Analysis

The analysis identifies and interprets the relationship between the two or more variables. Karl-Person's Correlation Coefficient has been used to find out relationship between the variables in order to know the effect in one variable may have effect in the correlated variable. In our study relationship between the various variable. It is calculated by:

$$r = \frac{n \sum xy - \sum x \cdot \sum y}{\sqrt{[n \sum x^2 - (\sum x)^2][n \sum y^2 - (\sum y)^2]}}$$

r = Correlation coefficient

n = Number of years

$\sum x$ = Sum of X series

$\sum y$ = Sum of Y series

$\sum xy$ = Sum of X and Y series

$\sum x^2$ = Sum of square of X series

$\sum y^2$ = Sum of square of Y series

x & y = Financial Variable of joint venture banks.

Correlation analysis describes the relationship between variables i.e. positive or negative. It helps to determine the following: A positive or negative relationship exists. The relationship is significant or insignificant. Establish cause and effect relation if any.

The statistical tool- correlation analysis is used in the study to measure the relationship between variables in determining whether the relationship is significant or not. For the purpose decision making interpretation are based on the following terms.

1. When, $r = 1$, then is perfect positive correlation.
2. When $r = -1$, then is perfect negative correlation.
3. When $r = 0$, then is no correlation.
4. When, 'r' lies between 0.7 to 0.999 (-0.7 to -0.999), then is high degree of positive (negative) correlation.
5. When 'r' lies between 0.5 to 0.6999 there is moderate degree of correlation.
6. When, 'r' is less than 0.5. There is low degree of correlation.

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

3.4.3 Trend Analysis

Trend analysis is the analysis of a firm's financial ratio over time used to estimate the likelihood of improvement or deterioration in its financial condition. It is important to analyze trend in ratios as well as their absolute level, for trends give clues as to whether a firm's financial condition is likely to improve or to deteriorate. Trend analysis is calculated by:

$$y = a + bx$$

$$\text{Here, } a = \frac{\sum Y}{N}$$

$$b = \frac{xy}{x^2}$$

Combine Mean is calculated by:

$$\bar{X}_{12} = \frac{\bar{X}_1 N_1 + \bar{X}_2 N_2}{N_1 + N_2}$$

CHAPTER-I

INTRODUCTION

1.1 Background of the Study

Loan management is the essence of the commercial banking consequently the formulation and implementation of lending policies are among the most important responsibilities of the directors and management. Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit. Loan management effects on the company's profitability and liquidity so it is one of the crucial decisions for the commercial banks. The banks take almost care in analyzing the creditworthiness of the borrowing customer to ensure that the interest and the principal amount on loans are timely recovered without much trouble and process for the recovery. A sound lending policy is essential for the good performances of the bank are further to attain economic objectives directed towards acceleration of the development. Lending policy should be carefully analyzed and the banks should be carefully while performing its credit creation effectively and to minimize the risk factor.

Lending is one of the most important functions of the commercial bank and the composition of the loans and advances directly affects the performance and profitability of the bank. There is intense competition in banking business with limited market and less investment opportunities available.

Due to loan management is not satisfactory and its being national issue and to contribute towards the topic through the study among the lot of topics, the loan

management topic is selected. Thus study aims to focus on the comparative loan management of Nabil Bank Ltd and Standard Chartered Bank Ltd.

Commercial banks are major financial institutional, which occupy quite important place in the framework in every economy because they provide capital for the development for the industry. Commercial banks formulate sound investment policies to make it effective, which eventually contribute to the economic growth of the country. The bound policies help commercial banks maximizing the quality and quantity of investment and hereby achieve the own objective if profit maximization and social welfare. Formulation of sound investment policies and co-ordinate and planned efforts pushed forward the forces of economic growth.

The need of financial resources in developing country like Nepal is essential for the economic development of country. The entire sector from industrial and economical to agriculture and infrastructure are in need of finding. Although the growth of industrial loans has not been encouraging in the recent years, there is sizable growth in commercial and other short term credits. Commercial banks are focusing loans on consumer loans like housing, vehicle, education loan etc. it is encouraging to explore to new sector for loan management but it should also be considered that industrial loan should be given prime importance as the economy largely depends on this sector.

Lending policies are not systematic and no clear cut vision of policy is available on lending aspect. In Nepal it has been found that on approval and lending decisions are made flexible to flavor the personnel networks. A new customer finds that loan providing process being very complicated and sometimes the documents submitted for loan sanctioning being fraudulent and for formality purpose only.

Loan management strongly recommends analyzing and managing the credit risks. Credit risk is defined as the possibility that the borrower will fail to meet

its obligations in accordance with the agreed terms and conditions credit risk is not restricted to lending activities only but includes off balance sheet and inter-bank explores. The goal of the credit risk management is to maximize a bank's risk adjusted rate of return by maintaining the credit risk exposure within acceptable parameters. For most banks, loan are the largest and most obvious sources of credit risk, however other sources of credit risk exist through out the activities of a bank, including in the banking book, and in the trading book, and both increasingly facing credit risk in various financial other than land, including acceptance, inter bank transactions and guarantees and the settlement of the transaction.

The loan management policy of a firm provides the framework to determine whether or not to extend credit and how much credit to extend. The loan management policy decision of a bank has two broad dimension; credit standard and credit analysis. A firm has to establish and use standards in making credit decisions, develop appropriate sources of credit information and methods of credit analysis.

The name and the year of the establishment of the commercial banks in have been listed below.

List of Commercial Banks in Nepal (Mid July 2009)

<u>S.N.</u>	<u>Name</u>	<u>Operation Date</u>
<u>(A.D.)</u> 1		Nepal Bank Limited
	(NBL) 1937/11/15	
2	Rastriya Banijya Bank (RBB)	1966/01/23
3	NABIL Bank Limited (NABIL)	1984/07/16
4	Nepal Investment Bank Limited (NIBL)	1986/02/27
5	Standard Chartered Bank Nepal Ltd. (SCBN)	1987/01/30
6	Himalayan Bank Limited (HBL)	1993/01/18
7	Nepal SBI Bank Limited (NSBI)	1993/07/07
8	Nepal Bangladesh Bank Limited (NBBL)	1993/06/05

9	Everest Bank Limited (EBL)	1994/10/18
10	Bank of Kathmandu Limited (BOK)	1995/03/12
11	Nepal Credit and Commerce Bank Ltd. (NCCBL)	1996/10/14
12	Lumbini Bank Limited (LBL)	1998/07/17
13	Nepal Industrial & Commercial Bank Ltd. (NIC)	1998/07/21
14	Machhapuchhre Bank Limited (MBL)	2000/10/03
15	Kumari Bank Limited (KBL)	2001/04/03
16	Laxmi Bank Limited (LXBL)	2002/04/03
17	Siddhartha Bank Limited (SBL)	2002/12/24
18	Agriculture Development Bank Limited	2006/03/16
19	Global Bank Limited	2007/01/02
20	Citizens Bank International Limited	2007/06/-21
21	Prime Bank Limited	2007/09/24
22	Sunrise Bank Limited	2007/10/12
23	Bank of Asia Nepal Limited (BOA)	2007/10/12
24	DCBL Bank Limited (DCBL)	2008/05/25
25	NMB Bank Limited (NMB)	2008/06/02
26	Kist Bank Limited	2009/05/07

Bank is defined as a financial intermediary that canalizes funds between deposits and entrepreneurs. It is a financial institution that accepts deposits and channels the money into lending activities. In a general sense, banks act as a financial intermediary. Intermediation is between deposits and entrepreneurs. A bank is an institution that deals with money by accepting deposits from the general public, corporate bodies and private organizations and deploys for profitable purpose in the form of loans and advances. Bank by accepting deposits takes up the role of custodian of public money. The transactions in the financial market heavily depend upon the banking system of the country. Without bank, it will be quite impossible for the industrialist and the entrepreneurs to go directly to general public for getting their saving or investments. So, the simplest definition is that, bank takes the savings of the

public by providing them with certain rate of interest and loans it to needy customers charging them higher rate of interest and thus, earns some profit by doing these transactions. This is the broadest form of the banking, but at this age of time, their functions have increased manifold. Remitting of money, letter of credit, guarantee, issue of money, controlling monetary activities of country, etc. are also major functions of bank. For better understanding, an in depth study of bank has been conducted. The term bank is mainly related to financial transactions to operate, run and facilitate various monetary activities.

According to Concise Oxford Dictionary, the term bank has been defined as “A bank is an establishment of the custody of money which it pays out on customers’ order.” In the word of Kent, “A bank is an organization whose principal operations are converted with the accumulation of the temporarily idle money of the general public for the purpose of advancing to other for expenditure.” A banker and a bank is a person or company carrying on the business of receiving moneys, and collecting drafts, for customers subject to the obligation of honoring cheques drawn upon them from time to time by the customers to the extent of the available on their current accounts.

Therefore bank can easily be defined as the custodians of deposits. Bank is an institution which deals with money by accepting various types of deposits, disbursing loans and rendering other financial services “A bank is a business organization that receives and hold deposits of funds from other, grants loans or extends credits and transfers funds by written orders of depositors”.

“The more developed financial system of the world characteristically falls into three parts: central bank, commercial banks and other financial institutions. The two banks selected for the study are joint venture commercial banks.

1.1.1. A Brief Profile of the Banks

Nabil Bank Ltd.

Nabil bank, 1st choice in Nepal. Nabil bank, the 1st foreign joint venture Bank set up in the nation with an objective to introduce modern banking services was registered under the Company Act, 1964, commenced its operations on 12th of July 1984 with Rs 28 million capitals and around 50 staff. Dubai Bank limited, Dubai was the foreign joint venture partner who extended Nabil a technical service agreement in the initial period the Bank, through its quality customer service and innovative products. Has today attained a distinguished recognition in the banking industry of Nepal.

The Bank provides a complete range of consumer retail, SME and corporate banking service through its offices spread across the country. Nabil is the sole banker to a multitude of large corporate, international aid agencies, NGO's and embassies, it is the largest private bank in the country in terms of branch and ATM network. On the technological front, the Bank has earned a reputation in providing an array of card products and any branch banking service. Nabil Bank is committed to surge ahead to continue to be the bank.

Standard Chartered Bank Ltd.

Standard Chartered Bank Limited was registered under the Company Act, 1964 in 1987. Standard Chartered Bank Limited has been in operation in Nepal since 1987. The Bank is an integral part of Standard Chartered group having an ownership of 75% and the balance owned by the Nepalese public. The bank is the largest international bank currently operating in Nepal.

Standard Chartered has a history of over 150 years in banking and operates in many of the world's fastest-growing markets in over 70 countries. Standard Chartered employs almost 75,000 people, representing over 115 nationalities, worldwide. This diversity lies at the heart of the bank's values and supports the bank's growth as the world increasingly becomes one market with 16 points of representation, 17 ATM and more than 350 local staff, Standard Chartered Bank Nepal Limited is in a position to serve its customers through an extensive

domestic network .in addition the global network of standard chartered group gives the bank a unique opportunity to provide truly international banking service in Nepal. Standard chartered Bank Nepal limited offers a full range of banking products and service in wholesale and consumer banking, the bank has been the pioneer in introducing 'customer focused' product and services and aspires to continue to be a leader in introducing new products in delivering superior services.

1.2 Focus of the Study

Banks have today gained paramount trust of the public. Banking industry offers a wide range of services addressing the needs of public in different walks of life. At present, a large number of banks are operating in Nepal. Naturally, they are rendering a wide range of services. They are trying to keep up pace with the changes taking place in the world. But quantity does not count for quality. The financial institution of all classes 'A' to 'D' are increased every year. In a small economy like Nepal, it is a question of great concern as to how so many banks are surviving and reaping profit. The concern is not only about these days but also the sustainability of the operating banks in future days also. Therefore the report will try to concentrate on two major private sector banks of Nepal, i.e.Nabil Bank Limited and Standard chartered Bank Limited. It will focus on the comparative loan management of these two banks regarding profitability, liquidity, leverage positions, cost minimization, etc.

1.3 Statement of the ~~problem~~Problem

–Loan management is the essence of the commercial banking; consequently the formulating and second lending policies are among the most important responsibilities of directors and management. Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit. Loan management effects on the company's profitability and liquidity so it is one of the crucial decisions for the commercial banks.

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The need of financial resources in a developing country like Nepal is essential for the economic development of country. The entire sector from industrial and economical to agriculture and infrastructure are in need of finding. Although the growth of industrial loans has not been encouraging in the recent years, there is sizable growth in commercial and other short term credits. Commercial banks are focusing loans on consumer loans like housing, vehicle, education loan etc. it is encouraging to explore to new sector for loan management but it should also be considered that industrial loan should be given prime importance as the economy largely depends on this sector.

Lending policies are not systematic and no clear cut vision of policy is available on lending aspect. In Nepal it has been found that on approval and lending decisions are made flexible to favors to personal networks also. A new customer finds that loan providing process being very complicated and sometimes the documents submitted the loan sanctioning being fraudulent and for formally purpose only. In this perspective the study deals with the following issues:

-) How effectively is the lending policy of selected sample bank is being followed?
-) Whether the trend of the deposit and loans of the commercial banks are satisfactory?
-) How the sample banks measures the liquidity position and impact of deposit on liquidity?
-) What is the portion of lending between customer and industrial loan?
-) How the banks measure the lending between consumer and industrial loan?
-) How the banks measure the lending performance in quality, efficiency and contribution of profitability

1.51.4 Objective of the Study

The main objective of the study is to analyze the loan management policy adopted by the sample banks. However the specific objectives are as follows:

-) To analyze the effectiveness of lending policy of the selected sample banks.
-) To measure the performance in quality, efficiency and contribution of profitability.
-) To examine the trend of the deposit and loans of commercial bank.
-) To study the liquidity position, the impact of deposit in liquidity and its effect on lending performance.
-) To provide suggestions and recommendation for the proper loan system.

1.6-5 Significance of the Study

There are few researches done in loan management of commercial banks. Loan management is one of most important aspect of the bank. The study of analysis of loan management of the chosen selected banks would be beneficial to the shareholders, banking professionals, investors, teachers and students of banking management.

This study is focuses in the qualitative measurement of the selected banks. Similarly, the finding of the study will equally important to other who is interested in knowing about this particular bank. Last but not the least, it will provide relevant and pertinent literature for the future research on the area of loan management of the banks.

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1.67 Limitation of the ~~study~~ Study

Since, the study is focusing to fulfill the partial fulfillment for the requirement course of MBS of T.U. It has some limitation. We have limited resources and may be difficult to explore researcher to find out new aspect. Reliability of statistical tools used and lack of research experience are the major limitation and some other limitations can be enlisted as follows:

-) This research is limited to the lending aspect mainly with the loan and advanced only.
-) The secondary data is used to analyze and interpretation for result. So the accuracy of the finding depends on the reliability of available information.
-) In some extent, the data published on the website of related banks has been taken.
-) Due to time and resource factor only two commercial banks are taken for the study.
-) The study covers the time period of 2004/2005 to 2008/2009.
-) There could be many factors affecting loan management decision. However only those factors related with lending policy has been considered in this study.

1.87 Organization of the ~~S~~study

This study has been organized into five chapters.

Chapter-~~I~~I: Introduction

The first chapter deals with the subject matter consisting introduction, background of the study, statement of the problem, objective of the study, significance of the study, limitation of the study and organization of the study.

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Chapter 2II: Review of Literature

-The second chapter is mainly focused with literature review that includes a discussion on the conceptual framework on loan management and review of major – studies relating with lending decision.

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Chapter 3III: Research and Methodology

The third chapter describes the research methodology used to conduct the present research. It deals with research design, sources of data, data processing procedures, population and sample; period of the study, method of analysis and financial and statistical tools.

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Chapter 4IV: Data Presentation and Analysis

The fourth chapter is concerned with analytical framework. It includes the analysis of financial indicators. Analysis of mean, correlation coefficient, regression analysis, trend analysis and financial analyses, the major findings are included are the end of the chapter.

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Chapter 5V: Summary, Conclusion and Recommendations

The fifth chapter includes the summary, conclusion and recommendations of the study which deals about the main theme of study and comparison of lending policy of the banks with recommended for improvement of loan management of the selected banks. The bibliography and annexes are also incorporated at the end of the study.

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CHAPTER-II

REVIEW OF LITERATURE

Review of literature mainly covers two parts. The first section of this chapter includes theoretical framework whereas second part is confined to review of the previous studies carried out by the various researchers. In this chapter, the overall concept and view of “financial performance” will be streamlined through the review of relevant literature related to this study. This chapter includes the conceptual framework, review of empirical studies, review of Nepalese study and research gap.

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2.1 Conceptual Framework

Bank is considered as the backbone in the development of the national economy. It is a financial institution, which acts as a transaction of money by accepting various types of deposit, disbursing loans and rendering other financial services. So, among the various function to provide loan to the environment of the investment and the bank and the bank has the major role in creating such an environment.

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Banks plays vital role in the economic development of a country. In fact, in the modern industrialized and service oriented era. The availability of the banks with competitive services is the measure of economic development of a country. While many people believe that banks play only a narrow role in the economy taking deposit and making loans the modern banking has had to adopt new roles in order to responsive to public needs. The principal role that a bank today play are:

The intermediate role:

▲ Transferring the saving received primarily from the households into credit (loans) for business firms and other in order to make investments in the new building, equipment and other capital goods.

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The Payment Role

▲ Carrying out payment for goods and services on behalf of their customer (such as by issuing and clearing cheque and dispersing currency and coins.)

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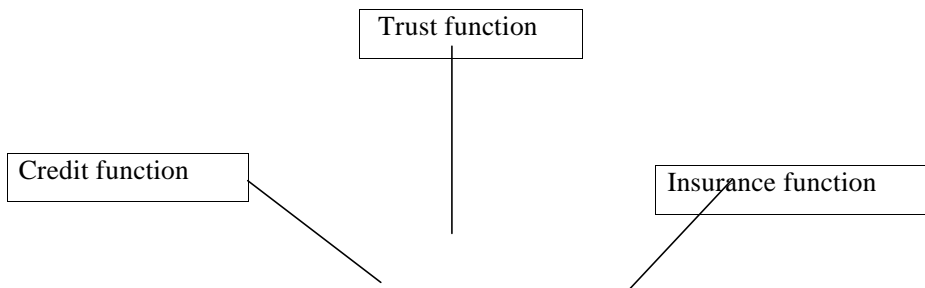
The Policy Role

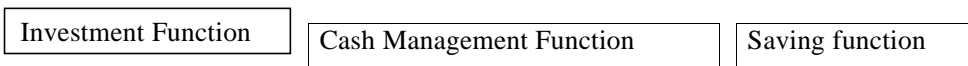
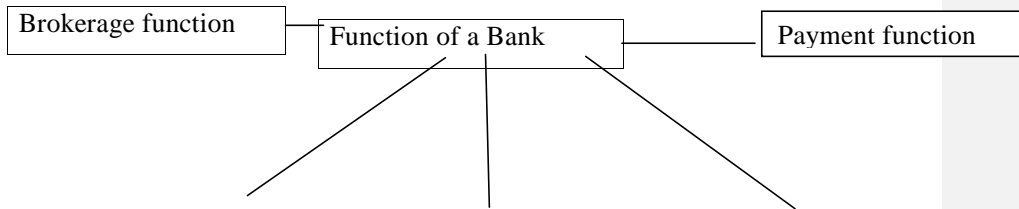
▲ Servicing as a conduct for government policy in attempting to regulate the growth of the economy and pursue social goal. Some of the vital functions performed by a full banking service institution today are summarized in the figure below.

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Figure 2.1
Functions of a Bank





The Guarantor Role:

Starting behind the customers to pay off the customers debt when those customers are unable to pay (such as by issuing letters of credit). Some of guarantees are big bond, performance bond etc.

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The Agency Role

Acting on behalf of the customers to manage and protect or issue and redeem their securities. During the last two and half decades the Nepalese Financial System has grown significantly. At the beginning of 1980s, there were only two commercial banks and two development banks in the country. After the adoption of economic liberalization policy, particularly the financial sector liberalization that paved the way for establishment of new banks and non-bank financial institutions into the country. Consequently, by the end of mid – January 2009, altogether 235 banks and non- bank financial institutions licensed by NRB are in operation. Out of them, 25 are “A” class commercial banks, 59 “B” class development banks, 78 “C” class finance companies, 12 “D” class micro-credit development banks, 16 saving and credit co-operatives and 45 NGOs.

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-) The number of commercial bank branches operating in the country increased to 617 in mid Jan 2009 from 555 in mid July 2008. Among the total bank branches, 48.95 percent bank branches are concentrated in the central region alone. By the end of mid Jan 2009, total 302 branches are being operating in this region. However, in the western, eastern, mid-western and far- western region are 19.45 percent (120), 19.29 percent (119), 7.78 percent (48) and 4.54 percent (28) respectively.
-) Entry of new banks in financial system along with increased in the business, the total assets i.e sources of fund of commercial banks went up by higher rate of 20.40 percent compared to 15.51 percent in the previous year. By the end of this fiscal year, the total assets of commercial banking sector reached to Rs. 682372.9 million from Rs 566736.0 million in the last year.
-) The share of loans and advances to total assets decreased to 49.99 percent in mid Jan 2009 from 53.45 percent in mid July 2008. Similarly, investment and liquid funds registered the 18.46 percent and 11.10 percent respectively. In the preceding year, the respective shares were 19.23 percent and 11.80 percent.
-) The composition of liabilities of commercial banks shows that, the deposit has occupied the dominant share of 70.32 percent followed by borrowing 3.16 percent and capital fund 2.42 percent in the mid Jan 2009. The respective shares of deposit, borrowing and capital fund in the previous year were 75.18 percent, 2.54 percent and 1.76 percent. Among the component of assets, loans and advances occupied the highest share of 49.99 percent followed by total investment 18.46 percent and liquid fund 11.10 percent in the same year.
-) In the mid Jan 2009, the loans and advances increased at lower rate of 12.62 percent compare to 32.30 percent in mid July 2008. By the end of mid Jan 2009, the total outstanding amount of loans and advances of

commercial banks reached to Rs. 341127.9 million. It was Rs. 302913.4 million in mid July 2008.

) The total investment of commercial banks in mid Jan 2009 increased by 15.65 percent and reached to Rs. 126002.1 million from Rs. 108954.8 million in mid July 2008. Similarly liquid fund increased by 13.25 percent and amounted to Rs. 75735.9 million.

) In the mid Jan 2009, total deposit of commercial bank increased by 12.62 percent compare to 26.25 percent growth in the mid July 2008. As of mid Jan 2009, it reached to Rs. 479864.2 million from Rs 426080.3 in the mid July 2008. Among the component of deposit, current deposit increased with rate of 8.71 percent compare to 24.56 percent in last year. Similarly, saving deposit and fixed deposit increased by 14.15 percent and 11.33 percent respectively.

) The saving deposit comprises the major share in total deposit followed by fixed deposit and current deposit. As of mid Jan 2009, the proportion of saving, fixed, and current deposits are 50.30 percent, 24.31 percent, and 12.71 percent respectively. In the last year the respective share of saving, fixed and current deposit were 49.63 percent, 24.59 percent and 13.16 percent.

) In the mid Jan 2009, the borrowing increased by higher rate of 49.58 percent compared to 13.00 percent in the previous year, By the end of mid Jan 2009, it reached to Rs. 21551.9 million from Rs. 14408.2 million in the mid July 2008.

) The entry of new banks as well as rise in the capital base by some of old banks attributed to change its Capital Fund. It is increased remarkable by 65.73 percent compared to previous year and reached to Rs. 16508.3 million in mid Jan 2009. It was Rs. 9960.7 million in mid July 2008.

) Out of the Rs. 344077.8 million outstanding credits in mid Jan 2009, the largest proportion of the loans and advances is occupied by manufacturing sector. The share of this sector is 23.43 percent followed by wholesale &

retailers' 17.32 percent, others 16.35 percent, construction 10.84 percent and finance, insurance & fixed assets by 8.88 percent. Similarly, service industries comprise 6.66 percent, transportation, communication & public services by 5.19 percent and agriculture by 4.15 percent in the same year.

) The outstanding of deprived sector credit of commercial banks in the mid Jan 2009 increased by higher rate of 99.62 percent compared to 12.41 percent in the mid July 2008. By the end of mid Jan 2009, it reached to Rs. 15353.60.million from Rs. 7691.40 million in mid July 2008. Sector credit to total outstanding loans and advances stood at 4.50 percent in the current fiscal period. Last year it was 2.82 percent.

) In mid Jan 2009, the credit to deposit ratio of the commercial banks remained same as of mid – July 2008. It was 71.09 percent as in mid July 2008. The ratio was 67.84 percent in mid July 2007.

) The non-performing loan of commercial banks declined significantly to 5.38 percent in mid Jan 2009 from 6.08 percent in the July 2008. The total amount of NPA remained to Rs. 18548.20 million from Rs. 18648.5 million in the July 2008.

Loans and advance

▲ The total loans and advances dispersed by the banking industry on Mid July 2008 rose by 36.14 percentages as compared to previous year and reached to Rs.274.16 billion. The loans and advances of the public banks have increased by 14.31% and private banks by 43.46%. The credit flow of the private commercial banks is growing in increasing trend. Though the credit growth of public sector bank is not consistent still their credit is also increasing.

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The Nepalese Banking system is riddled with a significant amount of Non Performing assets (NPA). The total volume of NPA as on Mid July 2008 was Rs.20.47 billion, which was Rs.25.56 billion in the previous year. The NPL ratio of public sector banks has come down to 15.01 percent from 55.13 percent of year 2003/04. Similarly, the NPL ratio of private sector banks combined has also come down to 2.55 percent from 5.82 percent of year 2003/04. It is clearly evident from the following picture that the volume of Non Performing assets is on the decline while the total loans (shown in above table) are continuously increasing, thus resulting in a favorable proportion of Non Performing With regard to quality of the loan portfolio of the individual banks, Nepal BangladeshBank (NPL-31.73%) followed by Rastriya Banijya Bank (21.43%), Nepal Credit & Commerce Bank (16.42%), Lumbini Bank Ltd. (14.92%), Nepal Bank Ltd. (12.38%), and Agriculture Development Bank (11.69%) hold double digit NPL. The volume of Non Performing assets, which was largely on account of the portfolio of the public banks last year, has switched to private banks in year 2007/08.

Non-Performing Loans of the Banks

Nepal Rastra Bank has prescribed a provision on all loan accounts of the banks, which escalates as the quality of the loan deteriorates. The banks are required to create loan loss provisions on the gross value of outstanding loans, rather than on the net loans, and they are not allowed the relaxation in terms of the value of the collaterals. The banks, thus, have to create provisions in accordance to the quality of their loan portfolios. So, the public banks with large volumes of Non Performing assets have large provisions in their balance sheets while the provisions of the private banks (except NBBL, NCCL, and LBL) are relatively lower. After the reform program was initiated in the public banks, the volume of NPA, both gross as well as net has come down, significantly. The loan loss provision being higher than non-performing assets indicates that the proportion

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of good loan is getting higher in the total credit portfolio and non-performing loans are getting lower.

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(Source: Annual Reports of 26 Commercial Banks '2008/09')

Sources of Major Problem in Credit Risk Management

Effective credit risk management allows a bank to reduce risks and potential NPLs. It also offers other benefit. Once banks understand their risk and their costs, they will be able to determine their most profitable business and thus j, credit-risk strategy supported by organizational changes, risk measurement technique and fresh credit process and systems. In the context of Nepal, the sources of major problems in credit risk management are as follows (Ramamurthy, 2004:3-5).

(ii) Financial statement (including audited) do not reflected a “true and fair view” of the business entity due to creative accounting. The audited financial statement as submitted by the customers do not reflect details relating to

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-) Encumbrance’s change on the company’s current/ fixed assets plus to whom they are changed.
-) Details of group company lending/borrowings
-) Status of income assessment etc.
-) Contingent liabilities.
-) Accounting policies.
-) Delegation of finding authority is based on seriously and not a complexes of the concerned officials.
-) No exchange of credit information lack of transparency among the competition banks giving rise to multiple banking complicating to excessive shortfall etc.
-) Absence of: Risk based pricing methodologiesCustomer risk rating methods Facility risk rating modelsPronounced name lending. Collateral

based lending instead of need based/ cash flow based lending. Over banked center contributing for severe competition and price cutting. Lack of corporate governance Permissive banking practice including names, lending, multiple banking etc. Macro level scenario of political inability slow growing economy, small domestic market. Ineffective judiciary Cross border risk disappearance of promoters Inadequacy of law to deal with crime like cheating, misfeasance.

2.2 Review of Books

Peter Rose (1999) in her book “Commercial Bank Management” states “Achieving superior profitability for a bank depends upon several crucial factors:

6. Careful use of financial leverage or the proportion of bank assets financed by debts as opposed by the shareholders equity capital.
7. Careful use of operating leverage from fixed assets or the proportions of fixed cost input the bank used to boost its operating earnings before taxes as bank output grows.
8. Careful control of operating expenses so that more dollars of sales revenue become net income.
9. Careful management of assets portfolio to meet liquidity needs while seeking the highest returns from any assets acquired.
10. Careful control of the bank's exposure to risks so that the losses don't overwhelm its income and equity capital”.

Michael R. Baye and Dennis W. Jensen (1996) through their book ‘Money, banking and financial market: an economic approach’ have tried to analyse the bank's profitability under an economic approach. They state “to maximize profits, banks should attract deposits unto the point where the value of marginal producer of deposits equals the interest rate paid on deposits.”

Rose Kolari & Fraser (2002) in the book, 'Financial Institutions: Understanding and managing financial services' says the following:

"Banks earn interest on loans and investments; they pay interest to the depositors. When interest rates changes, there may be an effect on income if a bank holds rate sensitive assets and liabilities. If, for example, a bank holds more rate sensitive assets than liabilities when interest rate rise, profits will be improved because the bank will receive more in increased interest revenue than it will pay out in rising costs. The reverse would be true during a period of falling interest rates.

The interest gap is the difference between rate sensitive assets and liabilities; holding more rate sensitive assets than liabilities is called a positive gap and excess of rate sensitive liabilities over assets result in a negative gap" (Fraser & Ormiston, 2002: 32)

Emphasizing the bank's modern functions Meir Kohn (1999) writes in his book, 'Financial institutions and markets': "Banks now have steadily expanded their activities in payment related services, in delegation and trust services, in credit substitution and services, and in forward transactions. In doing so, they have pursued economies of scope, relatively unconstrained by regulations" (Kohn; 1999:12).

Analyzing the behaviour and future prospects for profitability of a financial institution is a complex task. Many factors affect each institution's profitability. Among the most important factors are the friskiness of loans and investments made; liquidity needs and the institution's provision for these needs; the effectiveness of tax management practices; the level of efficiency in utilizing human and non-human resources; and the ability of management to control expenses (particularly interest expenses and employee costs). Well conceived lending policies and lending practices are essential if a bank is to perform its creating function effectively and minimize the risk inherent in any extension of credit (Kolari & Fraser; 1993: 124-125).

Mr. Shiva Raj Shrestha (2059), deputy director of NRB gave the following criteria for the measurement of commercial banks performance stating that “The financial health and performance of commercial banks should be evaluated under the following perspectives:

16. Deposit transactions
17. Position of investments, loans advances and overdrafts
18. Cash and liquidity position
19. Foreign currency reserve
20. Qualitative factors of loans and advances
21. Capital fund
22. Reserve funds, contingency and other funds
23. Interest rate
24. Position of income
25. Customer base and volume
26. Sources and uses of finance
27. Extension of banking services
28. Off-balance sheet transactions
29. Earnings per share
30. Banking personnel” (Shrestha; 2059: 107-108).

2.3 Review of Previous Studies

2.3.1 Review of Articles

Kshetry (2057), in his article says “To strike balance between profitability and services to the community, commercial banks should force on activities that provide energy to speed up the productivity and diversify services in the community” (Kshetry; 2057: 142).

Pradhan (1991), published his article in which he pointed out some major issue in local commercial banks in comparison of recently established joint venture banks through his article “Nepal ma Banijya Bank: Upalabdhi Tatha Chunauti.” The study dealt with the whole commercial banking system of Nepal in respect of their performance and profitability. Some of his finding relevant to this study is summarized as:

3. The deposit collection rate of banks is very poor in comparison to joint venture banks.
4. The patterns of deposits are also different between these banks. The ratio of current deposit in local banks is 9.34% only where the same as the joint venture banks is 52.5%. But the fixed deposit ratio is very high in local banks” (Pradhan; 1991: 3).

Shrestha (2055), Deputy Chief Officer of Nepal Rastra Bank, Banking Operation Department, giving a short glimpse on the “Portfolio management in commercial bank, theory and practice” figured out the following.

Investors would like to select a best mix of investment assets subject to following aspects:

6. Certain capital gains
7. Good liquidity with adequate safety of investment
8. Maximum tax concession
9. Flexible investment
10. Economic, efficient and effective investment mix.

He suggested that the banks having international network can also offer access to global finance markets. He pointed out the requirements of skilled manpower, research and analysis team and proper management of information system (MIS) in any commercial bank. Mr. Shrestha concluded that:

-) The survival of the banks depends upon their own financial health and various activities.
-) The Nepalese banks having greater network and access to national and international capital markets have to go for portfolio management activities for the increment of their fee based income as well as to enrich the client base and contribute in national economy (Shrestha; 2055: 45).

Karki (2057), summarized some of the challenges of Nepalese financial sector through his article “Nepalese Financial Sector: Challenges and Some Solution” that:

“The liquidity position of the banking sector is rated as high as 24 percent, but the productive sector of the economy is starved by credit crunch. This has created a paradoxical situation in the banking sector. The financial institutions especially commercial banks have to identify new areas of investment to increase loans and advances to reduce the liquidity position.

With the rapid growth in the number of bank, deposit insurance scheme is a must for social justice rather than economic justification” (Karki; 2057: 26-30).

Sharma (2000), opined “Private commercial banks have mushroomed only in the urban areas where banking transactions in larger volume is possible. The rural and sub-urban areas mostly remain unattended to any of these kinds of opportunities. This is likely to prevail till competition takes its full pace and reign in the urban areas” (Sharma, 2000: 13).

2.3.2 Review of Thesis

Dhungana (2003) in his thesis entitled “A study on joint venture banks’ profitability” concluded that the profitability ratio of all the joint venture banks i.e., NABIL, NIBL and SCBNL were satisfactory, and their efficiency was also satisfactory in utilizing the deposits. However, they were found to mobilize savings from different parts of the country. The profit indicated in their financial

statement was an inflated one, fluctuation in the foreign currency being the main reason.

The basic objectives of the research were to appraise Joint Venture Banks appropriately for the application of profitability and other objectives were listed as below:

-) To highlight the current profit planning adopted and its effectiveness in Joint Venture Banks.
-) To observe Joint Ventures Bank Profit Planning on the basis of overall managerial budget developed by the bank.
-) To analyze the variance of budget and actual achievement.
-) To study the growth of the business of the Joint Venture banks over the Period.

Major Findings observed in his study are as follows:

-) Objectives of the joint venture bank are expressed in literary form and not specified clearly therefore there is higher danger of it being misinterpreted in the ways of one's benefit by the concern
-) Major concentration of resources mobilization of NB bank is at deposit mobilization. In this respect they are increasing higher cost towards deposit mobilization.
-) Deposit mobilization of Joint Ventures bank is found to be considerable growing every year. (Dhungana, 2003:78).

Another researcher Khadka (2005) in his thesis entitled "A study on investment policy of NABIL in comparison to other joint venture banks of Nepal" found that the liquidity position of NABIL was worse than that of SCBNL and NIBL. The basic objectives of the research were to study investment policy of banks and other objectives were listed as below:

-) To highlight the investment policy of sample banks and its effectiveness credit management.
-) To study the liquidity and profitability position of sample banks.
-) To study the growth of the deposit and investment of sample banks over the period.

The banks such as NCC and NBBL were found to be having the worst performance as compared to all other private sector commercial banks. NABIL had been found to have more current assets as loans & advances but fewer amounts as investment on government securities. NABIL was comparatively less successful in on-balance sheet operations as well as in off-balance sheet operations than that of any other joint venture commercial banks. Profitability position of NABIL was also not found to be so better as other commercial banks despite NCC and NBBL. NABIL was more successful in deposit mobilization but had lower performance to maintain high growth rate of profit as compared to SCBNL and NIBL. Mr. Khadka suggested the joint venture banks to be more careful in increasing profit in real sense to maintain the confidence of shareholders, depositors and customers. The banks were strongly recommended to utilize their risky assets and shareholders' funds to gain highest profit margin and reduce their expenses and collect cheaper funds for attaining more profitability. So the banks were recommended to invest their funds in different sectors of investment strategies and administer various deposit schemes to collect funds such as cumulative deposit scheme, prize bonds scheme, gift cheque scheme, house building deposit scheme, etc

Khadka has strongly recommended Nabil to utilize its risks assets and shareholders fund to gain highest profit margin and reduce its expenses and collect cheaper fund for more profitability. He has recommended investing its assets in different sectors of investment and administering various deposits schemes to collect cheaper fund such as cumulative deposit scheme, prize bonds, gift cheque, house building deposit scheme etc. (Khadka, 2005: 82).

Shrestha (2008) in his thesis entitled “Profitability Analysis of Standard Chartered Bank Nepal Limited and Nabil Bank Limited”. The basic objectives of the research were to study investment policy of banks and other objectives were listed as below:

-) To study the profitability position of banks and its effectiveness on overall performance of banks.
-) To study the liquidity position of sample banks.
-) To study the growth of the profit, deposit and investment of banks over the period.

The following are the major findings of the study:

-) SCBNL had more consistent operating efficiency ratio than Nabil bank limited during the study period.
-) Both of the banks data showed that more than 90% of their total liabilities paid interest. These banks showed that smaller portion of their interest bearing liabilities paid as interest expenses.
-) Both the banks’ weighted average cost of deposit ratio was found to be at decreasing rate.
-) Nabil bank had lower EPS than SCBNL, which indicated that the performance of SCBNL was better than Nabil.
-) SCBNL was paying more dividend than Nabil bank limited during the study period. The amount of dividend was almost double for SCBNL than Nabil. It meant that Nabil was in need of fund, so it was paying fewer dividends and adding more amounts under the head of retained earnings.
-) Among the total income, more than 75% of the income came from interest sector. That indicated the main source of income was interest for both the banks.

-) The operating expenses ratio over total expenses comprised of more than 40% for both the banks.
-) Nabil had fluctuating return on total assets than SCBNL. SCBNL had higher return on equity than Nabil. Return on equity of Nabil was more fluctuating than that of SCBNL. SCBNL had higher return on equity ratio than that of Nabil.
-) SCBNL had also higher interest earned to total asset ratio than Nabil.
-) The total interest income to total earning assets ratio of both the banks were found decreasing over the years, which indicates a negative sign to the bank's performance.
-) Nabil bank's net profit margin ratio was higher than that of SCBNL. Similarly, net interest margin of Nabil was also higher than that of SCBNL (Shrestha, 2008: 76-77).

Another researcher Shrestha (2008) in his study "Cost volume and profit analysis of commercial banks: A case study of HBL" concluded that:

-) CVP analysis had not been practiced yet.
-) There was no practice of segregating the total costs into fixed and variable components. The costs were roughly classified and the classification was not scientific and appropriate.
-) All levels of management were not found to involve in profit planning and decision making of the bank.
-) There was no complete and comprehensive budgeting system.
-) There was no use of conducting the SWOT analysis.
-) The bank was found to invest more than 90% of its investment fund in government debentures only.
-) The lending of the bank was at an increasing trend.

-) Income from interest was at decreasing trend in the later years of study.
-) Margin of safety was excessively higher than BEP sales. And therefore it indicated the well performance of the bank on an average.

Karki, (2008) has conducted a research on “A Study of Investment Policy in Nepal Arab Bank Limited”, in comparison other joint venture banks in Nepal.

His research objectives of the study are as follows:

- v) To measure the banks investment policy. The lending strength shall be measured in absolute to analyze the volume of contribution made by each bank.
- vi) To determine the liquidity position, the impact of deposit in liquidity and its effect on lending practices.
- vii) To analyze the portfolio behavior of lending and measuring the ratio and volume of loans and advances made in agriculture, priority and productive sector.
- viii) To measure the impact of investment in quality, efficiency and its contribution in total income.

Based on the above objectives of the study, his research findings of the study are as follows:

The steady and high volume of loans and advances throughout the years has resulted Nabil's ratio to be the highest. Nabil has deployed the highest proportion of its total deposits in earning activities and this ratio is significantly above the normal ratios. This is the indicative of that in fund mobilizing activities Nabil is significantly better. In that topic he had recommended that in order to become success in competitive banking environment, bank should be able to utilize depositor's money as loans and advances. Since the largest items in bank's asset side is loans and advances, negligence of administering this could be the main cause of a liquidity crisis in the bank and also one of the main reasons of bank failure.

Kafle, (2009) in his study entitled “Non-performing Loans of Nepalese commercial banks.”

The researcher’s main objectives of the study are:

- iv) To know the problems of the non-performing loans and its effect in the ROA and ROE of the Nepalese commercial banks
- v) To find out whether the Nepalese commercial banks are following the NRB directives regarding loan loss provision for non-performing loan or not.
- vi) To make necessary suggestions and recommendations.

The major findings of the study are:

Through the research he has found that the no banks have been following NRB’s directives regarding the loan loss provision. He also conclude that the return on assets (ROA) and return on equity (ROE) of the bank deposited upon the NPLs. The high degree of negative correlation between NPL and ROA and the NPL and ROE clearly indicates that there is inverse relation between them. He has recommended that for the smooth operation of the commercial banks, the NPLs should be controlled for this bank should provide necessary training regarding loan management to the manpower’s. In order to remove, the NPLs, banks should take enough collateral so that banks can recover its loan amount. For the loan loss provision as per the NRB directive and to reduce the NPL, the bank management should be effective and the NRB’s monitoring and regulation is necessary.

2.4 Research Gap

Financial scenario and effectiveness of the banks has been changed in due period of time because of increase of number of financial institution in Nepalese economy. And it is observed that it is essential to study effectiveness of loan management of commercial banks taking samples of two banks: Standard Chartered Bank Limited and Nabil Bank Limited to support in fulfilling research gap. The review of above relevant literature has contributed to enhance

the fundamental understanding and knowledge, which is required to make study meaningful and purposive. There has been lots of article published on field of investment policy. Loans and advances of commercial banks .there are various research available on investment analysis and policy of commercial banks,impact and implementation of Nepal Rastra Bank guideline I commercial banks but there are not sufficient researches available on lending aspect of commercial banks. In addition to this, mo one has done a study on “loan management” with reference to Standerd charterd Bank and Nabil Bank Limited. Therefore the research attempts to study in this area. To know the loan management of these two banks will probably be the first study in this subject matter. So, this study will be fruitful to those interested person parties scholars, professor, students, businessman and government for academically as well as policy perspect.

CHAPTER-III

RESEARCH METHODOLOGY

This chapter is related to research methodology in this study. Research methodology is a way to systematically solve the research problem. In other words, research methodology describes the methods and processes applied in the entire aspect of the study. It may be understood as a science of studying how research is done scientifically. It is necessary for the researcher to know not only the research methods but also the methodology. This chapter includes the research design, population, and sample.

3.1 Research Design

Research design serves as a framework for the study, guiding the research instruments to be utilized, and the sampling plan to be followed. In other words, research design describes the general plan for collecting, analyzing, and evaluating data. Research design is a planned structure and strategy of investigation conceived to obtain answers to research objectives through analysis of data. The study is based on primary as well as secondary data. So the descriptive and analytical research designs have been used.

3.2 Population and Sample

A small portion chosen from the population for studying its properties is called a sample, and the number of units in the sample is known as the sample size. The method of selecting for study a small portion of the population to draw conclusions about characteristics of the population is known as sampling. Sampling may be defined as the selection of part of the population on the basis of which a judgment or inference about the universe is made. Here only 2 sample joint venture commercial banks have been taken out of 26 commercial banks. All the commercial banks in Nepal are the population of the study. The sample taken from the commercial banks are as follows:

TOTAL BANKS	SAMPLE TAKEN
26 Commercial Banks	NABIL and SCBN

3.3 Nature and Sources of Data

The research is based on secondary source of data for research purpose; published financial statements of concerned banks were collected. Similarly, financial statement of commercial banks and various markets related information were collected and tabulated in spreadsheet. Such secondary information was gathered from the share department of the concerned banks and Security Board of Nepal. In addition, an answer on certain queries made to staffs of concerned organization personal enquires and discussions were also being conducted for clarification and verification of collected data and for recommendation.

3.4 Analysis of Data

To meet the objectives of the study, the sources of secondary data of commercial bank are analyzed by using financial tools such as ratio analysis. Simple descriptive analysis tools such as frequency, Mean, standard deviations are used. The ratio analysis involves comparison for a useful interpretation of financial statements. The quantities judgment regarding loan management of a firm can be done with the help of rate analysis. For the analysis of the data the financial and statistical tools relevant to the topic are used. They are as follows:

3.4.1 Financial Tools

Ratio Analysis

A ratio analysis is simply the number expressed in terms of another and as such it expresses the quantities relationship between any two numbers. Ratio can be expressed in terms of percentage, proportion and as coefficient. The technique of ratio analysis is a part of the whole process of analysis of financial statements of any business of industrial concern especially to take output and

credit decision. Through this technique a comparative study can be made between different statistics concerning varied facts of a business different statistics concerning varied facts of business units. Just as the blood pressure, pulse and temperatures are the measure of the health of an individual, so the ratio analysis measures the economic financial health of a business concern. Thus, the technique of ratio analysis is of a considerable significance in studying the financial stability, liquidity profitability and the quality of the business and industrial concerns (Kothari, 1994:169).

For the study period following ratios are analyzed.

- 1) 15) Current Ratio
- 2) 16) Liquid fund to Total liabilities Ratio
- 3) 17) Liquid funds to Total Deposit Ratio
- 4) 18) Total Assets to Total liability Ratio
- 5) 19) Loans and Advances to Total Assets Ratio
- 6) 20) Loans and Advances and Investment to Total Deposit Ratio
- 7) 21) Loans and Advances to Shareholders Equity
- 8) 22) Interest Income to Total Income Ratio
- 9) 23) Interest Expenses to Total Deposit Ratio
- 10) 24) Interest Income to Interest Expenses Ratio
- 11) 25) Growth Ratio of Total Deposit
- 12) 26) Growth Ratio of Loans and Advances
- 13) 27) Growth Ratio of Total Investment
- 14) 28) Growth Ratio of Net Profit

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1) Current Ratio: It establishes the relationship between current assets and current liabilities. It is

Computed by dividing current assets by current liabilities. It is calculated as follows :

$$\text{current ratio} = \frac{\text{current asset}}{\text{current liabilities}}$$

2) Liquid fund to Total liabilities Ratio: It establishes the relationship between liquid fund and current liabilities. It is computed by dividing liquid fund to total liabilities. Its formula is :

$$\text{Liquid fund to Total liabilities Ratio} = \frac{\text{Liquid fund}}{\text{Total liabilities}}$$

3) Liquid funds to Total Deposit Ratio: it measures the position of the liquid fund on total deposit which is calculated by dividing to total deposit. Its formula is as follows:

$$\text{Liquid funds to Total Deposit Ratio} = \frac{\text{Liquid fund}}{\text{Total Deposit Ratio}}$$

4) Total Assets to Total liability Ratio: this ratio measures the relationship between total asset and total liabilities. It is computed by dividing total assets to total liabilities. Its formula is as follows:

$$\text{Total assets to total liability ratio} = \frac{\text{Total assets}}{\text{Total liabilities}}$$

5) Loans and Advances to Total Assets Ratio: this ratio judge the position of loan and advances on total assets. It is calculated by dividing loan and advances by total assets. Its formula is as follows:

$$\text{Loans and Advances to Total Assets Ratio} = \frac{\text{Loans and Advances}}{\text{Total assets}}$$

6) Loans and Advances and Investment to Total Deposit Ratio: This ratio measures the position of loan and advances and investment on total deposit. It is computed by dividing loan and advances and investment by total deposit. it is calculated as:

$$\text{Loans and Advances and Investment to Total Deposit Ratio} = \frac{\text{Loans \& Advances \& Investment}}{\text{Total deposit}}$$

7) Loans and Advances to Shareholders Equity: it is calculated by dividing loans and advances to shareholders equity. Its formula is as follows

$$\text{Loans and Advances to Shareholders Equity} = \frac{\text{Loans and Advances}}{\text{Shareholders Equity}}$$

8) Interest Income to Total Income Ratio: it is measured by dividing Interest Income to Total Income. Its formula is as follows:

$$\text{Loans and Advances to Shareholders Equity} \times \frac{\text{Interest income}}{\text{Total income}}$$

9) Interest Expenses to Total Deposit Ratio: it measures the position of the Interest expenses on total deposit. It is computed by dividing interest expenses to total deposit. Its formula is as.

$$\text{Interest Expenses to Total Deposit Ratio:} \quad \times \frac{\text{Interest expenses}}{\text{Total Deposit}}$$

10) Interest Income to Interest Expenses Ratio: it measures the position of interest income on interest expenses, which is computed by dividing interest income to interest expenses. Its formula is as follows:

$$\text{Interest Income to Interest Expenses Ratio:} \quad = \quad \frac{\text{Interest income}}{\text{Interest expenses}}$$

11) Growth Ratio of Total Deposit: it measures the growth ratio of the company or organization, which is compared by two years deposits i.e. current year deposit and previous year deposit. The calculation may be shows the increasing or decreasing rate of growth of the deposit. It is calculated by dividing current year deposit by previous year deposit. Its formula is as follows:

$$\text{Growth Ratio of Total Deposit:} = \frac{\text{current years deposit}}{\text{Previous year deposit}}$$

12) Growth Ratio of Loans and Advances: its measure the growth rate of loan and advances comparative by current years and last years. It is calculated by dividing current year's loan and advances by last year loans and advances. Its formula is as follows:

$$\text{growth ratio of loans and advances:} = \frac{\text{current years loan and deposit}}{\text{Previous years loan and advances}}$$

13) Growth Ratio of Total Investment : it usually measures the growth rate of total investment, which is computed by dividing current year's total investment and last year's investment. Its formula is as follows:

$$\text{Growth Ratio of Total Investment :} = \frac{\text{current years total investment}}{\text{Previous years total investment}}$$

14)Growth Ratio of Net Profit: it usually measures the growth rate of net profit, which is computed by dividing current year's net profit by previous year's net profit. Its formula is as follows:

$$\text{Growth Ratio of Net Profit} = \frac{\text{current years net profit}}{\text{Previous years net profit}}$$

3.4.2 Correlation Coefficient Analysis

The analysis identifies and interprets the relationship between the two or more variables. Karl-Person's Correlation Coefficient has been used to find out relationship between the variables in order to know the effect in one variable may have effect in the correlated variable. In our study relationship between the various variable. It is calculated by:

$$r = \frac{n \sum xy - \sum x \cdot \sum y}{\sqrt{[n \sum x^2 - (\sum x)^2][n \sum y^2 - (\sum y)^2]}}$$

r = Correlation coefficient

n = Number of years

$\sum x$ = Sum of X series

$\sum y$ = Sum of Y series

$\sum xy$ = Sum of X and Y series

$\sum x^2$ = Sum of square of X series

$\sum y^2$ = Sum of square of Y series

x & y = Financial Variable of joint venture banks.

Correlation analysis describes the relationship between variables i.e. positive or negative. It helps to determine the following: A positive or negative relationship exists. The relationship is significant or insignificant. Establish cause and effect relation if any.

The statistical tool- correlation analysis is used in the study to measure the relationship between variables in determining whether the relationship is significant or not. For the purpose decision making interpretation are based on the following terms.

- ~~1-6.~~ 1-6. When, $r = 1$, then is perfect positive correlation.
- ~~2.~~ When $r = -1$, then is perfect negative correlation.
- ~~3-7.~~ 3-7. When $r = 0$, then is no correlation.
- ~~4-8.~~ 4-8. When, 'r' lies between 0.7 to 0.999 (-0.7 to -0.999), then is high degree of positive (negative) correlation.
- ~~5-9.~~ 5-9. When 'r' lies between 0.5 to 0.6999 there is moderate degree of correlation.
- ~~6-10.~~ 6-10. When, 'r' is less than 0.5. There is low degree of correlation.

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

3.4.3 Trend Analysis

Trend analysis is the analysis of a firm's financial ratio over time used to estimate the likelihood of improvement or deterioration in its financial condition. It is important to analyze trend in ratios as well as their absolute level, for trends give clues as to whether a firm's financial condition is likely to improve or to deteriorate. Trend analysis is calculated by:

$$y = a + bx$$

Here, $a = \frac{\sum Y}{N}$

$$b = \frac{xy}{x^2}$$

Combine Mean is calculated by:

$$\bar{X}_{12} = \frac{\bar{X}_1 N_1 + \bar{X}_2 N_2}{N_1 + N_2}$$