

CHAPTER – I

INTRODUCTION

1.1 Background of the Study

Nepal is a developing country so it is striving to develop and modernize its economy rapidly on rational and socially desired footing, but the structure of the economy has still remained primarily agricultural with very small manufacturing base. Approximately the 81 percent population is dependent on subsistence agriculture that contributes nearly 40 percent share to the Gross Domestic Product (GDP) and this sector provides opportunity of employment of nearly 75 percent of the total labor force of the country and Gross Disposable Income \$370 Per annum. Beside the country's land locked location its limited exportable resources, low economic growth, low saving, low income, higher rate of population growth, limited transportation facilities, infrastructure and present political condition etc. are the major factors that have proved obstacle in the economic development of the country.

The economic development of Nepal is still in initial stage. If we are develop our country Nepal. We have to make expansion in financial sector. Financial market is very important for the economic growth of the country. The pace of development of the country is largely depends upon the economic activities. Economic activities are guided by finance institutions provide capital to develop trade, industry and business, Banks, Finance companies, Co-operative societies, insurance companies, Stock exchanges helps in the economic development of the country. So government have to make various economic policies such as industrial policy, foreign investment policy, privatization policy and trade and transits policy with the implicit objective to help the stage and the private sector.

The Nepalese financial sector is composed of banking and non-banking sector. Banking sector comprises Nepal Rastra Bank (NRB) and commercial banks. The non-banking sector includes development banks, micro-credit development banks, finance companies, co-operatives financial institutions, non-government organizations (NGOs) performing limited banking activities. Other financial institution comprises of insurance companies, employee's provided fund, citizen investment fund, postal saving offices and Nepal stock exchange.

As financial institution, Bank plays a significant role in the development of a nation. Generally, Bank refers to a commercial bank at Present. In present context we think commercial banks are the leaders of development. Various authors have defined the word "Bank" in different ways, "Commercial banks are the dealer of money and it substitutes for money such as cheques or bills of exchange, it also provides a variety of financial services" (Britannica, 1985: 600).

Over the Last five years, despite the political instability and low economic growth, Nepalese stock market has received a great deal of attention, both as a source of financial development and investment return, and in the context of swings in stock market valuation. The depth of a stock market, as capture by the market capitalization is an important measure of one aspect of financial development, much in the same way as monetization or the amount of private sector credit measure the depth of financial intermediation. In fact, commercial banking and stock market both contribute in a major way to the transformation of savings into investment, thereby enabling financial development and economic growth.

It is difficult to decide the function of a modern commercial bank because of their complexity and versatility in operation. Bank, when properly organized, aids and facilitates the growth of trade and industry. The issue of development always rests upon the mobilization of resources. Bank function of lending ensures required volume of capital to resources mobilization. In this way whole infrastructure of national development, direction of economic rate of progress is strengthen by banking system.

Commercial banks are organized on a joint stock company system primarily for the purpose of earning a profit. Among the various function of commercial bank mainly two essential functions may best be summarized as the borrowings and lending of money. The person who deposit money in the bank they becomes creditor and the person who borrows money from the bank they become debtor of the bank. In present context lending money has become one of the main sources of revenue of the bank. The principal function of credit is first to transfer property in the name of bank, who want to take loan. The transfer is temporary made for a loan price and interest. "The classical economic functions of bank and other financial intermediaries all over the world have remained virtually unchanged in modern times. What have been changed

are the intuitional structure, the instruments and the techniques used in performing these function" (Bhattacharya, 1998: 15).

According to commercial bank act 2031 B.S. "A commercial bank is that financial institution which accept deposits, grant loan and performs commercial banking function and which is not a bank, meant for co-operative, agriculture, industries of such specific purpose." Commercial banks are profit making organization and their goal is wealth maximization. The funds are collected and those funds are thoughtfully plotted in return generation parts and the benefit is distributed to its shareholders. The main form of investment by these banks is in the form of loans, purchasing securities issued by government which includes less risk.

To focus on lending, it can be divided into fund based and non-fund based lending. The fund based lending can be further divided into cash credit, overdraft, demand and term loan, bills purchased and discounted, export, packing credit, project finance, consortium finance, loan syndication, bridge loan etc. Similarly, non-fund based lending can be classified into documentary credit, guarantees and bill co-acceptance facility. Besides the lending function, there is another function, which is related with mobilization of fund and have lesser but significant vole in banks fund management. Investment is the secondary means of employing funds by commercial bank. Investment refers to buying shares; stocks, bonds, T-bill and securities, which already exist in the stock market in economy. An investment in banking scenario refers to placement of funds to stocks, securities, T-bills of government etc. The impact of bank investment can be of both real and financial, when bank puts its funds in T-bill of government, the total investment tends to increase and which will consequently increase the national income. It is simply because bank acquires those shares by investing the deposits that is holds from public. Investing in stocks, securities and T-bills has three importances. Firstly it generates income to the bank secondly it serves as a liquid fund and minimizes liquidity risk and the third it reduces the level of idle funds.

Now a day banks are facing challenges to Global crisis of economy. No banker can survive for a long run without proper understandings of global crisis of economy. Per capital incomes are decreasing day by day due to facing unemployment problem, no

body can saving properly. It directly effects on lending policies of the commercial banks. Almost all countries are finding out the solution of global crisis. Not only this but also commercial bank are facing competitive challenge to enhance earnings. Interest rate is in decreasing trend in loan as well as in saving; there is high competition among the banks. Hence bank should explore new loan and deposit scheme to attract the customer.

In this way commercial banks play significant roles in the development of trade, commerce and industry. "Moreover, the ability of banks to gather and analyze financial information has given rise to another view of why banks exist in modern society. Most borrows and depositors prefer to keep their financial records confidential, shielded especially form competitors. Banks are able to fulfill this need by offering high liquidity in the deposits they sell. More people believe that banks play only a narrow role in the country taking deposits and making loans the modern bank has had to adopt new roles in order to remain competitive and responsive to public needs. Hence, apart form the above roles" (Vaidhya, 2001: 31).

1.2 Development of Banking System in Nepal

In ancient time, there was also a lending business in Nepal. During those days people used to borrow money from moneylenders playing some interest. There was no accurate interest rate. Moneylenders determined interest rate. So there was monopoly in interest rate. Moneylenders are like Chau-Mahajans, Jamindars, Relatives, Friends and few informal organizations limited to ethnic group such as Guthi. The borrowing from the other people and the informal organizations was limited and based on personal understanding. At that time people deposit their gold, silver and valuable goods for the sake of security, thus, the private moneylenders can be taken as forerunner of the concept of financial institution.

In this regarding Prof. Ojha, J.C. said "but it is impossible to give correct chronological history in vies of the fact that no authentic historical records are available in respect to banking. It can be inferred from the history of Nepal regarding the rebuilding of Kathmandu in 723 A.D by Gunakam Dev, the king of the Kathmandu and that of Shankhadhar's (a merchant) action of introduction Nepal Sambat' some fifty seven years thereafter to make lending has been prevalent long

before that". Thus the above statement shows that lending system was introduced very long before 723 A.D. But there is no recorded document about lending. Then in 14th century during the rule of Malla King Jayasthiti Malla working occupation was divided in 64 categories. Among them "Tanka Dhari" was one. The main occupation of "Tanka Dhari" was lending money. It also shows that lending process was prevailing during the Malla Rule in Nepal.

During the period of Rana Prime Minister, Ranodip Singh a government institution called "Tejarath" was established. In this regarding Ojha states "Ranodip Singh, a Rana Prime Minister for 8 years (1877 to 1885) got interested in this problem and took concrete steps by establishing a government financial institution known as "Tejarath". The Tejarath helped the public by supplying easy and cheap credit at 5% interest on the security of gold and silver ornaments. The function of Tejarath was to supply credit at 5% interest rate per annum. It had benefited government officials. Tejarath did not grant to general people; it was limited only for government officials. Tejarath was regarded as the new area in history of banking development in Nepal.

Tejarath could not fulfill the credit needs of the whole society. It was a government institution that benefited government officials only. So the general people had to depend on moneylenders. The moneylenders exploited the rural people in different ways. On the other hand there was need of trade and industries development programs. To make free the rural people from the grips of lenders and to develop trade and industry in the country the need for a commercial bank was realized in the country. So, the Nepal Bank Limited was established in 1937 A.D. (1994 B.S.), which is the first commercial bank in Nepal. It was established under the Nepal Bank Act of 1963 A.D. at the beginning 49% of the ownership belonged to the promoters as well as general public and 51% of the ownership belonged to government. It also acted as Central Bank for more than three decades. "Nepal Rastra Bank" established in Baisakh 14, 2013 B.S (1956) under Nepal Rastra Bank Act 2012 B.S as the Central Bank of Nepal. The main objective of the central bank is to maintain internal and external stability. Besides the commercial banking functions, NRB is heavily assisting for the development of the whole economy. It is giving timely directives to all financial institutions operated and conducted in all over the country.

There are currently 26 commercial bank, 61 development banks, 78 finance companies, 58 micro finance non-governmental organization, 16 saving and credit co-operative, and 25 insurance companies, employees provident and one citizen investment trust in Nepal. The stock market is in infancy stage in terms of number of the companies listed and the ratios of market capitalization and turnover to GDP.

Table 1.1
List of Licensed Commercial Banks in Nepal

S.N.	Names	Operation Date (A.D.)	Head Office	Paid up Capital (Rs. In Million)
1.	Nepal Bank Limited	1937/11/15	Kathmandu	380.4
2.	Rastriya Banijya Bank	1966/01/23	Kathmandu	1172.30
3.	Agriculture Development Bank Ltd.	1968/01/02	Kathmandu	10777.50
4.	NABIL Bank Limited	1984/07/16	Kathmandu	965.75
5.	Nepal Investment Bank Ltd.	1986/02/27	Kathmandu	2407.10
6.	Standard Chartered Bank Nepal Ltd.	1987/01/30	Kathmandu	932.00
7.	Himalayan Bank Limited	1993/01/18	Kathmandu	1216.20
8.	Nepal SBI Bank Limited	1993/07/07	Kathmandu	874.50
9.	Nepal Bangladesh Bank Ltd.	05/06/1994	Kathmandu	1822.70
10.	Everest Bank Limited	1994/10/18	Kathmandu	838.80
11.	Bank of Kathmandu Limited	1995/03/12	Kathmandu	844.40
12.	Nepal Credit andCommerce Bank Ltd	1996/10/14	Siddharthanagar	1399.50
13.	Lumbini Bank Limited	1998/07/17	Narayangadh	1015.30
14.	Nepal Industrial & Commercial Bank Ltd.	1998/07/21	Biaratnagar	1140.50
15.	Machhapuchhre Bank Limited	2000/10/03	Pokhara	1479.10
16.	Kumari Bank Limited	2001/04/03	Kathmandu	1078.27
17.	Laxmi Bank Limited	2002/04/03	Birgunj	1098.10
18.	Siddhartha Bank Limited	2002/12/24	Kathmandu	952.20
19.	Global Bank Ltd.	2007/01/02	Birgunj	1000.00
20.	Citizens Bank International Ltd.	2007/6/21	Kathmandu	1000.00
21.	Prime Commercial Bank Ltd	2007/9/24	Kathmandu	700.00
22.	Sunrise Bank Ltd.	2007/10/12	Kathmandu	875.00
23.	Bank of Asia Nepal Ltd.	2007/10/12	Kathmandu	1000.00
24.	Development Credit Bank Ltd	2001/01/23	Kathmandu	1107.5
25.	NMB Bank Ltd.	1996/11/26	Kathmandu	1100.00
26.	KIST Bank Ltd.	2009/05/07	Kathmandu	200.00

Source: www.nrb.org.np

1.3 Profile of the Selected Banks

1.3.1 NABIL Bank Ltd.

NABIL bank is the first foreign joint venture bank established on 12th July 1984. At the initial stage it had a technical service agreement with Dubai Bank Limited which was later merged with Emirates Bank limited. NABIL is the first major joint venture bank in the country and it is managed by a team of qualified and highly experienced professionals. Their core objective was to support the nation with introduction of modern banking services.

The bank provides a complete range of consumer, retail, SME and corporate banking services through its offices spread across the country. It is the largest private bank in the country in terms of branch and ATM network. The bank has also adopted modern technologies and has provided an array of card products and Internet/Tele banking facilities besides ATM's and Any Branch Banking Service.

The current structure of equity is share by four parties. 50% of the shares are owned by foreign entity, 10% of the shares are owned by other licensed institution, 10% of the shares are owned by other entity and 30% of the shares are owned by general public.

Table 1.2
Share Capital of NABIL Bank Ltd.

Particulars	F.Y. 2008/09
1. Share Capital	
Authorized Capital	1,600,000,000
a. 16,000,000 ordinary shares of Rs. 100 each	1,600,000,000
Issued Capital	965,750,000
b. 9,657,500 ordinary shares of Rs. 100 each paid up	965,750,000
Paid Up Capital	965,750,000
c. 9,657,500 Ordinary shares of Rs. 100 each paid up	965,750,000

Source: - www.nabilbank.com

1.3.2 Everest Bank Ltd.

This bank was established on 17th November 1992 A.D. and started its operations from 18th October 1994 A.D. under the company act 2021 B.S. with an objective of carrying out commercial activities under the commercial bank act 2031, from the very beginning of its establishment till November 1996 A.D. It was managed by United

Bank of India Limited (UBIL). Later on, UBIL handed over the management to the Punjab National Bank (PNB) India. PNB has been providing top management services 31 branches in various parts of the kingdom with the objective of providing services to both the business community and the common people.

EBL is playing a pivotal role in facilitating remittance to and from across global areas. Being the first Nepalese bank to open a representative office in Delhi (India), the Nepalese in India can open account in Nepal from the designated branches of Panjab National Bank and remit their savings economically through banking channels to Nepal.

The current structure of equity is share by three parties. 50% of the shares are owned by Nepalese Promoters, 20% of the shares are owned by Punjab National Bank and 30% of the shares are owned by general public.

Table 1.3
Share Capital of Everest Bank Ltd.

Particulars	F.Y. 2008/09
1. Share Capital	
1.1 Authorized Capital	1,000,000,000.00
a. 10,000,000 ordinary shares of Rs. 100 each	1,000,000,000.00
1.2 Issued Capital	729,800,000.00
b. 7,298,000 ordinary shares of Rs. 100 each paid up	729,800,000.00
1.3 Paid Up Capital	838,800,000.00
c. 8,388,000 Ordinary shares of Rs. 100 each paid up	838,800,000.00

Source: - www.everestbankltd.com

1.3.3 Lumbini Bank Ltd.

Lumbini Bank Limited is a national level commercial bank offering a wide range of banking solutions and services meticulously customized to the needs of the customers. Established in 1998 A.D. this is the first regional commercial bank in Nepal, currently, they have 5 branches among the country. Which are as follows: - Hetauda, Narayagadh, Butwal, Durbarmarg and Biratnagar.

Lumbini Bank Limited is highly committed to assure of the standard and excellence in the services it offers. The management team of Lumbini Bank Ltd. is guided towards obtaining new challenges and opportunities.

Backed by state-of-the-art technology and experienced professionals adept in modern banking management, they are striving to make banking simple, fast and customer friendly. Just the way customers like it.

Lumbini Bank Limited has restructured various products, as a part of an ongoing process, to cater to the retail segment. The newly structured products cover Personal Loan, Home Loan, Vehicle Loan, Mortgage Loan, Educational Loan, Time Loan etc. and other services are Trade Finance, Letter of Credit, Remittance, SMS Banking, ABBF, Treasury, Foreign Exchange, Safe Deposit Lockers and 365 days Banking etc.

The current structure of equity is share by two parties. 66% of the shares are owned by Nepalese Promoters, 34% of the shares are owned general public.

Table 1.4
Share Capital of Lumbini Bank Ltd.

Particulars	F.Y. 2008/09
1. Share Capital	
1.1 Authorized Capital	1,600,000,000
a. 16,000,000 ordinary shares of Rs. 100 each	1,600,000,000
1.2 Issued Capital	1,000,000,000
b. 10,000,000 ordinary shares of Rs. 100 each paid up	1,000,000,000
1.3 Paid Up Capital	1,015,300,000
c. 10,153,000 Ordinary shares of Rs. 100 each paid up	1,015,300,000

Source: - www.lumbinibank.com

1.4 Statement of the Problem

Lending is one of the major terms of investment policy. So every financial institution should concentrate on lending as a major means of investment. But the sufficient return cannot have been found to be earned as well stable and appropriate.

Lending is the essence of commercial banking; consequently the formulation and implementation of sound lending policies are among the most important responsibilities of the bank's management well-conceived lending policies and careful lending practices are essential if a bank is to perform its credit creating function. Effectively and minimize the risk inherent in any extension of credit. Lending is a major source of income for a commercial bank though it involves high risk. Lending affects the company's profitability and liquidity, so it is one of the crucial decisions for the commercial bank.

Normally, every loan is good at the time it is sanctioned. It tends to be problematic with the passage of time. So, while extending loan, a bank has to take care of its ultimate collection ability. Banks sometimes lag behind in monitoring and supervising the loan they have already disbursed. As a result, some of the loans remain delinquent and they create problem to the bank. The bank loans turn into non-performing assets if not recovered in time. Beside, a bank has to incur costs in attempting to recover the loan.

In this study lending policy and Practices measure of commercial bank are analyzed. As mentioned above. Following are the major problems that have been identified for the purpose of this study

- What is the relationship of loan and advance; investment to total deposit and with loan loss provisioning?
- Lack of sustainable Lending environment.
- How aggressively is this commercial bank lending?
- Over liquidity caused by lack of good lending opportunities
- Increasing deposits without increasing in the lending sectors.
- What steps should be taken to improve the lending policy & Practices of the commercial bank?
- Does commercial banks follow Nepal Rastra Bank directive in terms of Lending?
- What is the Proportion of non-performing loan in total lending?

1.5 Objective of the Study

The main objective of the study is to analyze, examine and interpret the lending policy and practice adopted by commercial banks with reference to NABIL Bank Ltd, Everest Bank Ltd. and Lumbini Bank Ltd. Each joint venture bank has adopted its own lending policy and practice to mobilize its fund in different sectors. It may or not be more efficient in comparison to other joint venture banks. The other objectives of this study are given as follow:-

1. To study the relationship among different financial indicators.
2. To measure the efficiency of lending policy.
3. To identify major weakness of lending policy of sample banks.
4. To analyze the portfolio behavior of lending policy of sample banks.

1.6 Signification of the Study

Lending to different sectors is important for the economic development in general and reduction of poverty and unemployment in particular. Due to this need, there are many commercial and joint venture banks that cater to the needs of people. So, lending to the people and enterprise is very crucial to the country. Disbursement and collection of loan, if done properly and rationally can help reduce unemployment and poverty of Nepal.

In the context of Nepal, there is less availability of research work in lending policy and practices of commercial banks and other financial institutions. There are lots of research works on the performance of commercial banks but this specific topics does not seem given important before therefore, this study is an effort to bring forth the fact related to lending policy and practices of commercial banks with reference to NABIL bank Ltd, Everest bank Ltd and Lumbani Bank Ltd. It is expected that it will add idea to the management literature and finding related to these banks. It is an attempt to help the bank improve its performance and be able to face competition.

The study on a Case study on lending policy and practices of NBIL Bank Ltd, Everest Bank Ltd and Lumbani Bank Ltd would be beneficial to the shareholders, banking professionals, investors, teachers and student of banking management.

1.7 Research Methodology

Since the basic objective of this study is to analyze a case study on lending policy and practices of commercial banks in Nepal. Therefore, suitable research methodology as demanded by the study is followed. It is intended to use simple and lucid methodology as follows:

1.7.1 Population and Sample

There are altogether 26 commercial banks functioning all over the country and most of their stocks are traded actively in the stock market. Among them Nabil Bank Limited, Everest Bank Limited and Lumbini Bank Limited has been taken as sample for the study. Financial statements of last 5 years from 2004/05 to 2008/09 have been taken as sample data for a case study on lending policy and practices of commercial bank in Nepal.

1.7.2 Research Design

This research design will be quantitative and less descriptive, specific and analytical and exploratory.

1.7.3 Nature and Source of Data

The research will be based on secondary data. For the secondary source, Books, journals and other research papers are the secondary source of data that will be used for this study.

1.7.4 Statistics and Analytical Tools Used

This study comprises following tools and techniques:

- Bar and trend diagram.
- Trend Analysis
- Correlation Analysis
- Regression equation analysis
- Mean, Standard Deviation, Coefficient of Variation and Probable Error

1.8 Limitation of the Study

Every study has its own limitation; this study is also not an exception, which cannot be ignored. The study simply represents the partial fulfillments of the M.B.S. program. The study will be conducted within certain and constrains.

They are as follow:-

- Only Nepalese commercial banks have been considered for the study and only three banks selected as samples for the study.
- The study covers a period of 5 fiscal years, which will be tabulated and processed for drawing conclusion.
- The accuracy of the research work will be dependent on data provided by concerned organization.
- Time factor is major limitation of this study.
- This study concentrates only on those factors, which are related with lending policy and practices of Nepalese commercial banks. It does not consider other aspects of the banks.

- Because of the strict policy of the commercial bank the study is mainly based on Secondary data. The data published on annual reports of respective banks, articles, publication and journals etc have been taken into consideration. Any misrepresentation, mistakes, omission etc may affect the outcome to the study. Thus the reality of study depends on secondary sources of data and questionnaires filled and responses given by the respondents.

1.9 Organization of the Study

The study will divide in five chapters, each devoted to some aspects of the study of Lending policy and practices of commercial bank in Nepal. The title of each of those chapters is as follows.

Chapter-I: - Introduction

This chapter includes background of the study, Introduction, Statement of the Problems, Objective of the Study, Research methodology, Importance of the study, Limitations of the study and Chapter plan of the study.

Chapter-II: - Review of Literature

This chapter includes review of different textbooks, different thesis, review of journals, articles and research studies published by various authors.

Chapter-III: - Research Methodology

This chapter includes research design, data collection, methods and analysis and research variables.

Chapter-IV: - Presentation and Analysis of Data

Data processing, data analysis and interpretation are given in this chapter.

Chapter-V: - Summary, Conclusion and Recommendations

The last chapter contains the findings of whole study after which major conclusion and recommendations are provided.

CHAPTER–II

REVIEW OF THE LITERATURE

So many research works has been done in various aspects of commercial banks especially financial performance, investment policy, resource mobilization, lending policy, compliance of NRB directives by banks etc. There are some books, journals, articles other studies done related with lending and investment aspect of banks. Some of the relevant studies, literatures on lending and investment are reviewed below.

2.1 Theoretical/Conceptual Review

The chapter focuses to discuss briefly about theoretical concept of the loans of the loans and advance and its relation with other subject.

2.1.1 Origin and Development of Commercial Bank

According to the Alfred Marshal, in Greece, the temple of Delphi and other sacred acted as storehouse for the precious metals before the days of coinage and private purpose at interest, through they paid none themselves. Private money changers began with the task of reducing many metallic currencies, more or less exactly, to a common unit of value and went on to accept money on deposit rate interest and to lend it out at higher interest.

The ancient Rome of the 15th century we can find some history about the practice of various banking function like money changing, transfer of funds, issue of loans etc which are similar as to those of modern banking system. In the 7th century the use of commercial instruments was recorded. The revival of banking practices took place only towards the beginning of the 12th century A.D. In case of eastern countries it started vary late in comparison to western countries. In England, banking had its origin with London goldsmith who, in the 17th century, began to accept deposits from merchant and other for safe keeping of money and other valuable, crude money lending and money changing were present during the reign of Elizabeth-I (1533 to 1603 A.D.) and the Tower of London, which served as the British mint, "The bank of Venice" was the first public banking institution established in 1157 A.D. The famous

bank "Bank of Amsterdam" opened in 1609 it had occupied a very important place in the 17th century enjoying for a long time position of international commerce as prominent as the "Bank of England" in 1694 with capital of 1.2 million pound by a group of wealthy London merchants and financiers. Napoleon founded the "Bank of France" in 1800 A.D in France.

The 19th century comes with the vast scope for development of commercial banking. Accordingly to Vanish, M.C. the 19th century witnessed not only the phenomenal development of modern banking but also witnessed the solution of many stubborn monetary problems enabling banks to turn their attention away from old money changing business to many new important jobs that come in the wake of industrial process. The 20th century observed development of various banking institutions highly specialized, sophisticated particularly in advanced countries like the U.S.A., U.K. and others. Today various international organizations like I.B.R.D, A.D.B. etc have been developed. In England the commercial bank used to be referred to as the joint stock bank. In London, it has been called as clearing bank. In Western Europe commercial banks used to be called credit bank and investment bank.

The commercial banks in India established by the British in colonial age were called "Exchange Banks". So, the term banking system is different in various countries. According to Sayers the general acceptable term The typical commercial bank in most countries is very large institution having a number of branches scattered all over the countries i.e. England, Canada and Australia.

2.1.2 Nepalese Banking Sector

In any economy, the importance of the financial sector in general and the banking sector in particular cannot be underestimated. Banking plays a pivotal role in the overall development of an economy. Economic reforms initiated by the government 18 years ago have changed the landscape of several sectors of the Nepalese economy. The Nepalese banking sector is no exception. This sector has been going through major changes as a consequence of the economic reforms. The changes affect the ownership pattern of banks, regulatory aspects, availability of funds, cost of funds, opportunities to earn, a range of services (fee based and fund based) and management

of priority sector lending. As a consequence of liberalization in interest rates and cutthroat competition, banks are operating on a reduced spread.

The economic reforms have also generated new and powerful customers (the Nepalese middle class) and a new mix of players (public sector units, private banks and foreign banks). The emerging competition has generated new expectations from the existing and new customers. There still lies an urgent need to introduce new products. The existing products need to be delivered in an innovative and cost-effective way by taking full advantage of emerging technologies. Currently, the trend is to increase the number of financial institutions and not the quality of financial services being delivered. With 26 commercial banks already up and running, seven new commercial banks are waiting for the green signal from Nepal Rastra Bank. It is pretty evident that we are seeing growth in the width of the Nepalese financial sector; however, depth and specialization severely lack quality.

As the financial sector has evolved into the biggest sector in the economy, there is high demand for quality and competent human resources to manage it. Let's analyze table 2.1.

Table 2.1
Nepali Financial Market

	Commercial Banks	Development Banks	Finance Co.	Micro Financial Institution	Cooperatives	NGO in Banking Activities	Total
Number	26	61	78	58	16	47	285
No. of Employees	14273	2234	2568	989	1129	1842	20204
Asset Size	316.08 B	82.36 B	91.49 B	7.8 B	0.94 B	3.23 B	501.9 B
Op. Profit	13.99 B	3.68 B	2.56 B	1.13 B	0.81 B	0.84 B	23.01 B
Net Profit	8.39 B	1.84 B	1.28 B	0.66 B	0.41 B	0.44 B	13.02 B
Staff Expenses	1.62 B	0.65 B	0.32 B	0.16 B	0.09 B	0.39 B	3.23 B
Training Expenses	0.13 B	0.03 B	0.02 B	0.01 B	0.00 B	0.01 B	0.20 B

Note: - Figures for these cooperatives, which are registered with NRB, have only been included. There are some 1000 plus additional cooperatives, which are registered with the National Cooperatives Board, operating in Nepal. Figures for Op. Profit, Net Profit, Staff Expenses and Training Expenses pertain to a one-year period.

From the above table, it is evident that there are altogether 285 financial institutions (Other than Nepal Rastra Bank) in the country and more than 20,000 people working at these institutions. These human resources are responsible for managing approximately Rs. 502 billion worth of assets (primarily loans and advances), out of which 21 percent comprises two government-owned banks, Rastriya Banijya Bank and Nepal Bank Ltd. An Annual net profit of Rs. 13.02 billion generated by creating assets worth Rs. 502 billion means a very low return on assets of a mere 2.59 percent, which is even below the average savings deposit rate in the country, which is 4.75 percent.

Table 2.2
Challenges of the Nepali Financial Market

	Commercial Banks	Development Banks	Finance Companies	Cooperatives
HR-Knowledge Level	Fair	Needs Improvement	Below Average	Below Average
Use of Technology	Fair	Fair	Needs Improvement	Needs Improvement
Offering of Products and Services	Undifferentiated Products and Services	Undifferentiated Products and Services	Undifferentiated Products and Services	Undifferentiated Products and Services
Corporate Governance	Fair	Fair	Needs Improvement	Below Average
Level of Competition	Intense	Intense	Intense	Intense
Stringency of Regulations	Stringent	Stringent	Stringent	Not Consistent

While doing a root causes analysis of this scenario, two very strong reasons have evolved. The first reason is the poor quality of loans due to non-compliance of basic credit principles while granting loans coupled with lack of credit-skills assessment. The second reason is that almost all the financial institutions by and large are involved only in dealing with undifferentiated vanilla banking products. For example, if someone needs a car loan, which is typically a commercial bank product, he or she can walk into any development bank in the country. Yes, in the current scenario, it is very difficult for development banks in the country to burn their fingers by going into long-term project loans. However, they should be able to create their own niche

market. To give another example, there are simple value added products like “funded-risk participation” and “private labeling” in the trade finance area, “options and other derivative products” in the global market area and “remittance securitization” in our most lucrative area of “remittance”.

There is a serious problem in knowledge about the above mentioned products in Nepal’s banking community. As depicted in Table 2.1, the annual staff training expense of these financial institutions is very low, that is, Rs. 0.20 billion. This can be attributed to non-availability of structured banking related courses in the country. There is a handful of banking related training centers in the country, which are only providing piecemeal training courses in various areas, which are not adequate for true learning. Someone who has completed a postgraduate program in banking and finance from an overseas university will be able to say how much more we can do in Nepal’s financial sector even if we implement only 10 percent of what he has learnt in his postgraduate program.

The level of product diversification in areas such as trade finance, remittance, global market and even credit management is very low in Nepal. In terms of comparison, if we disregard India as it is one of the large economies and compare our financial market with that of Bangladesh, the Bangladeshi financial market would be rated 10 while we are not even at three. This means there is a huge gap to be filled before our banking sector starts operating at the optimum level.

If we study the analysis presented in Table 2.2, we see that our financial market needs to bring much improvement in the knowledge level of human resources, use of technology and corporate governance. Something noticeable in the table is that there are stringent regulations for financial institutions and that the level of competition among the players is pretty intense.

After considering all these factors, we can safely conclude that for true and sustainable financial sector reform, we also need to, besides addressing the issues of loan recovery and loan management, focus on capacity building of the players in the financial market by providing them platforms which will enable them to acquire specialized and focused knowledge on global banking products. It is highly evident

that an in-depth exposure to these products will not only add significant value to the banking sector's customers, but also enable banks to witness many new openings from where additional revenue streams can be generated for the banks.

2.1.3 Concepts of Commercial Bank

A bank is a business organization that receives and holds deposits of funds from other make loan or extents credits and transfer funds by written order of deposits (The Encyclopedia America, 1984: 302).

A commercial banker is a dealer in money and substitutes for money and substitutions for money, such as cheques of bill of exchange. It also provides a variety of financial service (The New Encyclopedia Britannica, 1985: 1460).

In the Nepalese context, commercial bank act, 1975 A.D. defines “A commercial bank is one which exchanges money, deposits money, accepts deposits, grants loans and performs commercial banking functions (Commercial Bank Act, 1974A.D).

Commercial banks are those banks which perform all kinds of banking function such as accepting deposits, advancing loans, credit creation and agency function. They provide short term loan, medium-term loans and long-term loans to different business house and trading companies. NRB act 2031 has defined the meaning of commercial bank as the bank which performs the commercial functions.

A commercial bank can be defined as an institution which deals in money in the words of the Crowther “Bank collect money from those who have it to spar or who are saving it out of their income and lend this money out against goods security to those who requires it” (Crowther, S.R., 1985:58).

Hence, we can conclude form the above that the commercial banks are established under the rules and legislation of the central bank of the country. It has to move as per the directives given by the central banks. Though banks are established for the mobilization of the saved fund, central bank makes certain rules so that the public or the customer of the bank may not undergo on loss of their hard earned money by the disinvestment procedure of the bank.

2.1.4 Role of commercial Bank in Economy Development

According to the Former Prime minister of India said “The role of commercial bank play in economy development of country needs no emphasis banking, when properly organized, aids and facilities the growth of trade”. The objective of bank is to ideal resources for productive use after collecting those scattered resources. Its role in economic development is so immense; it brings about greater mobility of resources to meet the emerging necessity of the economy. The essence of commercial bank is the financial intermediate between the ultimate savers and borrowers. A bank’s main function is to act as middle-man between the surplus and deficit units in the economy and as a bank like any other firm is in business to make profit its shareholders.

The major problem is almost all under development countries like Nepal in lack of capital formation and their proper mobilization. In such countries the commercial banks have to take more responsibilities and should act as development bank due to the lack of other specialized institutions. The importance of bank in economic life is greater. Nepal has sufficient natural resources. The commercial banks can help in economic development which can uplift the life style of the general people directly as the tax contribution form its operation profit and collection the tax form interest form its account holders and generation the employment opportunity itself. Economic stability can be maintained as better by the commercial banks as that of than direct way. The commercial banks accumulate scattered saving in term of deposit grant long term as well as short-term loan in the several sectors. Because of this industries can be run better way and reduces import of foreign goods and increase exports. This helps the increase of foreign currency reserve. Due to development of industrial activity on the one had people can enjoy employment opportunity and so far natural resources are exploited. Naturally, industrialization enhances to develop for agricultural sector. This “bank” can be rightly interpreted as the king of business world and promoter of economic development.

Commercial banks play vital role in economic development of the country. In brief the economy development so define is necessary and sufficient to generate high rates of saving and investment. The generation of high rates of saving and there by investment is possible only through banks. Banks occupies greater role in economic

development by generating the saving towards the desired sectors from one place to another, communicating with its branches and agencies in different parts of the country and the world and advising to the commercial people.

2.1.5 Function of Commercial Bank

The function of commercial bank is governed by the Commercial Bank Act 2031 and directives issued by Nepal Rastra Bank from time to time. The function of Commercial Banks can be classified into three broad categories:

Primary Function

-) Acceptance of Deposits:
-) Advancing of Loans:

Secondary Function

-) Bid Bond
-) Work at trustee
-) Agency Services
-) Performance Bond
-) Remittances of money
-) Financial Bank Guarantee
-) Safe Custody of Valuables
-) Advance Payment Guarantee
-) Underwriting of Capital Issue
-) Issuance of Guarantee on behalf of customers
-) Collection of Cheque, Bills and Other Instruments
-) Sell and purchase of Foreign Currency (including Travel Cheque)

General Utility Services

-) Underwriting of securities
-) Providing trade information to customers
-) Transfer of funds from one branch to another
-) Accepting and discounting bills of exchange of export
-) Providing reports on the credit worthiness of customers

-) Issuing letter of credit and standing as surety for customers
-) Accepting valuables, jewelry and securities for safe custody
-) Providing foreign exchange to persons going abroad and to imports
-) Advising customers with regard to investments and other financial matters.

2.2 Conceptual Review of Lending

2.2.1 Meaning of Lending (Credit)

The word Lending means Trusting. In the credit transactions the lender (or Banks) must have confidence in the borrower that she/he will be able to repay the money. In lending (credit) transactions, the creditor's turns over to the debtor to repay an equivalent amount usually money in future plus as added sum called interest. In other words the commercial bank earns profit by lending the amount in terms. Loan or credit and in return it gets interest.

In generally, we can say that lending is a thing that is lent, especially a sum of money. Like-wise debt means a sum of money owed to somebody. However in financial terms a loan of debt means principal or interest availed to he/she borrowers against the security. Debt means that bank owes or will lend to individual or person. Likewise the term loan is defined as a lending. Delivery by one party and receipt by another party, a sum of money upon agreement expressed or implied, to repay it with or without interest. Any thing furnished for temporary use to a person at his request, on that condition it shall be returned or it's equivalent in kind, with or without compensation for its use

Bank loan are classified as; (a) Loans and advance (b) Overdrafts (c) Cash credit (d) Discounting of bills and so no. but beside this, the other forms of credit are bills exchange cheques, Drafts, Promissory Note, Letter of Credit (LC), Travelers Cheque, Treasury bills (T-bills), Book credit etc.

Lending is the essence of commercial banking; consequently the formulation and implementation of sound lending polices 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 creating function effectively and minimize the risk inherent in any extension of credit.

2.2.2 Meaning and Effectiveness of Lending Policy

In initial step, setting lending policy, involves determining the lending objective and the amount of his or her investable wealth because there is a position relationship between risk and return for sensible lending strategies. It is not appropriate for an investor to say that his or her objective is to “make a lot of money”. What is appropriate for an investor in this situation is to state that the objective is attempt to make a lot of money while regarding that there is same chance that large loss may be incurred. Lending objective should be stated in terms of both risk and return (Francis, J.C., 1998: 40).

A good lending policy is not overly restrictive but allows for the presentation of loans to the board that officers believe are worthy of consideration but which do not fall within the parameters of written guidelines. Flexibility must exist to allow for fast reaction and early adaptation to changing conditions in a bank's earning asset mix and market environment. Consideration that from the basic elements for the effective lending policies including the following:

- I. Maturities:** - A lending policy should establish the maximum maturity for each type of credit and loans should be granted with a realistic repayment schedule. Maturity scheduling should be determined in relation to the anticipated sources of repayment, the purpose of the loan and the useful life of the collateral.
- II. Types of Loans:** - A lending policy should specify the types of loans and other credit instruments that the bank intends to offer to clients and should provide guidelines for specific loans. Decision about types of credit instruments should be based on the expertise of lending officers, the deposit structure of the bank and anticipate credit demand. Types of credit that have resulted in and abnormal loss should be controlled by senior management.
- III. Distribution by Category:** - Limitations based on aggregated percentage of total loans in commercial, real estate, consumer or other credit categories are common. Policies related to such limitations should allow for deviations that are approved by the board.

- IV. Geographic Limits:** - These limits are usually a dilemma. If a bank lacks understanding of its diverse market and does not have quality management, geographic diversification may become a reason for bad loan problems. The imposition of strict geographical limits can also create problems, particularly in the case of regions with narrow economies. In any case, a bank's business market should be clearly delineated and commensurate with its market knowledge, managerial and staff experience. Bank's officers should be fully aware of specific geographical limitations for lending purpose.
- V. Credit Concentrations:** - A lending policy should stimulate portfolio diversification and strike a balance between maximum yield and minimum risk. Concentration limits usually refer to the maximum permitted exposure to a single client, connected group and sector of economic activities. This is especially important for small regionally oriented or specialized banks. A lending policy should require that all concentration be reviewed and reported on frequent basis.
- VI. Limit on Total Outstanding Loans:** - A limit on the total loan portfolio is usually expressed relative to deposits, capital or total assets. In setting such a limit, factors such as credit demand, the volatility of deposits and credit risks should be considered.
- VII. Loan Pricing:** - Rates of various loan types must be sufficient to cover the costs of funds, loan supervision, administration and probable losses. At the same time, they should provide the reasonable margin of profit. Rates should be periodically reviewed and adjusted to reflect changes in costs or competitive factors. Rate differentials may be deliberately maintained either to encourage some types of borrowers to seek credit elsewhere or to attract a specific type of borrower. Guidelines for other relevant procedures, such as the determination of fees or penalty interest rates are also an element of pricing policy.
- VIII. Financial Information:** - A lending policy should define that financial statement requirements for business and individual at various borrowing levels and should include appropriate guidelines for audited, non-audited, interim, cash flow and other statements. If the loan maturity is longer than one year, the policy should require that the bank's officers prepare financial projections with horizon equivalent to the bank's loan maturity. To ensure that the loan

can be repaid from cash flow. All requirement should be defined in such a manner that any negative credit data would clearly violate the bank's lending policy.

- IX. Collections:** - A lending policy should define delinquent obligations of all types and specify the appropriate report to be submitted to the board. These reports should include sufficient detail to allow for the determination of the risk factor, loss potential and alternative courses of action. The policy should require a follow-up collection procedure that is systematic and progressively stronger. Guidelines should be established to ensure that all accounts are presented to and reviewed by board.
- X. Lending Authority:** - Lending authority is often determined by size of the bank. In smaller banks, it is typically centralized. In order to avoid delays in the lending process, products and types to decentralize according to geographical area, lending products and types of customers. A lending policy should establish limits for all lending officers. If policies are clearly established and enforced, individual limitations may be somewhat higher than would normally be expected, depending on the officer's experience and tenure with the bank. Lending limits could also be based on group authority, which would allow a committee to approve large loans. Reporting procedures and the frequency of committee meeting should be specified.
- XI. Maximum Ratio of Loan Amount to the Market Value of Pledged Securities:** - A lending policy should set forth margin requirements for all types of securities that are accepted as collateral. Margin requirement should be related to the marketability of securities. A lending policy should also assign responsibility and establish a timetable for periodic pricing of collateral.
- XII. Appraisal Process:** - A lending policy should outline where the responsibility for appraisal lies and should define formal, standard appraisal procedures, including reference to reappraisals of renewals or extensions. Acceptable types and limits on the amount of appraisal should be outlined for each type of credit facility. Circumstances requiring appraisals by qualified independent appraisers should also be described. The ratio of the amount to the loan to the appraised value of both the project and collateral, as well as the method of valuation and differences among various types of lending instruments should

be detailed. The lending policy should also contain a schedule of down payment requirements, where applicable.

XIII. Recognition: - A bank should recognize a loan, whether original or purchased, in its balance sheet. This should occur as soon as the bank becomes the party to the contractual provisions that apply to the loan. A bank should initially carry the loan at cost.

XIV. Impairment: - A bank should identify and recognized the impairment of a loan or a collectively assessed group of loans. This should be done whenever it is neither probable nor assured that a bank will be able to collect that amounts due according to the contractual terms of a loan agreement. Impairment can be recognized by reducing the carrying amount of the loan to its estimated realizable value through an allowance or charge-off, or by attributing charges to an income statement during the period in which the impairment occurs.

2.2.3 Types of Loan

Banks make a wide variety of loans to wide variety of customers for many different purposes. For customers, the cause of loan purchasing may be investment in business,

Purchasing automobiles, take dream vacations, pursuing college educations, constructing home and office building so on. On the basis of loan purpose, banks can be divided into following categories.

1. Term Loan

Term loan is money lent to the borrowers in a lump sum. Generally, subsequent debt in the loan account is not allowed except by way of interest, incidental charges, insurance premiums, expenses incurred for the protection of the security. Term loans are generally granted for loan period to finance fixed assets and are repayable on installments over the period of loan.

2. Project Loan

Project loan is granted to customers on the basis of the viability of the project. The financial institution asks the borrower to invest certain proportion to the project from their equity and the rest will be financed as project loan. The debt equity ratio in case of

project loan is generally 60:40. The project loan includes the term loan and working capital loan required by the project.

3. Working Capital Loan

Working capital is the difference between current assets and current liabilities. This type of loan is granted to the customer to meet their working capital gap. Working capital can be divided into fixed working capital and variable working capital. Fixed working capital is financed by way of short-term loan while variable working capital is financed by overdraft.

4. Loan Against Fixed Deposit Receipt

The depositor keeps fixed deposits for a specified period. If a depositor needs money before its maturity date, he can obtain loan against the security of such fixed deposits. Generally commercial banks allow up 90% of the fixed deposits as loans.

5. Priority/Deprived Sector Loan

Commercial banks are required to extend advances to the priority sector and deprived sector. Out of the total credit facility of the commercial 12% must be extended towards priority sector loan including deprived.

6. Overdraft

Overdraft facility is a kind of working capital loan. This facility is allowed in current accounts. Overdraft is an agreement by which the banker allows the customers to draw over and above the current account balance. The borrower cannot exceed the limit sanctioned to him. In this account, the balance will be fluctuating because of withdrawal and repayment of money by the borrower. Interest on overdraft is charged on debit balance on daily basis. Overdraft is generally granted to the businessmen for the fulfillment of their short-term needs.

7. Cash Credit

Cash credit is similar to the overdraft account by which the customer is allowed to overdraw his account. The borrower may operate the account within stipulated limited and when required. Cash credit is providing against the pledge or hypothecation of stock in trade, goods, plants and machinery, land and buildings so on.

8. Hire-Purchase Financing

Hire purchase is a type of installment credit under which the hire purchaser, called the hirer, agrees to take the goods on hire at a stated rental, which is inclusive of repayment of principal as well as interest, with an optional to purchase. Goods for the purchase of hire purchase may be bus, truck, car, jeep and machinery so on. Hire purchase facility can be granted to the person having fixed source of income. The facility can also be granted to the institutions.

9. Bill Purchase and Discount

Purchasing of bill of exchange of customers in whose favors limit is sanctioned is called purchasing of bills. Bills may be either documentary bills or clean bill. If a bill is accompanied documents of title to the good (Railway Receipt, Truck receipt, Airway Bill) it is called documentary bill. In the absence of such document, it is called clean bill.

10. Bridge-Gap Loan

If a term loan is approved to some customers and the approving institution cannot disburse the facility because of incompleteness of legal and other formalities. In this situation customer may ask as bridge gap loan.

11. Consortium Loan

While a single financial institution cannot grant credit to a project because of single borrower limit or other reasons, two or more such institutions may agree to grant credit facility to the project. Such kind of loan is called consortium loan. Financial institutions may also go on consortium financing to share the risk of project between them.

12. Real Estate Loan

It is the credit extended to purchase or improves real property, such as land and building. Real property- land building and other structure secure such loans. Real estate loans include longer-term loan to finance the purchase of farmland.

13. Commercial and Industrial Loan

Commercial and industrial loan are extended to business firms to support the production and distribution of their products and services. It is granted business to cover such expenses as purchasing inventories, paying tax, meeting payrolls too.

14. Housing Loan

Financial institutions also extend housing loan to their customers. Housing loans may be of different nature e.g., residential building, commercial complex, construction of warehouse etc, housing loans are granted to the customer if they have regular source of income or if they earn revenue from the housing project itself.

15. Off-Balance Sheet Transaction

The bank provides the facilities to the client being the guarantor in some transaction. This facility provided to the client mainly in two ways. First bank guarantee and second is letters of credit. This transaction is also called off balance sheet transaction.

16. Bank Guarantee

No loan is disbursed in the transaction of Bank Guarantee. Hence I would like to introduce it in a single sentence. Bank guarantee expresses a commitment of the bank to make good any financial loss and beneficiary of the guarantee may sustain when the party named in Guarantee on whose behalf the guarantee is issued falls to perform the contract and or discharge his/her obligation.

17. Letter of Credit

Letter of credit is a commitment by a bank on behalf of its customer to pay the counter value of goods/ services within a given date of its supplier according to agreed stipulated and against presentation of specified documents. Letter of credit is used and instrument for settlement of payment arising out of the commercial transaction like sale/purchases so on. In such credit payment obligation arises only upon fulfillment of specified conditions.

2.2.4 Features of Sound Lending Policy

The income and profit of the commercial banks depend upon its lending procedure. The greater the credit created by bank, the higher wills the profitability. A sound lending policy is not only per-requisite for commercial banks profitability, but also

crucially significant for the promotion of commercial saving of backward country like Nepal. Some features of sound lending policy are considered as under:

1) Safety

Safety is the most important principle of good lending. If borrower invests the money in an unproductive or speculative venture, or if the borrower himself is dishonest, the advance would be in jeopardy. Similarly, if the borrower suffers losses in his business due to his incompetence, the recovery of the money may become difficult. The banker ensure that the money advanced by him goes to the right type of borrower and is utilized in such a way that is will not only be safe at the time of lending but will remain so throughout, and after serving a useful purpose in the trade or industries where it is employed, is repaid with interest.

2) Liquidity

The borrower must be in a position to repay within a reasonable time after a demand for repayment is made. This can be possible only if the money is employed be borrower for short-term requirements and not locked up in acquiring fixed assts, or in schemes, which take a loan time to pay their way. The source of repayment must also be definite. The reason why bankers attach as much importance to “liquidity” as to “safety” of their funds is that a bulk of their deposits is repayable on demand or at short notice.

3) Purpose

The purpose should be productive so that the money not only remains sate but also provide a definite source of repayment. The banker must closely scrutinize that purpose for which the money borrowed for a particular purpose accordingly.

4) Profitability

Like other commercial institutions, banks must make profit. They have to pay interest on deposits received by them. They have to incur expenses on establishment, rent, stationery, Salary etc. they have to make provision for depreciation of their fixed assets, and also for possible bad or doubtful debts. After meeting all these items of expenditure which enter the running cost of banks, a reasonable profit must be made;

otherwise, it will not be possible to carry anything to the reserve of pay dividend to the shareholders. It is after considering all these factors that a bank decides upon its lending rate.

5) Collateral/Security

It has been the practice of banks not to lend as far as possible except against security. Security can be considered as insurance, security may be generally classified as personal and tangible, as well as primary and collateral. The banker carefully scrutinized all the different aspects of an advance before granting it. At the same time, he provides for an unexpected change in circumstance which affected the safety and liquidity of advance.

6) Spread

Another important principle of good lending is the diversification of advances. An element of risk is always present in every advance, however secure it might appear to be. In fact, the entire banking business is one of taking calculated risks and successful banker is an expert in assessing such risks. He is keep on spreading the risks involved in lending, over a large number of borrowers, industries and over different type of securities.

7) Legality

Illegal securities will bring out many problems for the investor. Commercial banks must follow the rules and regulation as well as different directions issued by Nepal Rastra Bank, Ministry of Finance and other while mobilizing its funds.

8) National Interest

Even when an advance satisfies all the aforesaid principles, it may still no be suitable, the advance may run counter to national interest. It in the changing concept of banking factors such as purpose of the advance, viability of the proposal and national interest are assuming a greater importance than security and export-oriented industries.

2.2.5 Step of Lending Process

From the viewpoint of both principles, practice and lending process has the following steps:

1. **Evaluation of Loan Proposal:** - After a person and institution submit a proposal bank make a deep study and analyses from different angles on the proposal. Before approving the loan proposal the bank evaluates all necessary documents for providing loan. In the case of person or businessman the study of such documents are different. It will be accepted or rejected depending on the will of the bank. If the bank feels the loan proposal satisfactory, it can approve the loan accordingly.
2. **Types of Loan:** - After accepting the proposal of a borrower, the bank discusses on these subjects, what types of loan the projector or the proponent. In this way, it becomes the division of the loan. Generally, there are many types of loan like industrial loan, hire purchase and the employees' loan so on. The loan can be classified in another way too like secured loan and unsecured loan. The bank wants to keep its safe. So, the banks can classify loan in this way. The loan can be classified in the process of approving the loan.
3. **Loan Interview:** - Once a customer decides to request a loan, an interview with a loan officer usually follows right away, giving the customer the opportunity to explain he or her credit needs. That interview is particularly important because it provides an opportunity for the bank's loan officer to assess the customer's character and sincerity of purpose. If the customer appears to lack sincerity in acknowledging the need to follow to the terms of a loan, this must be recorded as a strong factor evaluating against approval of the loan request.
4. **Site Visit:** - If a business or mortgage loan is applied for, an officer of the bank usually makes a site visit to assess the customer's location and the condition of the property. Site visit helps to verify the accuracy of the information provided by the applicant. It also reveals the degree of customer's sincerity and character.
5. **Reference Check:** - The loan officer may contact other creditors, who have previously loaned money to this customer to see what their experience has been. Did the customer fully adhere to previous loan agreements and keep satisfactory deposit balance? This payment record often reveals much about the customer's character, sincerity of purpose, and sense of responsibility in making use of bank's loan.

6. **Preparation of Necessary Documentation:** - If every thing up to this point is favorable, the customer is, then, asked to submit several crucial documents in order to fully evaluate the loan request, including complete financial statements. In case of a corporation, the applicant is also asked of board of director's resolution authorizing the negotiation of loan with the bank. Such documents are:
 - a. The statement of income and expenditure
 - b. Citizenship certificate.
 - c. The certificate of income tax registration.
 - d. The certificate of renewal.
 - e. Scheme of the institution or the business.
 - f. Any contract or agreement.
 - g. The memorandum of understanding.
 - h. Documents relation to insurance
 - i. Other necessary documents.
7. **Credit Analysis:** - Once all documents are on file, the credit analysis division of the bank conducts a thorough financial analysis of them aimed at determining whether the customer has sufficient cash flow and backup assets to repay the loan. The credit analysis division then prepares a brief summary and recommendation, which goes to the loan committee for approval. In case of larger loans, member of the credit analysis division gives an oral presentation, and discussion will ensue between staff analysis and the loan committee over the strong and weak point of loan proposal.
8. **Loan Amount:** - The bank may or may not give the amount, which proponent he or she has demanded. It is the matter depended on the will of the bank. Yet in determination of loan quantity is made by paying attention to the need of the customer, evaluation of the securities and the state and position of the business.
9. **Perfecting Collateral:** - When the loan committee approves the customer's loan request, the loan officer of the credit committee will usually check on the property to be pledged as collateral or can acquire title to the property involved in case the loan agreement is defaulted. This often referred to as perfecting the bank's claim to collateral. Once the loan officer and the bank's loan committee are satisfied that both the loan and collateral are sound, the note and other documents are made up for a loan agreement.

10. **Loan Acceptance Charge:** - After completing all processes, the bank decided to provide loan to the loan proponent. According to this decision, the proposed loan in it. According to provision of the loan document, borrower can withdraw the money form the bank. But sometimes, such a situation may be created that the borrower's doesn't take the loan after the bank accepts the loan. In such condition, the bank can recover the charge from the proponent if he or she does not take the loan. Because, the bank can't withdraw that amount until the period is not ended. The cash remains in unproductive form in the bank. Therefore the bank takes that charge for accepting that loan.
11. **Monitoring:** - After advancing loan to the customer, it seems to be the end of lending process. But actually it is the beginning of lending process. Can the loan officer put the signed loan agreement on the shelf and forget about it? Hardly! The new agreement must be monitored continuously to ensure that the terms and conditions are being followed and that all required payment of principal and interest are being made as promised. For larger commercial credit, the loan officer will visit the customer's business periodically to check on the firm's progress and to see what other services the customer may need.

2.2.6 Criteria for Providing Loan

A bank has to set some criteria for providing loan. Persons who come to a bank for the purpose of demanding loan, the bank should not provide loan random choice, not by examining and investigating. If a loan is provided without proper investigations it will lose the principal and interest. Therefore the bank always had to follow some criteria for providing loan. These are as follows:

1. Personal Character

Before providing loan, a bank should make an inquiry and examination of a person who come to the bank with proposal of loan. Though it is very difficult to fine out true character of person, it must be checked out. The bank should study whether the person has good character with intention to pay the loan or not, whether he is person of criminal nature of not, whether a creditor has filed a petition against him in the court for recovery of debt or not. If the person is doubtful in nature, character and the bank has uneasiness to trust him, if so, it should not accept the proposal of loan. If he

possesses good character and other criteria are satisfactory to the bank, it should accept the proposal.

2. Capacity or Competency

First of all it should be checked out whether the person is a capable under law to make a contract with bank or not, i.e. according to the contract Act 2056, if he is (capable) a competent person, there after the bank should know what kin of qualifications the proposal makers does have and in which subject or business he is related with, whether he has competency or skill in that business or not. Under this heading the bank should carefully examine all things, which are relating to capacity of borrower.

3. Capital

If any person or businessman comes to make a proposal for a loan in a bank, economic condition should be examined. His demand for money should be matched with the status of his household condition, how much the sum of money he wants to invest in his business. If the economic condition of the proponent is poor or less, or inferior to the amount for loan, the bank should reject his proposal. In brief, the quantity of amount of proponent financial condition should be stronger than the quantity of amount demanded.

4. Security/Collaterals

A bank is legal person. It doesn't provide the loan without securities or collaterals. It always studies and analysis whether the securities or collateral recovers the banks principal and interest of the loan. Inspired by the same concept, it classifies the security. A security means property, which is pledge able under the existing law while giving loan or document relating there to or any other security acceptable to the bank. But the Nepalese banking law has not defined collateral. But the collateral falls under the security, itself. If a bank is satisfied on primary security, it does not require collateral, if the bank is not satisfied with the primary security, the bank may ask collateral, if the borrower can't give collateral, the bank does not provide loan to him.

5. Tangible and Intangible Security

Securities, like raw materials, finished goods, agricultural produce, machinery's land and buildings shares and debentures, fixed deposit receipts life insurance polices are

those that have physical form and are, therefore, called tangible securities. In addition to tangible securities, or when tangible security is not available, a banker can also take intangible securities, like guarantees of reputed persons to cover an advance. In case of need, the banks call upon the borrowers in their personal capacity to repay the advance.

6. Secured and Unsecured Advance

When sufficient tangible security is available to cover the amount of advance, it is called a secured advance. When tangible security is not available to back the advance or is not sufficient to cover the advance in case of need, it is called an unsecured advance.

7. Primary and Collateral Security

Primary security is the security, which the borrower himself offers to a banker as the main security for an advance. Collateral security is the additional security, which the banker may insist upon as it helps him to realize his dues in case the primary security defaults. Section 47.b (1) of the commercial bank act 2031 reads as follows:-
“Notwithstanding anything mentioned in prevailing law the bank may provide loans with security of moveable property in the following circumstances, and the bank shall provide the loans only after stipulating conditions acceptable to it:

-) Moveable Property acceptable to the bank as a security under its possession
-) Entrusting the security to the possession of the borrower on the condition that bank may take possession of the property whenever it so wants
-) If the movable property of the borrower is not in its possession, by obtaining a document providing for its ownership on such property.

8. Credit Information

The bank should find out the credit information of the person or businessman who comes to request for a loan. Credit information such as the loan proponent's character, the securities given to the bank, the detail of the property and their reality, a bank can get all information about loan proponent and the businessmen. It can be a great help to the bank. It is difficult for a bank to find out the real condition of the loan proponent.

9. External Environment

Before providing loan, a bank always should evaluate the external condition or environment of the industry, business shown by the loan proponent, whether the business shown by the proponent is saleable or usable in the market or not, the proposal of loan proponent should not be approved, though the above mentioned five ground are received satisfactory by the bank. Because, a businessman can't gain profit from the financial position whose may deteriorate. Therefore, while providing loan, it should study the external environment too.

2.2.7 Review of Relevant Directives

Nepal Rastra Bank is the leader of money market and capital. It is the chief of all the banks operation in the country. Funds used by banks for the purpose of advancing loans and leased assets are that of public. Banks collects deposits from public and it is very same fund that banks use to make profit and give back to the public. Thus, to prevent this public fund being misutilized and to protect the savings of public, NRB has given directives to perform all other jobs of all banks. NRB issues directive from time to time to enhance the strength of the commercial banks. The main objective of the directives is to control and monitor the commercial banks and other financial institutions.

Nepal Rastra Bank has issued various directives in order to develop a healthy, competitive and secured banking and economic system to ensure national development. The new, updated and comprehensive set of directive has been issued on 2060-03-29 and is effective from 2062-04-01. While some of them are collections of existing directives, some other is new additions. It can be sagely assumed that with the updated and comprehensive set if directive, the functioning of commercial banks would be more transparent and systematic. At present the number of guidelines issued by NRB to commercial bank reaches sixteen which are as follows:

1. The provision of minimum capital fund to be maintained by the commercial bank.
2. The provision of loan classification and loan loss provisioning on the credit.
3. The provision relating to limit on credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy.
4. The provision relating to accounting policy and the structure of financial statements to be followed by the commercial banks.

5. Regulation relating to minimization of risk inherent in the activities of commercial banks.
6. The provision of institutional good governance to be followed by commercial banks.
7. Time frame for implementation of regulatory directives issued in connection with inspection and supervision of commercial banks.
8. Regulation relating to investment in shares and securities by commercial banks.
9. The provision of submission of statistical data to the NRB banking management division and inspection and supervision division.
10. Regulation relating to sale and ownership transfer of promoters shares.
11. Regulation relation to, stringent blacklisting procedure for loan defaulters.
12. The provision relating to compulsory deposited amount of NRB.
13. Regulation relating to developing the branch office of commercial banks.
14. Provision relating to interest rates.
15. Provision relating to collection of financial sources.
16. Provision relating to consortium financing.

Among the various new and updated directive, we discussed only relating to lending policy and practices as below:

a) Capital Structure of Banks

Capital can be defined, as the money invested in the business. It is required to conduct the business activities and is the primary requirement for initial period of business. Capital refers to those funds contributed by the bank's owners, consisting mainly of stock, reserve and earnings that are retained in the bank rather than paid out to the stockholders. The current regulation of NRB prescribes that all the new commercial banks are to be established in Kathmandu at national level should have minimum paid up capital Rs. 2000 million; the existing banks in operation are required to enhance the capital level to Rs. 2000 million by the end of F/Y 2065/66 B.S. For this purpose and objective all the commercial banks have furnished their plans to enhance the level of capital accordingly. With effect from F/Y 2062/63, the commercial banks need to have minimum of capital adequacy as below:

Table 2.3

Capital Fund to be Maintained

Time Period	Capital Fund in % on the Basis of Total Risk Weighted Assets		
	Core Capital	Supplementary Capital	Total Capital Fund
2062/63	6%	6%	12%
2063/64	5%	5%	10%
2064/65	6%	6%	12%

It is to be noted that capital fund comprise of both primary capital and supplementary capital. Similarly the risk-weighted assets will include both on-balance sheet item and off-balance sheet items. Standard format and weighted percentage is given in the directive itself and commercial bank need just to fill the columns to see whether required percentage is maintained or not.

b) Loan Classification and Loan Loss Provision

In such loan means lent at interest. In commerce and finance term is used as the transfer of money or other property on promise of repayment along with interest, usually at a fixed future date. Loan loss provision is an arrangement made in order to safeguard from bankruptcy if loaned amount is not recovered or if the debtors default or repayment of loan. It provides buffer against future unexpected losses.

From the effective F/Y 2058/59, bank should classify outstanding amount of Loans and Advances on the basis of aging. Loan and Advantages should be classified into the following four categories:

) Pass Loan

Loans and Advance whose principle amount not due and past due for a period up to 3 month shall be included in this category. These are classified as performing loans.

) Sub-Standard Loans

All loans and Advances that are past due for a period of 3 month to 6 month shall be included in this category.

) Doubtful Loans

All loans and Advances, which are past due for a period of 6 month to one year, shall be included in this category

) Loss Loans

All Loans and advance which are past due for a period of more that one year as well as advances which have least possibility of recovery of considered unrecoverable and those having thin possibility of even partial recovery in future shall be include in this category.

c) Additional Arrangement for “Loss” Loan Provision

Even if the loan is not due, loans having any or all of the following discrepancies shall be classified as “Loss”

-) The borrower has been declared bankrupt
-) The borrower is absconding or cannot be found
-) The credit has not been used for the purpose originally intend
-) Purchased or discounted bills are not realized within 90 days form the due date
-) Loans provided to the borrowers included in the blacklist and where the credit information bureau blacklists the borrower
-) Owing to non-recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation

d) Loan Loss Provisioning

The loan loss provisioning on the basis of the outstanding loans and advances and bills purchases classified as per this directives, shall be provided as follows:

**Table 2.4
Provision for Loan Loss**

S. no.	Classification of Loan	Define as	Age	Loan Loss Provision
01	Pass or Good	Performing Loan	Principle not overdue up to 3 months	1%
02	Sub-standard	NPL	Principle overdue by more than 3 to month	25%
03	Doubtful	NPL	Principle overdue by more than 6 to 12 moth	50%
04	Loss	NPL	Principle overdue by more than 12 month	100%

Loan loss provision set aside for performing loan is defined as general loan loss provision and loan loss provision set for non-performing loan is defined as “specific loan loss Provision”

e) Relation to Collateral

All collateral used to back loan and advances should be adequate to cover up the principal and interest and should also be, legally secured. In the event of non-realization of principal and interest of loan, there must be no difficulty in acquiring the title of the collateral asset.

f) Additional Provisioning for Personal Guarantee Loans

Where the loan is extended only against personal guarantee, a statement of the assets, equivalent to the personal guarantee amount not claimable by any other shall be obtained. Such loan shall be classified as per above and where the loans fall under the category of Pass, Substandard and Doubtful in addition to the normal loan loss provision applicable for the category, an additional provision by 20% point shall be provided. Classification of such loans and advances shall be prepared separately. Hence the loan loss provision required against the personal guarantee loan will be 21%, 45% and 70% for Pass, standard and Doubtful category respectively.

-) Evidence of existing of adequate loan documentation.
-) The internal and external cause contribution to deterioration of the quality of loan.
-) An evaluation of the borrower/enterprise's management with particular emphasis on efficiency, commitment and high standards of business ethics.
-) The reduced or risk inherent to borrower/enterprise determined by analyzing its balance sheet and profit and loss account in order to estimate recent cash flows and to project future ones, in addition to assessing market conditions.

Loan Loss Provision in respect of rescheduled, restructured or swapped loan

-) Expect for priority sector, in respect of all types of rescheduling or restructured or swapped loan, if such credit falls under pass category according to Nepal Rastra Bank directive, loan loss provision shall be provided at minimum 12.50%
-) In case of rescheduling or restructuring or swapping or insured of insured or guaranteed priority sector credit, the loan loss provisioning shall be provided at one fourth of the percentage.
-) In respect of swapped loans, the bank accepting the loans in swapping has to provide loan loss provision classifying the loan is swapping shall obtain

certification from the concerned bank of financial institution as to the existing classification.

g) Loan Loss Provision for Priority Sector Lending

Full provision as per normal loan loss provisioning shall be made against the uninsured priority and deprived sector loans. However in respect of insured loans the requisite provisioning shall be twenty five percentage of the percentage normal loan loss provisioning. The required provisioning in the case of insured priority/deprived sector credit is as follows:

Table 2.5

Loan Loss Provision for Priority Sector Lending

Classification of Loans	Loans Loss Provision for Priority/Deprived Sector Lending
Pass or Good	0.25%
Sub-Standard	5.00%
Doubtful	12.00%
Loss or Bad	25.00%

h) Phasing Out Priority Sector Lending

Priority sector lending or directed lending may be defined as lending to those people or sectors who/which are normally deprived of lending by organized institutions. The financial institutions would normally concentrate to urban sector and a big lending. They tend to avoid financing low volume large number loans due to low profitability, high operational cost and difficulty in monitoring. Also the trading sector gives instant return but production sector on the other hand takes relatively a long time to generate returns. This very nature of the production sector normally does not attract finance from financial institutions. However, it is necessary to invest in production sector for the long-term benefit of the economy as well as for financial enlistment of the mass of people living below the poverty line. To this end, Nepal Rastra Bank could have played and has in fact played an important role using the tool named as directed lending.

A review of the history in this regard shows us that Nepal Rastra Bank issued its first directive on directed lending on 1975 requiring banks to direct their five percent of total deposit to small sector. An amendment on this directive came shortly after that which increased it to Seven percent. Based on this a comprehensive directive on

priority sector lending was issued which again increased the ratio to 10 percent of total deposit. On 1986, the priority lending was connected with total lending of bank and new directive was issued entailing 25 percent of total lending to be directed towards production sector inclusive of 8 percent to priority sector. On 1989 this percentage were increased to 40 and 12 respectively. In the next year, deprived sector lending was also introduced.

In this way the priority sector lending has a long time existence in Nepalese banking sector, beginning much before the establishment of private sector banks. The objective is very clear, to facilitate the financially poor people living in any area of the country have easy access to the advantages of banking system of the country. Now lets see what exactly is the requirement under the directed lending. In order to qualify for including in priority sector a loan should be used in identified sectors or purposes and the amount to a particular borrower should not exceed the given limit. In other words the purposes and the amount are the 9 determinant factors here. Broadly speaking the following loans given to each party is qualified as priority lending:

1. Loan up to Rs 2 million to agriculture, service and domestic industry.
2. Loan up to Rs 5 million to import of machinery and raw material by export oriented industry.
3. Loan up to Rs 100 million to establish power project of national priority.
4. Loan up to Rs 20 million for tea plantation, packaging, cold storage, and technical education institutes etc.
5. Loan up to Rs 10 million to produce computer hardware or software, electric or solar vehicle or to purchase captive generator.
6. Loan up to Rs 1 to purchase vehicle to drive by borrower himself as public transportation.

The deprived sector lending included the investment in share of rural development bank or RMDC, loan to individual up to Rs 30,000 and lending to recognized cooperatives, NGOs and development banks. Such organized financial institutions work as intermediary between the commercial banks and deprived people. Those banks, which do not comply with these requirements, are imposed with a cash penalty computed on the shortfall of the amount of priority sector lending.

2.3 Review of Previous Studies

This is the second phase. When the topic is finalized the related available materials like published books, journals, thesis, government publications business reports and so on have to be reviewed. The objective of reviewing the literature is to develop certain expertise and knowledge in one's area.

2.3.1 Review of Books

According to William F. Sharpe, Gordon J. Alexander and Jeffery V. Bailey, "Investment in its broadest sense means the sacrifice of current dollar for future dollars. Two different attributes are generally involved: time and risk. The sacrifice takes place in the present and is certain. The reward comes later, if at all and the magnitude is generally uncertain" (Sharp, Alexander and Bailey, 2003: 1).

Charles P. Jones defines, "An investment is the commitment of funds to one or more assets that will be held over some future time period" (Jones; 1988:5).

Shakespeare Vaidhya (1997) in his book "*Banking and Insurance Management*" has described the sound investment policy. He writes, "A sound investment policy of a bank is such that its funds are distributed on different types of assets with good profitability on the one hand and provides maximum safety and security to the depositors and banks on the other hand. Moreover risk on banking tends to be concentrated in the loan portfolio. When a banks gets into serious financial trouble, its problems usually spring from significant amounts of loans that have become uncollectible due to mismanagement, illegal manipulation of loans, misguided lending policies or unexpected economic downturn. Therefore the bank's investment policy must be such that it ensures that it is sound and prudent in order to protect public's fund.

He also adds that, what types of loans do bank make? How much of loans in each loan be invested? The banks make a variety of loans to a wide variety of customers from many different purposes form purchasing automobiles to construction of homes and making trade with foreign countries. Therefore, no uniform rules can be laid down to determine the portfolio of a bank. The environment in which the bank operates is influenced by its investment policy. The nature and availability of funds and also

assets differ widely from country to country and also from region within a country. For example, scope of a banks operating in Jumla will be different from the scope of bank operating in Kathmandu city may not be applicable to the customers of Jumla because the demand for loans are less in rural areas whereas it is higher in city or in urban areas”.

Bhattacharya (1975) in his book, “*Banking Strategy, Credit Appraisal and Lending Decisions*” has put the recommendation of Tondon Committee from the report submitted this committee. The committee has prepared this report, however these recommendation stills deserve great significance in the sector of credit appraisal and Lending. Breaking away from the traditional methods of credit appraisal, the system proposed by the Committee enjoined upon the banker:

-) To develop healthy banker-borrower relationship
-) To improve the financial discipline of the borrower
-) To assess the need based credit of borrower on a rational basis
-) To ensure proper end-use of bank credit by keeping a closer watch on the borrower’s business and thus to ensure safety of the banks funds

The committee examined the examined the existing system if lending and recommended the following broad change in the lending system:

-) The credit needs of borrowers assessed on the basis of their business plans.
-) Credit be made available in different components only, depending upon the nature of holding of various current assets.
-) Borrowers are required to hold inventory and receivables according to norms prescribed by the Reserve Bank of India from time to time.
-) Bank credit only supplementary to the borrower’s resources and lot in replacement of them. Banks not to finance 100 present of borrower’s requirement.

2.3.2 Review of Articles

In this section effort been make to examine and review of some related articles and journals published in different economic journals, which among the various reviews of various journals pertaining to the study, the major and mostly contribution to the study has been outline below.

Pralhad G., Arunnodaya (NRB 2008; 456) in his articles "*Liquidity Crisis in Nepalese Financial system and its impact on Economy*". Liquidity shortage circumstances be it a short or long run, it impedes sound financial mobility in all spheres of financial life. While in long run, it will definitely have great impact on growing economy. While liquidity shortage persists in economy for a long time, interest rates on both deposit and loan go up. It therefore, rules out for the cheap consumer loan. However, increase in interest rates on productive sector investment doesn't make any significant difficulties. To tackle to this problem, commercial banks need to run its financial transaction in as low spread as possible. On the contrary, growing interest rate on deposit will finally pressure to informal outflow from the economy.

Sharma B. (2004) in his article "*Banking the Further of Competition*" has said, due to the lack of investment avenues, banks are tempted to invest without proper credit appraisal and one personal guarantee, whose negative side effects would show colors only after 4 or 5 years. Again he said that "Private CBs have mushroomed only in urban areas where banking transactions in large volume is possible. The rural and sub urban areas mostly remain unattended,

Rawal T., Arunnodaya (2003) this articles he explain, "*Banking Sector's NPA Alarming*". Non-Performing Assets in banking sectors that currently stands at 30%, the total NPA in the banking system is about 35 billion, while it is even worse in case of two largest commercial banks; Rastriya Banijya Bank and Nepal Bank Limited. The NPA levels at the state run RBB stands at 52%, while the figure at NBL reads 62%, which together account for 37% of total deposit of some Rs 200 billion and 40% of the total loan outstanding of Rs. 125 billion of the banking system. Private sector bank has less non-performing assets in comparison to RBB and NBL.

Neupane, NRB 46th Anniversary; 142, He said that directives asked the financial institutions to provision 100% on collateral that the banks accept themselves after they fail to action. As per the directive, the banks cannot place such assets in their income account until such collateral is converted into cash. Prior to directive, banks used to provision for losses on non-banking assets only if amount recovered form auctioning of collator is not to cover the principal and interest.

Mundal S. (2008), CEO of Standard Chartered Bank Nepal in an article titled, “*Investing with intelligence*”, has expressed the following view;

-) People within organization and investors say that the current economic condition of the country is a big barrier of making opportunities available to prospective investors.
-) Investor’s awareness of the market is not up to the mark. A through risk analysis should be alone before making any decision.

He finally suggested that investors should put a little extra for a proper study before any investment decision.

www.google.com, under the Global Financial Crisis (2005), the personal savings rate in America hit a post Great Depression low of negative 0.5% - people were spending more than they were earning. These reduced savings rates were offset at the time by increasing real estate values and a growing national deficit of more than \$9 trillion, which was temporarily propped up by lending from foreign nations. Low ‘teaser’ mortgage rates lured Americans to buy homes that would eventually reset at higher payment values. Financial experts in Wall Street bought up and packaged these ‘subprime’ mortgage backed securities and distributed them worldwide, as a fail-safe means for investment.

All the while, America’s manufacturing base was being decimated, losing more than 3 million jobs since 2000. The industrial sector, along with many others, were rendered unable to compete in the world through faulty trade agreements that closed down factories, off-shored entire industries and put Americans into service jobs with lower pay and poorer benefits.

Then the housing bubble burst and home prices, which had for so long offset wealth stagnation and reduced savings in the American middle class, started to plummet. Citizens that had taken subprime loans saw their rates reset to higher amounts and started to default on their mortgage payments. As a result, an estimated 2 million Americans were in danger of losing their homes.

The rise in foreclosures sent banks and financial institutions- such as Bear Stearns- that had bet on the now ‘toxic’ loans to suffer catastrophic losses in capital. Foreign investors that had already been stockpiling dollars as a reserve currency begin to ‘unload’ the greenback due to its declining worth by buying up more and more American companies, diverting U.S. innovation, profits and key ownership positions abroad.

According to “*The economic outlook Understanding the Local Effects of the Global Financial Crisis*” It all started in midsized US cities such as Phoenix and Las Vegas. The banks which financed the housing booms of those towns then pooled their loans, trrenched and resold them to willing investors via securitization. This opportunity to immediately sell the loan incentives these banks have to innovate new methods to increase their lending. In particular, banks started to issue adjustable rate mortgage (ARM) to even those people with credit rating lower than 600 called “sub prime” borrowers who had defaulted or delayed in their credit payment in the past. It was a classic moral hazard problem: since the banks could “sell” the loans to other investors, they were careless in screening the borrowers. A bubble started to form in the housing market, abetted also in part due to a 1997 law that allowed capital gain in houses to be deductible, making speculation very attractive.

During the last decade, several banks of Nepal deposited their money in India, due to lack of investment opportunity at home, which had depressed the interest rate in Nepal. Around the same time, the interest rate was also low in the US economy because many Indian, Chinese and other banks had bought US securities to hedge against currency depreciation against the dollar. Several Asian governments also bought US securities to peg the exchange rates at the level their export oriented industries find favorable. Those how purchased risky securities could also purchase credit default swamps (CDS) – an insurance against default. For a brief time, these layers of financial instruments made almost everybody feel they were safe, and that they were getting their share of the housing market boom.

The availability of cheap loans to buy houses increased their demand, which led to the increase in the price of houses. However, several of these buyers were speculators, who didn’t intend to line in the houses they bought. It was inevitable that once demand for houses started dropping, they would try to sell the houses quickly and if

they couldn't do that, they would default on the payment. In February 2007, the first sign of default in mortgage arrived: mortgage related index, ABX, dropped. Then, in May, UBS closed Dillon Read, its hedge fund, after incurring a loss of 125 million dollars. In July, the major US home loan provider, Countrywide Financial Corp, reported a drop in earnings, and National Association of Home Builders reported a year-on-year home sale drop of 6.6%. In Europe, a German Bank, IKB, had to be rescued, because its home related roll over asset-backed papers couldn't be sold in the short term liquidity market and it lacked enough liquidity to operate. After this incident, banks became cautious, and became reluctant to extend loans to other financial institutions. Meanwhile, this slowly resulted in the liquidity crunch for firms. To mitigate this situation, the Fed lowered the discount rates by half a percentage point. The measure worked temporarily, as funds operated by foreign governments (sovereign funds) responded by investing 38 billion in the November 2007-January 2008 period. In January, Fitch downgraded Ambac, a normally reliable giant that insures municipal bonds against default, which sent a shock wave throughout the world.

In India, where the stock market exchange SENSEX had risen from 13,000 in March 2007 to its all time high 20,873 in January, decline in the stock market started at this period. Some major Indian firms which were able to raise money abroad to finance their projects suddenly faced a very risk-averse international financial market. Later, in a talk at the International Monetary Fund (IMF), Dr Rakesh Mohan, deputy governor of the reserve Bank of India, said that if the situation persisted, these firms would be forced to seek loans domestically, driving interest rates up. This probably of Nepali banks deposition their money in India.

Around that time, a Saudi-backed investment firm, Carlyle Capital, couldn't meet its margin calls, and a fraction of its assets was liquidated. Bear Stearns was a major creditor for Carlyle, and this action affected Bear Stearns. The hedge fund clients of Bear Stearns felt uneasy about this, and there was a run on the firm the next day. The New York Fed then arranged an overnight deal for JPM organ Chase to acquire Bear Stearns. During the July-August period, Indy Mac, three large mortgage firms, were put in conservator ship by the Federal Deposit Insurance Corporation (FDIC) and the US government respectively. In September, Lehman Brothers declared bankruptcy

and Merrill Lynch was acquired by Bank of America. In India, this alarmed authorities, and they asked the banks to furnish their exposure to Lehman Brothers. Out of 77 banks, 14 banks reported their exposure to Lehman Brothers (The concern for Nepal lies here: in particular, it is crucial to find out whether our banks have any ties with These Indian banks and the extent of such ties in order to estimate the exact impact on Nepal.) On Sept.16, 2008, AIG, a big insurance firm, saw its share price plunge by 90 percentages. Meanwhile, though more than 20 banks failed in the United States during this period, Asian banks remained largely immune from the crisis. The attitude in Asia can be summarized by the result of a study done by Reserve Bank of India in September 2007 which concluded that there had been no direct exposure of Indian banks to the sub prime disaster of the United States. However, as it turned out later, some banks had purchased collateral debt obligation of American banks, and would suffer a bit.

Back in states, the way thee firms fell had a significant effect on the trust among firms and banks. Firms stopped trusting other firms, and the mechanism that was greasing the wheels of the giant financial machine almost stopped functioning. Panic spread, and in the chaos, Washington Mutual, a 158 year old bank, became victim of an electronic bank run, and was sold to JPM organ Chase by FDIC. Another big bank Wachovia was sold to wells Fargo in September. During this panic, firms, state and local governments too reported difficulty in getting credit. To restore normalcy, The US government passed an 800-billion-dollars bailout package. The market however though it was too small, given that 8 trillion dollars had been lost in one previous year in the stock market and reached negatively to it. The Fed meanwhile kept on buying asset backed securities and reduced the interest rate to almost zero in December, just to facilitate the credit access of the firms.

Around this time, the global fiscal crisis alerted Nepali businessman Binod Chaudhary emphasized that the first order effect – in which Nepali firms were directly affected – would be significant, whereas the finance minister and others seemed to think first order effect would be insignificant while allowing for second order or higher order effect. In India, the equity market suffered because of reversal of portfolio equity flows. It caused negative effects on the Forex market and liquidity conditions. Besides that, India as a country was deemed to be unaffected. Assuming Nepali financial

institution only foreign exposures is to Indian banks, the Nepali financial ministers and other who claimed Nepal to be quasi-immune from international financial system, were right. Furthermore, the Nepali equity market is not financed with foreign money; the corporate world is not big enough to raise money for the international sector, so, it is unlikely to feel any heat due to the liquidity crunch. However, policymaker perhaps underestimated the effect by ignoring a channel through which Nepal could be hit badly: foreign employment of Nepali youth.

Nepal's exposure to the foreign world has always been limited. Nepal's major export has been its low-skilled youth, which are normally employed in recession proof sectors such as military or household defense. Lately, the Nepali youth has responded to the labor demand surge in Arab countries. The surge was due to extra money Arabs reaped during oil price hike. Some of the extravagant projects initiated in the Arabian countries are likely to suffer now, and their labors demand will decrease. To what extend will it affect Nepal is difficult to predict. Given Nepal's labour market situation, in which year roughly 250,000 people enter the labour market, and given an overall hostile attitude towards industrialists in current Nepal, mainly because of powerful labour unions, new job creation by the industrial sector has come to a standstill. In this context, how those unemployed and returned youth will behave will determine the true effect of the financial crisis.

2.3.3 Review of Previous Thesis

Several thesis works has been done under the topic "Lending policy and practices" the relevant works for this study are presented below.

Purushottam Poudel (2004) in his thesis paper, "*A study on Lending Practices of Joint Venture Commercial Banks,*" Master Degree Thesis T.U. has studied two joint venture banks. His main objective was to know the volume of contribution made by both sample banks in lending, to determine the impact of deposit in liquidity and its effect of lending practices. He found that;

-) NBBL has more consistency than HBL.
-) Current ratio NBBL was higher than that of HBL.
-) Liquidity position of NBBL was better.

-) Profitability ratio like return on equity, earning per share of HBL was higher than that of NBBL.
-) There was positive correlation between total deposits and loan and advances of both banks.
-) The growth ratio of NBBL was higher than HBL but there was consistency among ratios of NBBL.

He has suggested that HBL should increase its current ratio. NBBL has to increase its profitability. He has made an attempt to show that lending practices of two joint venture banks but the time limit has made the research to be compressed and only to tell the situation of 5 year period only.

Ritcha Sharama (2005) in her thesis paper, "*Loan Disbursement and collection of Nepal Bangladesh Bank Limited*," Master Degree Thesis T.U. has studied joint venture of Nepal Bangladesh Bank Limited. Her main objective was to know the total amount of loan disbursed out of total deposit, types of loan disbursed and measure the status of loan recovery out of total loan disbursed. She is found that;

-) The deposit collected by the bank during six years period is in increasing trend but the percentage increase in deposit is fluctuating.
-) The loan disbursed by NBBL is also affected by factors other than the amount of deposit collected like the poor economic state of the country with loss investment opportunities and the Government regulation or the increment of loan loss provision.
-) NBBL has followed NRB directives and lent almost 12% each year in priority and deprived sector, loan loss provision single borrower credit limit and interest spread of the bank is as per NRB regulations. The average interest spread during the six years period of study is 4.71%.
-) The loans, which are easier to recover, include specific loans like hire purchase, housing, education loan etc. because of the selected group of customers.
-) According to the credit department of NBBL, defaulters are more in case of overdraft loans as all types of people are the borrowers of this loan and personal defaults are more than the business firms in age of overdraft loan.

Rajya Laxmi Khadgi (2006) in her thesis paper, “*A study of investment policy Analysis of NABIL Bank Ltd*”, Master Degree Thesis, T.U. has studied only the bank NABIL. Her objective was to study the resource mobilization and investment policy of NABIL Bank, to find out the current and future investing strategy of NABIL bank.

She found that:

-) The sample bank has been able to meet its short-term obligation and satisfactory liquidity position.
-) The bank has taken moderate risk towards the mobilization of its risky assets.
-) NABIL has invested very nominal percentage of total working fund into shares and debentures.
-) There is satisfaction in the level of profitability which indicates the good earning capacity.
-) She found that the growth rate of deposits is in increasing trend.
-) The net profit of the banks has increased too.
-) There was positive correlation between total deposits and loan advances during the study period.

She has suggested NABIL to increase investment in government securities. To increase the risk free investment is also suggested. The more fund have to be mobilized into shares and debentures of other companies.

Gopal Pokhrel (2007) on his thesis, “*Interest Rate Structure and its Relation with Deposit, Lending and Inflation in Nepal*” concludes:

-) The interest rate on both deposit and lending of all sample banks are in decreasing trend.
-) The saving deposit amount and saving interest rate have negative relationship.
-) Fixed deposit amount and fixed interest rate shows negative relationship.
-) The relationship between interest rate on deposit and inflation rate is positive.
-) The interest rate on lending and inflation rate has low degree of positive correlation coefficient.

Rabi Shrestha (2008) in his thesis paper, “*Interest Rate Structure Influence on Deposit and Lending of Joint Venture Commercial Banks in Nepal,*” Master Degree Thesis T.U. has studied six joint venture banks. His main objective was to know the

relationship of interest rate on deposit amount and lending amount and analyze the position of interest rate and loan and advance ratio. He found that;

-) The interest rate on both deposit and lending of all sample banks are found to be in decreasing trend. But on the contrary to this deposit amount and lending amount is increasing every year except NBBL.
-) The saving deposit amount and saving interest rate have negative correlation.
-) The t-statistic between fixed deposit interest rate and fixed deposit amount is insignificant.
-) He found that lending interest rate of the productive sector loan were decreased lesser in magnitude in comparison to the non-productive sector loan.
-) The study show weak on mobilization of collected deposit.

Finally he suggest that interest rate on deposit is too less so increase the interest rate on deposit, central banks should pay special attention towards decreasing trend of interest rate on deposit and government to improve the political situation of the country.

Shunil Kumar Shrestha (2008) in his thesis paper, “*Lending Policy of Commercial Banks in Nepal*,” Master Degree Thesis T.U. has studied three joint venture banks. His main objective was to know the status of non-performing loans, analyze the portfolio behavior of lending and identify major weakness of lending policy of these commercial banks. He found that;

-) EBL and LBL are able to mobilize their deposit in right way but NABIL was unable to utilize its deposits.
-) Compare to other banks NABIL bank has lower covariance.
-) EBL and NABIL banks have lowest credit risk but LBL is in better position among these three banks. LBL was able to utilize its assets in the form of Loan and Advances.
-) NABIL and EBL banks are able to manage their loan loss provision but LBL is unable to manage its loan and advances and makes effort for timely recover loan.
-) EBL and LBL were earned more then 83% interest from loan and advance, but NABIL bank was unable to get more income form their lending.

-) EBL and NABIL bank higher capital ratio but LBL has lowest capital risk ratios.
-) The volume amount of deposit of all three commercial banks is in increasing trend. Total deposit position of EBL is comparatively lower than NABIL and is better in comparison to LBL.
-) The trend of LBL net profit is negative. NABIL and EBL net profit in positive trend in every year. Each and every year growth rate of net profit is decreasing trend. NABIL bank is in better position among the three banks. LBL is in worst position.
-) Regression equation of non-performing loan on loan and advances of NABIL and EBL banks is negative which reveals the negative relationship between these two variables. But the LBL regression is positive. It indicates the LBL was suffering from non-performing loan.

At last he suggests that all banks should be find out the new area for lending and investing to utilize their deposit. Some proportion of lending in commercial banks made agriculture and domestics industries sector.

Riwaj Rokka (2009) in his thesis paper, “*A Comparative Study on Deposit Mobilization of Joint Venture Commercial Banks,*” Master Degree Thesis T.U. has studied two joint venture banks. His main objective was to know the relationship between deposit collection and distribution, analyze the financial position and analyze the trend of deposit mobilization towards investment, loan and advances. He found that;

-) The contribution of the deposit to the net profit is higher in the banks
-) Only increment of deposit does not give any return to the bank. So the banks must make sound investment policy for the mobilization of the available funds.
-) He found that sample banks mainly focuses on its two functions i.e. collection of deposit through various schemes and granting those amounts as loan to the clients by providing various facilities.
-) They analyze to liquidity ratio of the EBL is stronger than other bank HBL.
-) He found that activity ratio of EBL has mobilized its collected deposits on investment better than HBL.

Capital adequacy ratio of EBL is good enough to row its capital than HBL.

He has suggested finally, if Everest Bank Ltd is successful banker they must utilize depositor's money as loan and advance. Loan and advances is the largest item of the bank in the assets side. And Himalayan bank Ltd is interested only in investing private sector. It is better for the bank to increase its profit by lending in highly profitable projects.

Santosh Acharya (2009) in his thesis paper, "*Investment Practices of Commercial Banks*," Master Degree Thesis T.U. has studied two joint venture banks. His main objective was to know the fund utilization and mobilization, various ratios and study risk and profitability positions of concerned banks. He found that;

- J Liquidity ratio of BOK is higher than NABIL and ratio of loan and advances to current assets ratio of BOK is less than NABIL.
- J The ratio of total investment to total deposit ratio of BOK is lower than NABIL. But both banks have fluctuating trend.
- J The mean credit risk of BOK is high than NABIL. The fluctuation of ratios of BOK are consistent the NABIL.
- J BOK has higher growth ratio in term of total deposit. NABIL's ratios are little weak.
- J The coefficient of correlation between outside assets and net profit of BOK is higher than its $6 * P.Er >$. So there is significant relationship between outside assets and net profit. But NABIL have insignificant relationship between outside assets and net profit.
- J Trend value of total deposit and loan and advance of both banks has followed an increasing trend.
- J The capital risk of NABIL is higher than BOK. This shows there is high risk for NABIL but there is chance to high profit too.

He suggested both banks liquidity position is not satisfactory so manage the liquidity position; they invest more funds in share and debenture of other financial institutions. He suggested that commercial bank adopted modern method to investment and fund mobilization.

2.4 Meaning of Some Terms

The most used word in this study has been clarified below:

1. Deposit

Deposit is the amount collected by different means of account. Deposits are very helpful for generating profit as well as a source for liquidity. Deposit is liability for a bank because it is that specific amount borrowed from different clients. Deposits are affected by the interest rate paid to the deposits, type of customers, facilities provided by banks etc.

2. Loan and Advance

Every financial institution must be very careful while providing loan because the non payment of the loan can cause a heavy loss to the bank. Still it is riskier the banks must lend their money to earn desired revenue in form of lending interest rate. More banks are interested to provide short term loans which can be collected in a short span of time. Lending through bank has cheaper rate due to excess demand. The increase in economic activity also increases the volume of loan. Loans are basically provided against collateral which are usually immovable or moveable properties.

3. Investment of other Company's Share and Debentures

Some part of fund is usually invested in other organizations shares. To meet the directives of NRB, probability of getting return in possible alternatives, lack of huge gains forces, the bank has to invest in other's fund.

4. Investment on Government Securities, Bonds

This activity is done to increase the investment through it provides less return and is know as less risky assets. These securities are highly liquid. Depositors may demand their funds at any time so to maintain that liquidity position too without loss in the value this investment is usually done.

5. Off-balance Sheet Activities

Basically they are not shown assets or liabilities. For example letter of credit, latter of guarantee etc. these activities are risky though they are also the alternative source of income.

2.5 Research Gap

There is a certain gap between the present research and past research. Previous several researches are done in this topic called Lending Policy and Practices. Previously many researches were done by using secondary data. The information of this very research is also based on secondary data but many effective tools and technique are used to get the desired result as per the objective of this study. To analyze the facts financial tools as well as statistical tools were used to get the desired objective of the study. Financial tools include ratio analysis and the statistical tools include mean, standard deviation, coefficient of variation, correlation of coefficient analysis, Probable Error, Regression analysis and also include trend analysis. In present context, these are the hot issue in Nepalese commercial banks. The previous researchers could not submit the present fact. This research will deliver the answer to the recent questions and it will also give the latest information about the current practices of concerned commercial banks.

CHAPTER – III

RESEARCH METHODOLOGY

3.1 Introduction

Research methodology is a way to systematically solve the research problem. It highlights the method adopted in the process of present study. It also focuses about the sources and limitation of the data. Which are used in the present study? It indicates the various objectives in view. So it is the methods, step and guide lines, which are to be followed in analysis and it is a way presenting the collected data with meaning fully analysis.

The reliability and validity of research work is facilitated by research methodology and the basic objective of this chapter is to guide chapter four for data presentation, descriptive and empirical analysis of interest rate in its effect and deposit and lending. The study of research mythology gives the students the necessary training in gathering materials and arranging them, participating in the field work which required, and also training in techniques for collection of data appropriate to factionaries and controlled experimentation and in recording evidence sorting it out and interpreting it.

3.2 Research Design

Research design is drawing an outline of planning or arranging details and in an economic, efficient and relevant manner before the data collection and data analysis. Research design is also the strategy for conducting research work which describes the general framework for collection, analysis and evaluation of identified data. Research design is the specification procedures for collecting and analyzing the necessary steps to help and identify an opportunity such that deferent between cost of obtaining various levels of accuracy and the expected values of the information, associated with each level of accuracy is maximized.

Research design is purely and a plan for a study that guides the collection and analysis of data. It is an investigation and it answers the research question. Research design consist the scheme in which thee is an outline of what the research will do from writing the hypothesis and their implication to the final analysis of data.

Research methodology is a process of making decision before the situation arises in which the decision has to be carried out. It guides the researcher to progress in the right direction in order to achieve the goal. The design of research is concerned with making controlled scientific inquiry. Research design must include all the aspects for testing of hypothesis and drawing logical conclusion there from.

3.3 Population and Sample

At present twenty six commercial banks (including government owned, public and joint venture) are operations in Nepal. Due to the time and resource factors, it is not possible to study all of them regarding the study topic. Therefore samplings are done selecting from population. The population for the study comprises **26** commercial banks out of them all three joint venture banks are taken as sample to draw the conclusion about population since population of joint venture banks are not large.

3.4 Data Collection Techniques

Data are collected from the one source that is secondary source. In this study secondary data has been taken as it is the main source of data.

Secondary data is the information which had been collected by some individual or agency and statistically treated to draw certain conclusions and also to extract some

other information. The main advantage of this type of data is its availability and lower cost than primary data. It saves time too. The main drawback of this data is that the available data may not be specific to the problem. The rule says that so research should be done without a search of secondary data and it should be whenever it is possible.

The major source of this study is secondary data which has different sources. The sources are annual reports where balance sheet, P/L account of concerned banks is included. Some other data and information have been collected from the authoritative source like library of different collage, Nepal stock exchange limited, Nepal Rastra Bank, Security Exchange board, economic survey and different articles, reports, magazines etc. the articles published by the banks are also the source of information. These data are the prerequisites of any project study. They are all raw information which will be turned to different outcomes and the answers to the research questions. This is very necessary in the study without which the study can't take momentum.

3.5 Data Processing and Presentation

The information or data obtained from different sources will be in raw form. From that information, direct, presentation is not possible. So it is necessary to process data and convert it into required form. After then only the data are presented for this study. This process is called data processing. For this study only required data are taken from the secondary sources (bank's publication) and presented. For presentation different figures and tables are used. Similarly graphical presentation is also made. For reference the photo copies of raw data are attached in the last portion of thesis. So far as the computation is concerned, it has been done with the help of scientific calculator and computer software program.

3.6 Analysis of Data

To achieve the objective of the study, various financial, statistical and accounting tools have used in this study. The analysis of data will be done according to pattern of data available. The various calculated results obtained through financial, accounting and statistic tool are tabulated under different heading. Then they are compared with each other to interpret the results. Various tools applied in this study are presented as follows:

3.6.1 Financial Tools

Financial statement provides the vital information about the firm's position at a point in time and its operation over some past period. Financial tools availability has helped to analyze the strength and weakness of a firm. Ratio analysis is a technique from which different results are known. Simply ratios are designed to show relationship between financial statement accounts within firms. Translation of the accounting figures into relative value allows us to compare the financial position of one firm to another, mathematical expression are needed to show the relationship between the various accounting figures. Ratio analysis is a part of the whole process of analysis of financial statements of any business or individual concern especially to take output and credit decision. Even though there are ratios to analyze and interpret the financial statement, only those ratios that are related to lending operation to the have been covered in this study.

3.6.2 Statistical Tools

Statistics are numeric statement of facts. The various statistical tools help us to collect and present numerical data in the proper way and to analyze them. In this tool we study mean, standard deviation, variance, co-efficient of variation least square correlation co-efficient analysis, probable error, regression analysis and trend analysis. This individual and collective analysis can be very useful for decision making. This study includes the following statistical analysis:-

a) Mean

This is also known as average and it is used to get one single value which describes or interest the whole data. It is used for comparison too. The sum of all the observations divided by the number of observations is mean and it is formulized as,

$$\bar{X} = \frac{\sum X}{N}$$

Where,

\bar{X} = Mean

N = Number of Observations

$\sum X$ = the sum of observations

b) Standard Deviation

Standard deviation determines the reliability of central tendency or mean. It measures the dispersion. Dispersion is variability of data and it finds out how individual values fall apart on an average. The higher standard deviation has higher variability. The standard deviation is defined as the positive square root of the arithmetic mean of the squared deviation from their arithmetic mean is a set of values. It is usually denoted by the Greek letter (Sigma). It is presented as,

$$\sigma = \sqrt{\frac{\sum (X - \bar{X})^2}{n}} \quad \text{Or} \quad \sigma = \sqrt{\frac{1}{n} \sum f_n A^2}$$

Where,

N = Number of observations

Or,

$$\sigma = \sqrt{\frac{\sum X_1^2}{n} - \frac{(\sum X_1)^2}{n}}$$

c) Variance

Variance is the square of standard deviation. This tool is also used to interpret data with the help of numeric facts. It is denoted by σ^2 . It can be formulize as,

$$\sigma^2 = \frac{\sum (X - \bar{X})^2}{n}$$

d) Coefficient of Variation (C.V.)

The relative measure of dispersion based on standard deviation is called coefficient of standard deviation. 100 times coefficient of standard deviation is called coefficient of variation. It is used to compare the variability, homogeneity of two or more distributions. High C.V. is more variable or less consistent and vice versa. It is formulizes as,

$$C.V. = \frac{\sigma}{\bar{X}} \times 100$$

e) Correlation Coefficient Analysis

This tool interprets the relationship between two or more variables. It shows whether two or more variable are co-related positively or negatively. These following coefficient of correlation which are related to investment policies are as follows,

- Co-efficient of correlation between deposit and total investment.
- Coefficient of correlation between deposit and loan and advances.
- Coefficient of correlation between outside assets and net profit.

It is formulized as;

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

Where,

N = No. of observation

$\sum X$ = Sum of observation in series X

$\sum Y$ = Sum of observation in Series Y

F) Coefficient of Determination

Coefficient of determination is the square of correlation coefficient. It denotes the extended of charges in dependent variable that can be explained by independent variable.

Coefficient of Determination (r^2) = $r \times r$

g) Probable Error

Probable error of the correlation coefficient is denoted by P.E. it is used for the testing the reliability of the calculated value of r. P.E. is defined by,

$$P.E. = 0.6745 \frac{1 - r^2}{\sqrt{n}}$$

Where,

P.E. (r) = Probable error of correlation coefficient

r = Correlation coefficient

n = Number of observation.

h) Regression Analysis

Regression analysis is used to estimate the likely value of one variable from the known value of the other variable i.e. in regression analysis we established a kind of average irreversible functional relationship between the two variables. The cause and effect relationship is clearly indicated through regression analysis than by correlation. Regression analysis has been developed to study and measure the simple regression analysis equations. It is the line which gives the best estimates for the values of Y for any specified value of X.

Regression equation of Y on X is given by

$$Y = a + bx$$

Where,

Y = Dependent variable a = Intercept of the line

X = Independent variable b = Slope of the line

The values of the constants “a” and “b” can be determined by solving two normal equations (applying principle of method of least squares)

i) Trend Analysis

The trend analysis is used to predict the future. It is a pattern according from the past and it is assumed that the same patterns will occur in future. The following trend analysis has been used in this study,

- Trend analysis of Total Deposits.
- Trend analysis of Loan and Advances
- Trend analysis of Total Investment
- Trend analysis of Net profit

Following equation is developed to calculate trend value, “Any value of independent variable x, the estimated value of y, denoted by Y_c can be written as,

$$Y_c = a + bx$$

Where,

Y = the dependent variable

a = the region i.e. arithmetic mean

b = the slope coefficient i.e. ratio of change

x = the independent variable

CHAPTER – IV

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

In this section, all the collected data are presented in the filtered form and are analyzed thoroughly. This is the one of the major chapter of this study because it includes detail analysis and interpretation of data from which concrete result of Nepalese market can be obtained in this chapter, the relevant data and information necessary for the study are presented and analyzed keeping the objectives set in mine. This chapter consists of various calculations made for the analysis of interest rate and its effects on lending and deposit amount of sample banks. This chapter consists of detail analysis and interpretation of data relating to interest on deposit and lending, deposit collection and loan & advance of each selected organization from Nepalese financial system. To make our study effective and precise as well as easily and understandable, this chapter is categorized in three parts, presentation, analysis and interpretation. The analysis is based on secondary and primary data available. In presentation section, data are presented in terms of table, graph chart of figures, according to need. The presented data are then analyzed using different statistical tools which are mentioned in chapter three. At last the results of analysis are interpreted. This chapter provides the major and necessary findings which are very helpful for the subject matter of this study.

4.1.1 Measurement of Lending Strength

The relationship between various assets and liabilities of the balance sheet has been established to show the lending strength of commercial banks. An attempt is made to determine the lending strength in absolute figure of each commercial bank.

A) Loan and Advances to Total Assets Ratio

Loan and advances is the major components of the total assets, which indicate the ability of banks to utilize its deposits in the form of loans and advances to earn high return. It is an appropriate level to generate profit. The high degree of this ratio indicates the good performance of the commercial banks in mobilizing its funds by

way of lending function. However, its reverse side, the high degree of this ratio is representative of low liquidity ratio either.

Granting the loan and advances always carries a certain degree of risk. Thus, this asset of banking business is towards risk assets. The low ratio is indicative of low productivity and high degree of safety in liquidity and vice versa. The interaction between risk and return determines this ratio. This ratio is calculated by dividing loan & advances by total assets. It's expressed as,

$$\text{Credit Risk Ratio} = \frac{\text{Total Loan and Advance}}{\text{Total Assets}}$$

Here,

$$\begin{aligned} \text{Total Loan and Advances} &= \text{Loan and Advances and Overdraft} + \text{Bill} + \text{Cash} \\ &\quad \text{Credit Local and Foreign} + \text{Purchased and Discounted} \\ \text{Total Assets} &= \text{Current Assets} + \text{Fixed Assets} + \text{Loans for Development Bank} + \\ &\quad \text{Investment} + \text{Miscellaneous Assets} \end{aligned}$$

Table 4.1 show the five years average loan & advances to total asset ratio of NABIL, EBL and LBL banks

Table 4.1
Loan & Advance to Total Assets Ratio

Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	61.60%	57.87%	57.04%	57.54	62.89	59.39	2.38	4.01
EBL	64.60%	61.42%	63.76%	67.55%	65.27%	64.52	1.99	3.10
LBL	70.47%	70.05%	67.32%	75.31%	68.12%	70.26	2.79	3.97

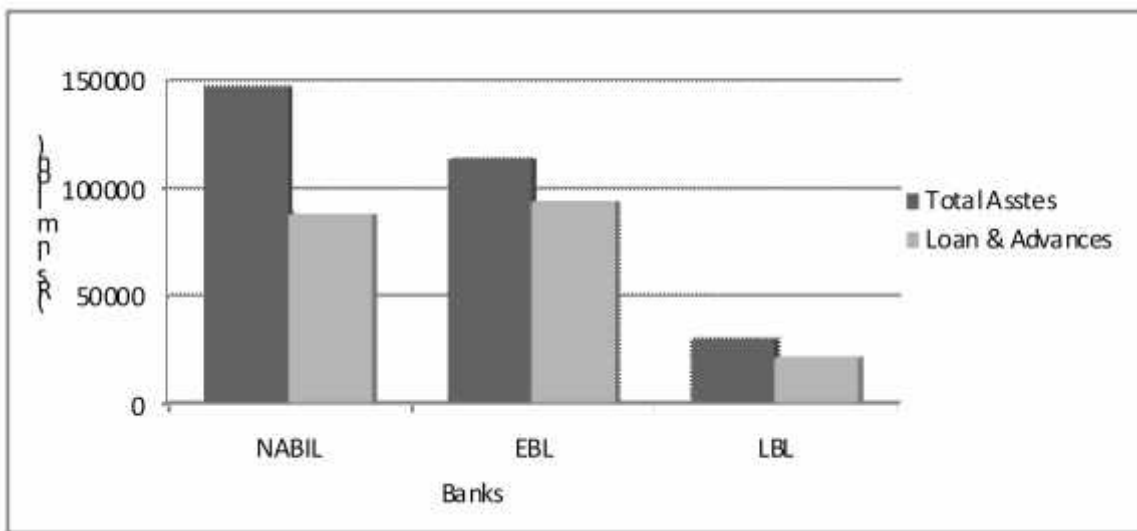
Source: Appendix: 1

The mean loan & advances to total asset ratio of LBL is higher then NABIL and EBL banks. So that LBL have maximum risk in loan and advance but in other side LBL was success to mobilize its total assets and get more profit. EBL and NABIL banks have lowest credit risk. Lowest ratio indicates the bad performing of these two banks. They are unable to utilize their total assets as loan & advances. This regarding that LBL has higher ratio then other two banks which indicate the LBL is in better position among these three banks.

Standard Deviation of EBL is lower than NABIL and LBL banks. So that EBL have lower risk in its assets. The Coefficient of variation of EBL is lower than NABIL and LBL banks. This is clear that the EBL loan & advances to total assets ratio is less variable than other banks.

Figure 4.1 show per year loan & advances and total assets of NABIL, EBL and LBL from 2004/05 or 2008/09.

Figure 4.1
Total Loan and Advances to Total Assets



B) Loan and Advances and Investment to Total Deposit Ratio

Loan & Advances and investment are the major area of fund mobilization of commercial banks. Loan & advances is the first type of application of funds, which has more risk as compare to investment and gives more return. Investment is cushion against the liquidity risk and at the same time, it gives return. The investing activity of commercial banks has low level of risk and low level of return. Loans and advances and investment to total deposit ratio indicates the firm’s fund mobilization power. The main sources of bank’s lending and investment is its deposits.

Loan & advances and investment to total deposit ratio measures the ability of bank in generating income from bank’s deposit liability. This ratio is calculating by loan & advances and investment dividing by total deposit. Loan & advances and investment to total deposit ratio is favorable when it is 85% or higher. It is expressed as,

$$\text{LA \& Investment to Total Deposit Ratio} = \frac{\text{Loan Advance \& Investment}}{\text{Total Deposit}}$$

Here,

Total Investment = Investment in Government Securities + Others
 + Investment in Shares + Debentures

Total Loan and Advances = Loan and Advances and Overdraft + Bill + Cash

Credit Local and Foreign + Purchased and Discounted Total

Deposit = Saving Deposit + Fixed Deposit + Call Deposit + Certificate of Deposit

Table:-4.2 show the five year average loan & advances and investment to total deposit ratio of NABIL, EBL and LBL banks.

Table 4.2
Loan & Advances and Investment to Total Deposit Ratio

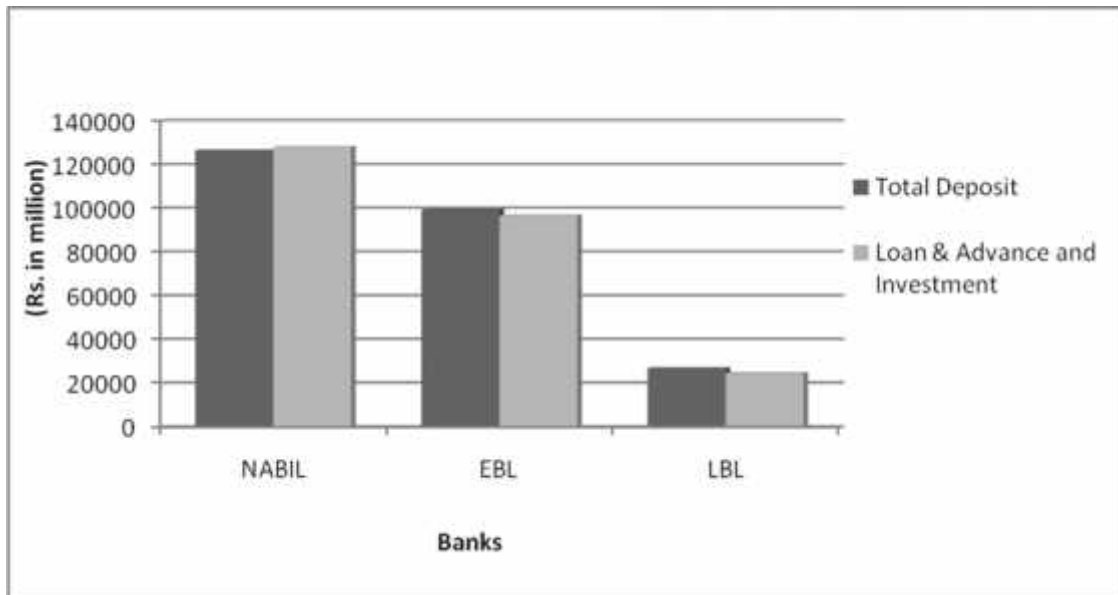
Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	101.8%	98.73%	104.9%	98.1%	102.8%	101.3	2.56	2.53
EBL	96.53%	101.4%	102.5%	99.67%	91.29%	98.3	4.1	4.12
LBL	91.86%	76.42%	78.1%	108.4%	100.6%	91.1	12.5	13.68

Source: Appendix: 2

The mean ratio of loan & advances and investment to total deposit ratio of whole NABIL, EBL and LBL banks are higher then 85%. That means loan & advances and investment to total deposit ratio of these commercial bank above the standard. They are able to mobilize their deposit in the form of loan & advances and investment. Show that they are able to generate higher profits. They have lowest deposit expenses. NABIL is the best performer in utilization its deposit in the form of loan & advances and investment.

Figure 4.2

Loan & Advances and Investment and Total Deposit



Standard deviation and coefficient of variable of NABIL is lower than EBL and LBL banks. It's cleared that NABIL loan & advances and investment to total deposit is less variable than EBL and LBL banks.

Above Figure 4.2 shows the NABIL, EBL and LBL banks five year average loan & advance and investment and total deposit and their ratio.

C) Loan and Advances to Total Deposit Ratio

Commercial banks can collect deposit only ten times more than their authorized capital. Commercial bank cannot provide all deposit for loan & advance and investment and so on. According to NBR directives, commercial bank can provide only up to 88% of loan from fixed deposit, 50% from saving deposit and call deposit. However, they can not provide loan from current deposit. Commercial bank must deposit two or five percentage of their total deposit in Nepal Rastra Bank account. This percentage is fixed by their types of deposit.

The main sources of bank's lending are its deposit. Thus, loans and advances to total deposits ratio actually measures how successfully the commercial banks are able to mobilize their total deposits on loans and advances for the purpose profit generation

and fund mobilization power. Higher the ratio indicates the better mobilization of total deposits, but too high ratio is not being better from its liquidity point of view. Lower ratio indicates the idle amount of deposit. So that higher ratio is favorable. Total loan and advances to total deposit ratio is calculated by total loan and advances divided by total deposit.

$$\text{Loan and Advance to Total Deposit Ratio} = \frac{\text{Total Loan and Advance}}{\text{Total Deposit}}$$

Here,

Total Loan and Advances = Loan and Advances and Overdraft + Bill + Cash

Credit Local and Foreign + Purchased and Discounted Total

Deposit = Saving Deposit + Fixed Deposit + Call Deposit + Certificate of Deposit

Table 4.3 show the average loan and advances to total deposit ratio of EBL, LBL and NABIL banks from fiscal year 2004/05 to 2008/09.

Table 4.3
Loan and Advance to Total Deposit Ratio

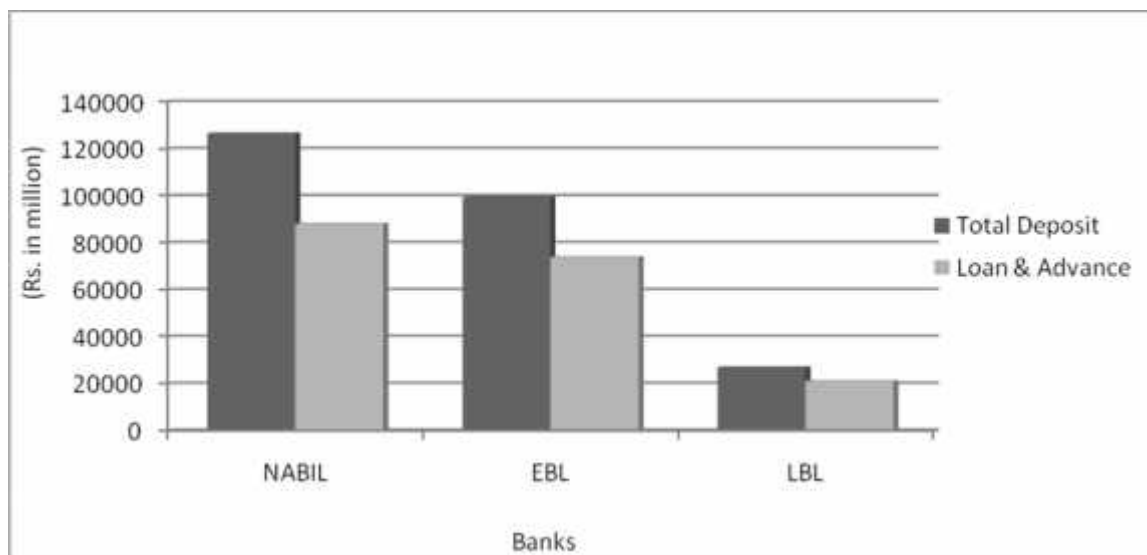
Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	72.57%	66.79%	66.6%	66.94%	73.87%	69.36	3.18	4.6
EBL	75.45%	71.01%	75.13%	76.5%	73.43%	74.3	1.92	2.58
LBL	78.58%	62.34%	63.75%	94.1%	88.17%	77.4	12.72	16.44

Source: Appendix: 3

The loan and advances to total deposit ratio of NABIL bank was in increasing trend per year where as EBL and LBL ratio was in mix trend in last five years. Among these three banks EBL and LBL are able to mobilize their deposit in right way. EBL and LBL ratio was higher then NABIL bank. Their mean ratio is 74.3% and 77.4% respectively. These two banks are able to get more profit form their loan and advances. NABIL bank is unable to utilize their deposit for the profit generating purpose in effective way. NABIL bank means ratio is only 69.36% it means, NABIL have so many idle amount of deposit which increases it deposit expenses. Deposit expenses will decrease the NABIL bank profit.

LBL have higher risk than NABIL and EBL. Standard Deviation of LBL is 12.72. The coefficient of variation of EBL is lower than that of EBL and NABIL banks which indicate that loan and advances of it is stable and consistent. The figure: - 4.4 show the five year average total loan and advances and total deposit of EBL, LBL and NABIL banks.

Figure 4.3
Loan and Advances and Total Deposit



Lastly, it can be concluded that the LBL ratio was strongest than EBL and NABIL. EBL and LBL are in strong and better position regarding mobilization of total deposit on loan and advances and acquiring higher profit. Higher ratio is not good from the view point of liquidity as the loans and advance are not liquid as cash and bank balance.

D) Non interest Bearing Deposit to Total Deposit Ratio

The cost of deposit is the major expenses of commercial banks. Banks cannot avoid costly deposit at all but they can maintain the certain proportion between interest bearing deposits and non-interest bearing deposits by administering the interest rate structure. Current deposit is known as non-interest bearing deposit. This ratio measures the volume of non-interest bearing deposits in total deposits. In practices interest bearing deposits has always been playing a significant role in the mix of deposit liability. Non-interest bearing deposit to total deposit ratio is calculated by no-

interest bearing deposit divided by total deposit. Higher ratio is favorable because in this types deposit banks did not pay any kinds of interest. It is expressed as follows,

$$\text{NIBD to Total Deposit Ratio} = \frac{\text{Non-Interest Bearing Deposit}}{\text{Total Deposit}}$$

Here,

Total Deposit = Saving Deposit + Fixed Deposit + Call Deposit + Certificate of Deposit

Non-Interest Bearing Deposit = All types of Current Deposit

Table 4.4 explains the ratio of five year average non-interest bearing deposit to total deposit ratio of NABIL, EBL and LBL.

Table 4.4
NIBD to Total Deposit Ratio

Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	19.5%	15.26%	14.76%	12.36%	12.38%	14.85	2.61	17.57
EBL	10.15%	8.37%	14.41%	13.58%	12.95%	11.89	2.27	19.06
LBL	3.37%	3.34%	5.78%	6.58%	6.59%	5.21	1.4	26.9

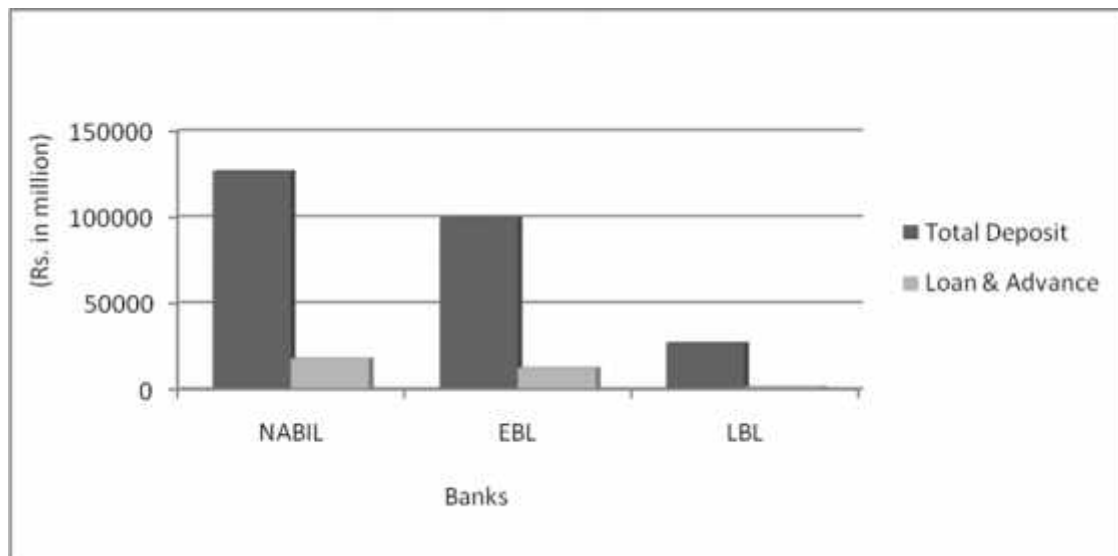
Source: Appendix: 4

In the last five year NABIL bank's NIBD to total deposit ratio was higher than other two banks. This indicates that NABIL bank was successful in collecting cheapest fund. Higher ratio decrease NABIL bank interest expenses and it will increase its profit. EBL and LBL banks have lowest ratio. EBL and LBL banks mean ratio is 11.89% and 5.21%. EBL and LBL banks are unable to collect NIBD. That means they have mostly interest bearing deposit which increase their deposit expenses. Their interest expenses will high which affect their interest income in negatively i.e. lower ratio decrease their profit.

LBL have lowest risk then other bank because its standard deviation is 1.4 which is lowest then other two banks. But its CV is higher. NABIL bank has lower CV between these three banks.

Figure 4.4 show the five year average NIBD and total deposit of EBL, LBL and NABIL banks.

Figure 4.4
NIBD and Total Deposit



E) Cash and Bank Balance to Total Deposit Ratio

Cash and bank balance are assets that constitute the commercial banks first live of defense. It consists of cash in hand, foreign cash on hand, cheques and other cash items balance with domestic commercial banks, financial institution and balance held in abroad. Cash and bank balance to total deposit ratio measures the proportion of most liquidity assets i.e. cash and bank balance among the total current assets of banks.

This ratio is calculated cash and bank balance divided by total deposit. Higher ratio shows the banks ability to meet demand for cash another way higher ratio also show idle of cash in bank. However, high ratio is unfit as capital will be tied up and opportunity cost will be higher. Minimum 12% of this ratio was to be maintained by every commercial bank. This ratio is expressed as,

$$\text{Cash and Bank Balance to Total Deposit Ratio} = \frac{\text{Cash \& Bank Balance}}{\text{Total Deposits}}$$

Here,

$$\text{Cash and Bank Balance} = \text{Local Currency} + \text{Foreign Currency} + \text{Current Account} + \text{Other Account}$$

Total Deposit = Saving Deposit + Fixed Deposit + Call Deposit + Certificate of Deposit

Table 4.5 shows the five year average cash and bank balance to total deposit ratio of EBL, NABIL and LBL bank from fiscal year 2004/05 to 2008/09.

Table 4.5
Cash and Bank Balance to Total Deposit Ratio

Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	3.83%	3.26%	6.00%	8.37%	9.03%	6.10	2.32	38.1
EBL	10.40%	11.25%	13.15%	11.13%	18.50%	12.88	2.95	22.9
LBL	10.40%	8.40%	8.31%	11.27%	15.44%	10.76	2.60	24.2

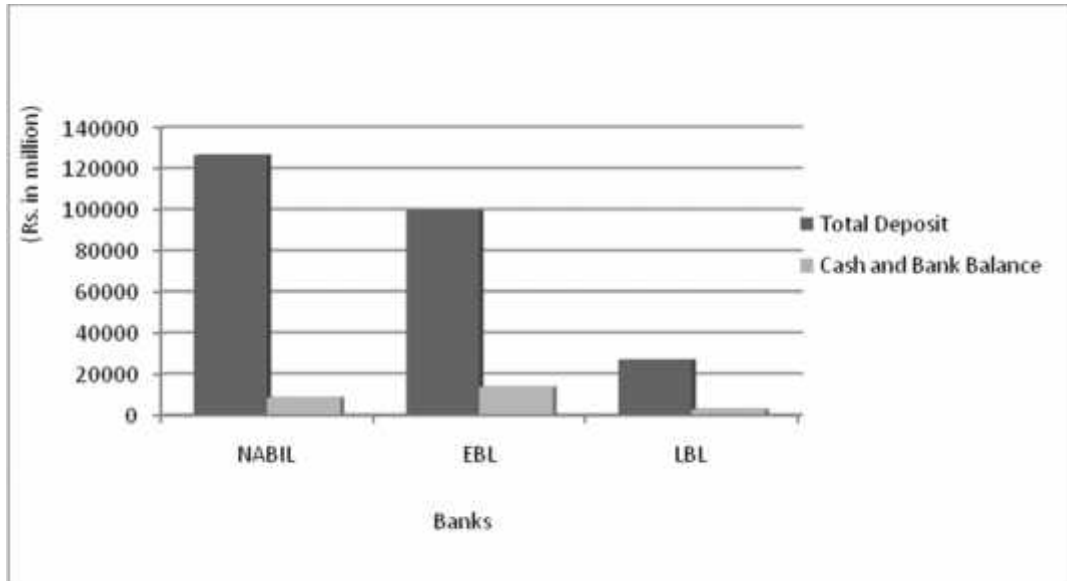
Source: Appendix: 5

Mean ratio of Cash and bank balance to total deposit ratio of EBL is 12%. NABIL and LBL are unable to maintain their ratio on the average. They are unable to meet their customer daily requirement for cash. But in other side, they are able to utilize their fund successfully. NABIL have lower ratio then other banks. This is cause by they are utilized their funds in productivity way.

Standard deviation of NABIL bank is lower than other two banks and coefficient of variation of EBL is lower then other banks. It's clear that EBL cash and bank balance to total deposit are less variable then other banks.

Figure 4.5 shows per year cash and bank balance to total deposit of EBL, NABIL and LBL banks.

Figure 4.5
Cash and Bank Balance and Total Deposit



4.2 Measuring the Lending Performance in Quality, Efficiency and its Contributed in Total Profitability

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

A) Interest Expenses on Deposit to Total Deposit Ratio

Commercial banks should be give priority to collect the cheaper deposit from various sources. The commercial banks performance depends upon its ability to generate cheaper funds. More the cheaper fund will be the profitability in generating loan and advances and vice versa. The high ratio indicates of costly deposit collection and this adversely affects its running cost and lending performance of banks. This ratio is calculated interest expenses on deposit divided by total deposit. This ratio is expressed as,

$$\text{Interest Expenses of Deposit to Total Deposit} = \frac{\text{Interest Expenses}}{\text{Total Deposit}}$$

Here,

$$\text{Interest Expenses} = \text{Interest Expenses for Saving} + \text{Fixed} + \text{Call Certificate of Deposit}$$

$$\text{Total Deposit} = \text{Saving Deposit} + \text{Fixed Deposit} + \text{Call Deposit} + \text{Certificate of Deposit}$$

Table 4.6 shows the five year average Interest Expenses of Deposit to Total Deposit Ratio of EBL, NABIL and LBL bank from fiscal year 2004/5 to 2008/09.

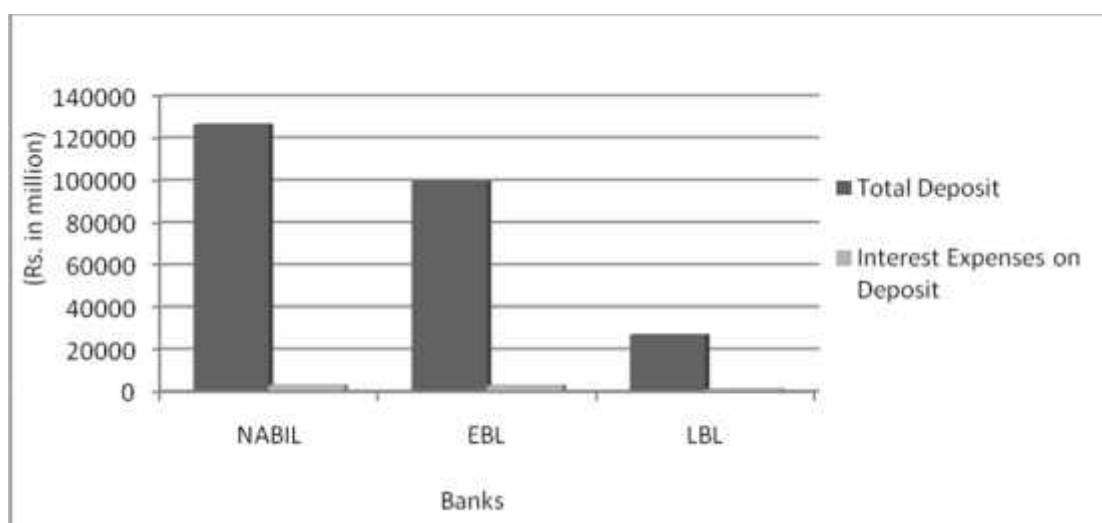
Table 4.6
Interest Expenses on Deposit to Total Deposit Ratio

Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	1.67%	1.85%	2.38%	2.38%	3.09%	2.27	0.50	21.85
EBL	2.97%	2.91%	2.84%	2.64%	3.03%	2.88	0.14	4.74
LBL	4.80%	4.50%	4.39%	4.57%	4.1%	4.48	0.22	5.01

Source: Appendix: 6

The above table 4.6 shows the five year average total interest expenses on deposit to total deposit ratio of NABIL, EBL and LBL banks. Five year mean interest expenses on deposit to total deposit ratio of NABIL, EBL and LBL is 2.27%, 2.88% and 4.48% respectively. NABIL bank was able to manage its deposit in lower cost. So that NABIL can use its deposit in efficiency way and get more profit. EBL have the average ratio. LBL bank has higher cost of deposit. Higher ratio increases their running cost. It decreases their lending performance, efficiency and profit. LBL have costly deposit fund. So that LBL have higher running cost. NABIL bank was only able to manage its deposit for lowest cost among these three commercial banks and LBL have the higher costly deposit expenses.

Figure 4.6
Interest Expenses on Deposit to Total Deposit



Standard deviation of NABIL is lower than other two banks. So that NABIL bank has lower risk in its deposit than other banks. Coefficient of variable of LBL is lower. It's clear that LBL interest expenses on deposit to total deposit are less variable than other banks.

B) Loan Loss Provision to Total Loan & advance Ratio

It is occurred when the debtors fail to pay their loan. Loss of loan is not only the default of debtors but the failure of recovery loan by the commercial bank. Negligence in its part makes a negative impact on the earning and capital of the banks very badly. Greater loan loss provision is made in income statement if high loss is expected. However, this will lead to low profit and possible losses and product low increase of decrease capital.

The loan loss provision to total loan & advance ratio shows how efficiently the commercial bank manages their loan & advances and makes effort for timely recovery of loan & advances. This ratio is calculated dividing loan loss provision by total loan & advances. It is expressed as bellows,

$$\text{Loan Loss Provision to Total Loan \& Advance Ratio} = \frac{\text{Provision for Losses}}{\text{Loan and Advance}}$$

Here,

$$\text{Provision for Loan Losses} = \text{Substandard} + \text{Doubtful} + \text{Loss Loan}$$

$$\text{Total Loan and Advances} = \text{Loan and Advances and Overdraft} + \text{Bill} + \text{Cash}$$

$$\text{Credit Local and Foreign} + \text{Purchased and Discounted}$$

Table 4.7 show the five year average total loan loss provision to total loan and advances ratio of NABIL, EBL and LBL banks.

Table 4.7
Loan Loss Provision to Loan & Advances Ratio

Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	2.30%	0.03%	0.09%	0.30%	0.17%	0.58	0.87	150.2
EBL	1.17%	0.72%	0.66%	0.54%	0.39%	0.69	0.27	38.04
LBL	9.58%	28.6%	5.67%	6.52%	5.25%	11.13	8.9	79.87

Source: Appendix: 7

The mean ratio of loan loss provision to loan and advances ratio is 0.58%, 0.69% and 11.13% of NABIL, EBL and LBL respectively. LBL have higher ratio then other two banks. So that LBL is unable to manage their loan and advances and makes effort for timely recover loan. LBL loan loss provision to loan and advances ratio is highest. Highest ratio increase expenses and it also decrease the profit.

NABIL and EBL banks are able to manage their loan loss provision i.e. their ratio was less then 1.0%. They are able to utilize their loan and advances and get return from their loan. Among all of them NABIL is success to mange his loan and LBL have the worst ratio among all of the banks. Standard deviation and coefficient of variable of EBL is lower then other banks. EBL loan loss provision is less variable and less risky then other two banks.

C) Total Interest Income from Loan and Advances to Total Interest Income

Loan and advances plays a big role in interest income. This ratio measures the contribution made by interest form loan and advances to total interest income. Commercial bank main sources of income was generate from loan and advances. This ratio measures how efficiently the banks have employed their fund in lending. It is calculated by dividing interest income from loan and advances by total interest income. Higher ratios indicate higher profit from loan and advances. It is expressed as,

$$\text{Return on Loan and Advances Ratio} = \frac{\text{Interest from Loan \& Advances}}{\text{Total Interest Incomes}}$$

Here,

$$\text{Total Interest Income} = \text{Interest Incomes for Loan} + \text{Investment} + \text{Advances} + \\ \text{Governments Securities} + \text{Bonds etc}$$

$$\text{Total Loan and Advances} = \text{Loan and Advances and Overdraft} + \text{Bill} + \text{Cash} \\ \text{Credit Local and Foreign} + \text{Purchased and Discounted}$$

Table 4.8 show the five year average total interest income form loan and advance to total interest income ratio of NABIL, EBL and LBL banks.

Table 4.8

Total Interest Income from Loan & Advance to Total Interest Income Ratio

Banks	Fiscal Years	Mean	S.D.	C.V.
--------------	---------------------	-------------	-------------	-------------

	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	60.86%	62.60%	65.15%	75.62%	77.99%	68.44	7.00	10.23
EBL	76.47%	71.96%	81.27%	58.97%	88.26%	75.38	9.83	13.03
LBL	91.06%	93.1%	91.63%	96.16%	90.48%	92.49	2.03	2.19

Source: Appendix: 8

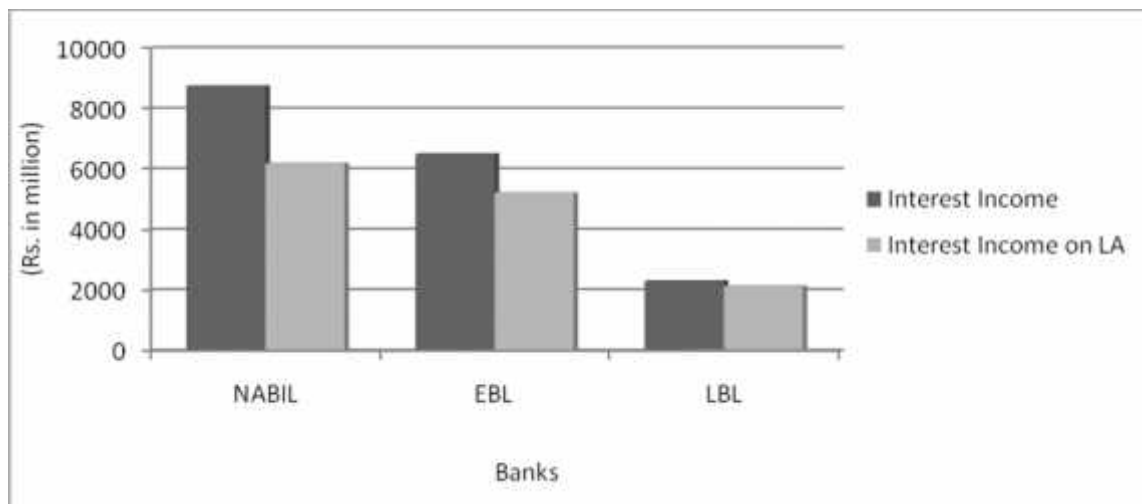
The five year average mean ratio of loan and advances to total interest income ratio of NABIL, EBL and LBL was 68.44%, 75.38% and 92.49% respectively. NABIL have the lowest ratio among these three banks. NABIL bank was unable to get more income from their lending. EBL and LBL were earned more than 75% interest from loan and advances. EBL and LBL are success to utilize their lending for generating profit. However, in average interest income from loan and advances is satisfaction situation of commercial banks.

Standard deviation and coefficient of variable of LBL is lower. It's clear that LBL total interest income from loan and advances and total interest income is less variable and less risky then other two banks.

Figure 4.7 show the total interest income from loan and advances and total interest income and their ratio of NABIL, EBL and LBL.

Figure 4.7

Total Interest Income from Loan & advances and Total Interest Income



D) Interest Suspense to Interest Income from Loans and Advances Ratio

Interest suspense means the interest due but not collected. NRB directive do not allow the commercial banks to book due but unpaid into income. The increasing in the interest suspense decreased the profit of the company. Such interest is shown in liability side of balance sheet under the heading “other liability”. This ratio interest suspense is to total interest income from loans and advance measure the composition of due but uncollected interest in the total interest income from loans and advances. The high degree of this ratio indicates to low interest turnover and low degree of ratio indicated high interest turnover of banks.

$$\text{Interest Suspense to Income from LA Ratio} = \frac{\text{Interest Suspenses}}{\text{Income for Loan \& Advance}}$$

Here,

Interest Suspense = All not collected interest for Loan and Advance

Income for Loan and Advances = Interest from Loan and Advances and Overdraft + Bill + Cash Credit Local and Foreign + Purchased and Discounted

Table 4.9 show the five year average total interest income form loan and advance to total interest income ratio of NABIL, EBL and LBL banks.

Table 4.9
Interest Suspense to Interest Income from Loan & Advance Ratio

Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	23.86%	19.6%	24.37%	25.30%	20.63%	22.75	2.23	9.79
EBL	42.01%	35.41%	28.34%	27.36%	18.62%	30.35	7.90	26.05
LBL	23.07%	29.88%	17.94%	15.80%	16.99%	20.74	5.20	25.09

(Source: Appendix: 9)

Above table show the ratio of interest suspense to the interest income from loan and advance ratio of NABIL, EBL and LBL was 22.75%, 30.35% and 20.74% respectively. LBL have the lowest ratio among these three banks. LBL bank was able to collecting more interest income from their lending. NABIL and EBL were unable to collected interest income for their landing. LBL is successfully generating profit among then other two banks.

Standard deviation and coefficient of variable of NABIL is lower. It's clear that NABIL bank interest suspense to interest from loan and advance is less variable then other banks.

E) Total Interest Expenses to Total Assets Ratio

Total interest expenses to total assets ratio measures the percentage of total interest expenses against total assets. This ratio was calculated by dividing total interest expense by total assets. Higher ratio indicated the higher interest expenses on total assets and vice versa. It is expressed as below,

$$\text{Total Interest Expenses to Total Assets Ratio} = \frac{\text{Interest Expenses}}{\text{Total Assets}}$$

Here,

Total Interest Expenses = Interest Expenses for Saving + Fixed + Call Certificate
of Deposit

Total Assets = Current Assets + Fixed Assets + Loans for Development Bank +
Investment + Miscellaneous Assets

Table 4.10 show the five year mean ratio of total interest expenses of deposit to total deposit ratio of NABIL, EBL and LBL banks.

Table 4.10
Total Interest Expenses to Total Asset Ratio

Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	1.41%	1.60%	2.04%	2.04%	2.63%	1.94	0.42	21.71
EBL	2.54%	2.52%	2.41%	2.29%	2.70%	2.49	0.13	5.52
LBL	4.30%	5.06%	4.64%	3.65%	3.48%	4.16	0.67	16.27

(Source: Appendix: 10)

Five year mean ratio of total interest expenses to total assets ratio of NABIL, EBL and LBL bank is 1.94%, 2.49% and 4.16% respectively. NABIL bank was able to mobilize its assets with lower expenses. Therefore, NABIL bank was success to generate more profit. LBL and EBL banks have higher ratio. They have to minimize their expenses. It can be concluded that NABIL banks was in better position from payment of interest point of view. It seems to be that NABIL bank successful to

collect its assets from less expensive sources in comparisons to EBL and LBL. Day by day commercial banks expenses volume is increasing trend.

Standard deviation and Coefficient of variable EBL is lower then other two banks. So that EBL has lower risk in its expenses then other banks. It's clear that EBL total interest expenses to total asset ratio are less variable then other banks.

F) Capital Risk Ratio

The capital risk ratio indicates how much assets value may decline by bank before the position deposition and other creditor. Therefore, a bank needs to maintain sufficient capital in relation to be nature and condition of its assets, its deposits liability and other corporate responsibilities. Capital risk ratio measures ability of bank to attract deposits and inter bank funds. It also determines the level of profit.

A bank can earn if a bank chose to take high capital risk. Capital fund include the reserve, share premium, paid up capital, retain earning so on. Capital risk ratio is calculated capital fund dividing by risky weighed assets. It is expressed by,

$$\text{Capital Risk Ratio} = \frac{\text{Total Capital Funds}}{\text{Risky Weighed Assets}}$$

Here,

Total Capital Fund = Reserve and Surplus+ Share Premium+ Paid-up Capital +
Retain Earning etc.

Risky Weighed Assets = Investment + Loan and Advance + other Assets

Table 4.11 show the five year average capital risk ratio of each and every commercial bank.

Table 4.11
Five year Average Capital Risk Ratio

Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABII	12.44%	12.31%	12.04%	11.10%	10.70%	11.72	0.69	5.90
EBL	13.54%	12.32%	11.20%	11.44%	11.12%	11.92	0.92	7.67
LBL	6.35%	(15.11)	(7.8)	6.92%	17.78%	1.62	11.7	716.4

(Source: Appendix: 11)

The five year average mean ratio of capital risk ratio of NABIL, EBL and LBL was 11.72%, 11.92% and 1.62% respectively. EBL and NABIL bank have higher ratio. That means they are success to mobilize their capital fund and they have higher capital ratio risk i.e. they have higher capital risk and they are able to get high return from their capital fund.

LBL has lowest capital risk ratio. This indicates that LBL was unable to utilize their capital fund i.e. LBL was unable to get profit.

G) Return on Total Assets Ratio

The commercial bank has to earn to satisfactory return on total assets. Commercial banks have to well manage their assets, efficiently utilize of their assets to get higher return from their assets. Return on total assets ratio measures the profit earning capacity by mobilizing their available total assets.

Return on total assets ratio was calculated net profit divided by total assets. Higher ratio is preferable because higher ratio indicates the higher return form the total assets and lower ratio indicates the bad performance of total assets. It is expressed as,

$$\text{Return on Total Assets Ratio} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

Here,

Net Profit = Net Profit includes the profit that is left to the internal equities

Offer costs charge and expenses

Total Assets = Current Assets + Fixed Assets + Loans for Development Bank +

Investment + Miscellaneous Assets

Table 4.12 show the five year average return on total assets of NABIL, EBL and LBL banks.

Table 4.12
Return on Total Assets Ratio

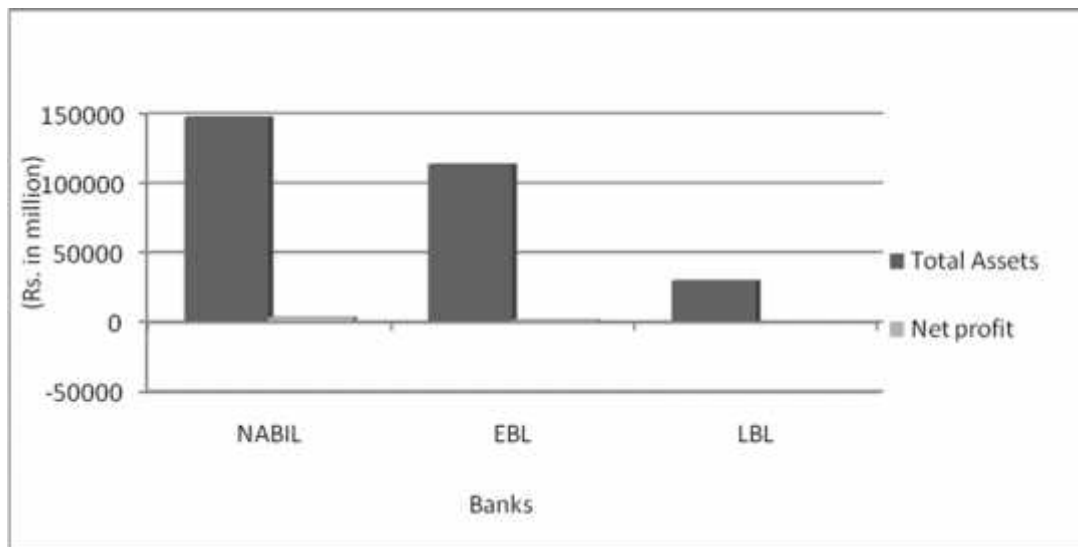
Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABII	3.02%	2.84%	2.47%	2.01%	2.35%	2.54	0.36	14.10
EBL	1.45%	1.49%	1.38%	1.66%	1.67%	1.53	0.12	7.50
LBL	(4.38)	(18.9)	3.37%	4.60%	3.99%	(2.28)	8.95	(394)

(Source: Appendix: 12)

The mean return on total assets of NABIL, EBL and LBL bank is 2.54%, 1.53% and (2.28) % respectively. LBL was unable to mobilize its assets in effective way. So that it returns on total assets is negative. LBL have the negative return from its assets. NABIL and EBL bank was able to mobilize their assets effectively and they are able to get profit. NABIL return on assets higher then other banks.

Figure 4.8 show the NABIL, EBL and EBL banks average return on total assets from year 2004/5 to 2008/09.

Figure 4.8
Total Assets and Net Profit



Standard deviation of EBL is lower than other banks. So that EBL bank has lower risk in its return than other banks. Coefficient of variable of LBL is negative. Coefficient of variable of EBL is lower. It's clear that EBL return on loan and advances is less variable than other banks

H) Return on Loan and Advances Ratio

Return on loan and advances ratio measure the earning capacity of banks on its deposit mobilized on loan and advances. Mostly loan and advances included loan cash credit, overdraft bills purchased and discounted. In other words, this ratio indicates how efficiently the banks have employed its resources in the form of loan advances. Return on loan and advances ratio calculated by dividing interest income from loan and advances by loan and advances. High ratio indicates a high success to mobilize fund as loan and advances and vice versa. It is expressed as,

$$\text{Return on loan and advance Ratio} = \frac{\text{Income on Loan \& Advance}}{\text{Total Loan \& Advance}}$$

Here,

Income for Loan and Advances = Interest from Loan and Advances and Overdraft + Bill + Cash Credit Local and Foreign + Purchased and Discounted

Total Loan and Advances = Loan and Advances and Overdraft + Bill + Cash

Credit Local and Foreign + Purchased and Discounted

Table 4.13 shows the five year average return on loan and advances ratio of NABIL, EBL and LBL bank as follows.

Table 4.13
Return on Total Assets Ratio

Banks	Fiscal Years					Mean	S.D.	C.V.
	2004/05	2005/06	2006/07	2007/08	2008/09			
NABIL	6.14%	6.35%	6.65%	7.00%	7.91%	6.81	0.62	9.13
EBL	7.22%	6.63%	6.81%	6.27%	7.89%	6.96	0.56	7.95
LBL	11.06%	10.73%	10.94%	9.60%	9.25%	10.32	0.74	7.23

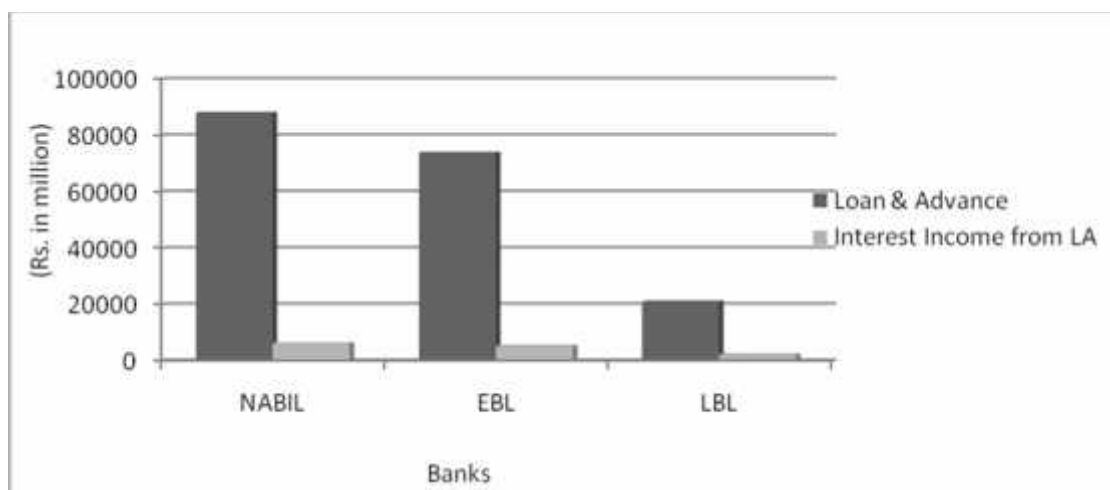
(Source: Appendix: 13)

The average mean return on loan and advances of NABIL, EBL and LBL are 6.81%, 6.96% and 10.32% respectively. LBL banks have the higher return from its loan. NABIL and EBL banks get more return from their loan.

Standard deviation of NABIL is lower than other banks. So that NABIL bank has lower risk in its return than other banks. Coefficient of variable of LBL is lower. It's clear that LBL return on loan and advances is less variable than other banks.

Figure – 4.9 show the NABIL, EBL and LBL banks average return on loan and advances from year 2004/05 to 2008/09

Figure 4.9
Return on Loan and Advances Ratio



I) Net Profit of Commercial Bank

Profit is the main elements that make commercial bank to survive in long run. It plays the vital role of commercial bank. Net profit after all types of deduction such as bonus to employees, taxes and provision has been used in this analysis. The volume of Net profit measures the success of a firm in every aspect of its efficiency. It is expressed by,

Net Profit = Net Profit includes the profit that is left to the internal equities offer costs charge and expenses

Table 4.14 shows the five year average net profit of NABIL, EBL and LBL bank.

Table 4.14
Net Profit of Commercial Bank

(Rs. in million)

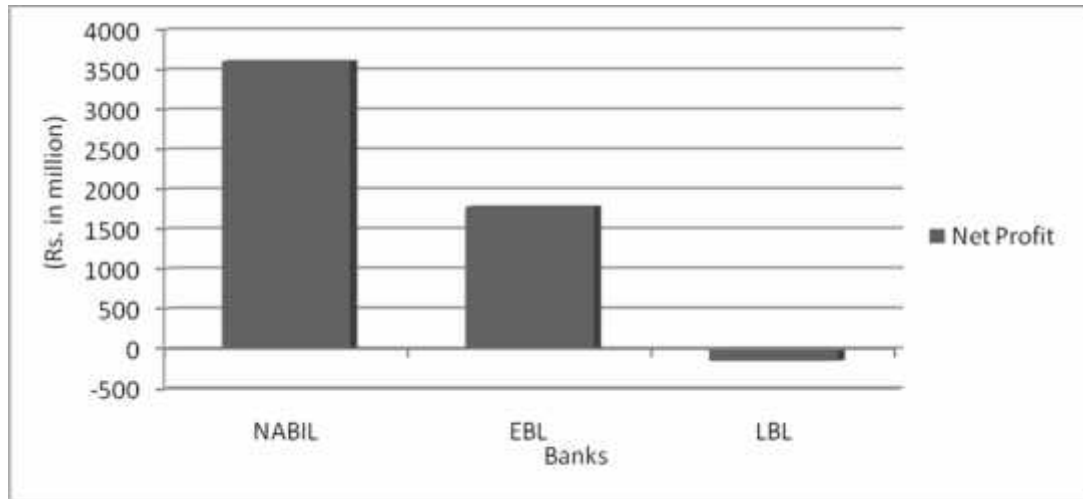
Banks	Fiscal Years					Average
	2004/05	2005/06	2006/07	2007/08	2008/09	
NABIL	518.64	635.27	673.96	746.47	1031.06	721.08
EBL	170.81	237.30	296.41	451.22	624.07	355.97
LBL	(196.8)	(806.1)	192.41	327.65	332.21	(30.12)

(Sources: Annual Income Statement of NABIL, EBL and LBL 2005 to 09)

The average net profit of NABIL, EBL and LBL is Rs.721.08, 355.97 and (30.12) million respectively. LBL was suffering for loss. LBL average net profit is negative. LBL was bearing loss in the year 2005 and 2006. It makes his net profit is negative. LBL was unable to generate profit from their lending and other activity. NABIL and EBL are able to get highest profit in the study period.

Figure 4.12 show the per year profit of these commercial banks.

Figure 4.10
Net Profit of Commercial Banks



4.3 Non-Performing Loan Status of Commercial Banks

The loans falling under category of substandard, doubtful and loss loan are regarded as non-performing loan. The bank should try to decrease NPL so that profitability of the banks can be strength. The effective loan management decreases the percentage of NPL.

As per international standard only 5% or below NPL allowed but the context of Nepal Maximum 10% or below NPL may be acceptable. The ratio of loan loss provision to total and advances describes the quality of asset in form of loan is bank holding. Loan loss provision, in fact is the cushion against future contingency created by the default of the borrowers. Loan loss provision indicates the figure that is the summation of provision made against all types of loans as per the NRB directive. According to the NRB directive, it directs to make the provision of 1%, 25%, 50% and 100% for good loan, sub-loan, doubtful loans and bed loans respectively. Loan loss provision occupies the large share in the total provision. Presented in the profit and loss account and definitely decrease the profit of the company. Since according to the NRB directive 1% provision is to be provided for all good loans. It does get a large portion of the total loan loss provision.

The higher ratio of NPL is the system is an indicator of financial crisis and it should be resolved as soon as possible. Hence, the lower ratio of NPL to total gross loan is preferred. It is expressed as,

Non-Performing Loan = % of Non-Performing Loan | Total Loan

Table 4.15 shows the last five year non-performing loan and percentage of non-performing loan in total loan

Table 4.15
Five Years NPL and % of non-performing loan

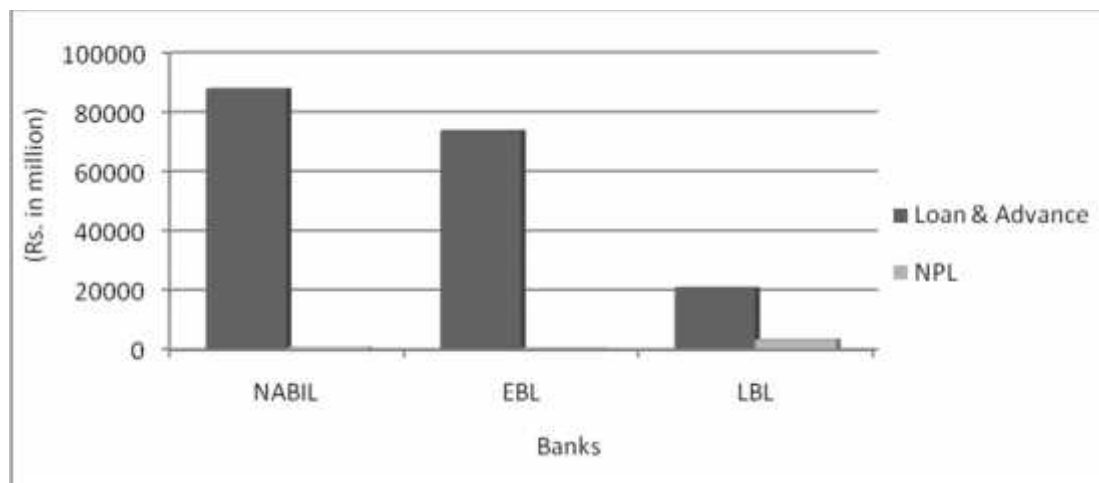
(In Million)

F/Y	NABIL		EBL		LBL	
	NPL (Rs.)	NPL (%)	NPL (Rs.)	NPL (%)	NPL (Rs.)	NPL (%)
2004/05	140.80	1.32%	124.19	1.63%	482.45	15.23%
2005/06	178.34	1.38%	124.48	1.27%	925	30.99%
2006/07	174.12	1.12%	109.32	0.80%	782.35	20.37%
2007/08	158.11	0.74%	128.09	0.68%	800.8	14.92%
2008/09	220.71	0.80%	117.46	0.48%	514.74	9.06%

(Source: Annual Bank Supervision Report 2009, NRB)

NABIL and EBL banks was able to maintenance its NPL among the three commercial banks. Their ratio of NPL is in decreasing trend. This decreasing trend of non-performing loan was indicating that NABIL and EBL are successful to manage their loan. This decreasing trend of non-performing loan was also indicating the increase trend of their profit and performance. LBL was badly suffering from NPL from the last five year. NPL of LBL was above the international standard which is 5%. Around the 20% of total loan was suffering from NPL and it effect their loan recover and its profit. NPL keeps impotence in determination of profitability of the bank. The bank should always try to decrease NPL so that profitability of the bank can be strengthened.

Figure 4.11
Gross Loan to NPL of Commercial Bank



4.4 Portfolio Behaviors of Lending

There are various types of borrowers on economy sector. It invests fund in various types' borrowers. Therefore, commercial bank provides loan and advances in different sector to minimize their risk and maximize profit. The loan and advances granted to various sector of economy and for various purposes to total volume of loans and advances is measured.

a) Priority Sector Lending

Commercial bank gives lending in some priority sector. Priority sector lending was classified into five sectors. They are agriculture, machine and import domestic industries, services and power sectors. The table 4.16 show the loan and advances provide by NABIL, EBL and LBL banks in priority sector.

Table 4.16
Priority Sector Lending of Commercial Banks

(Rs. In Million)

Priority Sector	NABIL	EBL	LBL
Agriculture	214.50	105.53	645.22
Domestic Industries	586.56	1485.55	154.61
Services	2132.2	1865.33	298.33
Power Sector	541.22	0.00	452.02
Machine and Import	20.54	20.11	348.22

(Sources: Annual Report of concern bank 2004/05 to 2008/09)

NABIL and EBL give main priority to Lending in service sector. Their more than 50% loan was occupied by services sectors. After that Domestic industries sector occupied second position for lending. Agriculture sector occupied least amount for lending. EBL is not interest in power sector where as NABIL and LBL bank provide loan in this sector. Above table show that three commercial bank only main priority to lending for more profit sector.

b) Sector wise Loan and Advance

There are six sector wise loan and advances which are Production, Construction, Services Industries, Wholesaler and Retailer, Finance and Insurance and Consumable Loan is main sectors wise lending area. From the table - 4.17 show the sector wise loan and advances.

Table 4.17
Sector Wise Lending of Commercial Banks

(Rs. In Million)

Sector	NABIL	EBL	LBL
Production	28632.41	15463.23	6846.50
Construction	5422.22	6930.45	598.59
Services Industries	5621.80	2195.36	2865.27
Wholesaler and Retailer	99658.10	10678.60	5685.70
Finance and Insurance	8562.2	1355.81	689.40
Consumable Loan	153.22	823.30	2.23

(Sources: Annual Report of concern bank 2004/05 to 2008/09)

Major portion of the loan portfolio of the NABIL, EBL and LBL was distributed to production sector and wholesale and retail sector. Lending to production sector alone stood higher portion lending of total loan and advances. Lending to wholesale and retailer was second choice of these banks in last five year. Services industries were able to tap some position of total loan and advances. Other major loan and advances distributed sector included consumable loan. Finance and insurances, construction sector

c) Securities Wise Loan and Advance

Commercial banks are also classified their loan and advances according to securities, Such as gold, silver, government and non-government securities, fixed assets receipts, guarantee, credit card and others.

Table 4.18
Securities Wise Lending of Commercial Banks

(Rs. In Million)

Securities	NABIL	EBL	LBL
Government Securities	246.80	121.40	9.45
Non-government securities	0.00	5.55	25.11
Fixed assets Receipt	325.22	515.52	86.50
Guarantee	9865.40	9747.8	8.66

Others	5968.4	965.40	2542.5
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(Sources: Annual Report of concern bank 2004/5 to 2008/09)

The table 4.18 shows the commercial bank lending in different kinds of securities. Main portion of the loan portfolio of the NABIL and EBL was distributed to guarantee to securities. Guarantee and guarantee in other securities. These assets guarantees are in increasing trend per year because commercial banks are lending maximum of their amount in land and building, agricultural and non agricultural product, vehicles so on. In these sectors LBL was uninterested to lending in guarantee sector. Fixed account receipt was covering some portion of total loan. Government securities and non-government securities were able to tap only few portions of total loan and advices.

4.5 Coefficient of Correlation Analysis

Correlation is a statistical device designed to measure the degree of association between two or more variables. There are five types of correlation coefficient which are Positive correlation, negative correlation, linear correlation, non-linear partial correlation and multiple correlations. The coefficient of correlation measures the liner association between variable whereas the coefficient of determination measure the proportion of the variation in one variable which can be explained by the variation in the second variable.

Probable error of correlation coefficient is an old measure for testing the reliability of an observed correlation coefficient. If $r < P.E. (r)$ there is no evidence of correlation i.e. correlation is not significant. If $r > P.E. (r)$ there is evidence of correlation i.e. correlation is significant (Three Writer, 2007).

a) Correlation between Total Deposit and Loan and Advances

It measures the intensity, magnitudes or degree of relationship between the two variables. In the analysis, deposit is independent variable and loan and advances is dependent variable. The main objectives of computing coefficient of correlation (r) between two variables are to justify whether deposit significantly used as loan and advances or not. The table 4.19 shows the value of ' r ', ' r^2 ', $P.E. (r)$, and $6P.E. (r)$ between total deposit and loan and advances.

Table 4.19

Correlation between Total Deposit and Loan and Advances

Banks	Evaluation Criteria			
	R	R²	P. E.(r)	6P.E.(r)
NABIL	0.99	0.9801	0.0059	0.035
EBL	0.9983	0.9967	0.00096	0.006
LBL	0.7861	0.6181	0.1152	0.6913

(Sources: Appendix- 14, 15 and 16)

The table given above shows the value of 'r', 'r²', P.E. (R) and 6 P.E. (r) between total deposit and loan and advances of NABIL, EBL and LBL. We found that coefficient of correlation(r) between total deposit and loan and an advance of NABIL, EBL and LBL is 0.99, 0.9987 and 0.7861 respectively. It shows the high degree of positive relationship between two variable loan and advances and deposit. The value of coefficient of determination (r²) of NABIL, EBL and LBL is 0.9801, 0.9967 and 0.6181 respectively. That means 98.01%, 99.67% and 61.81% of variation in the dependent variable (loan and advances), has explained by independent variable (total deposit) respectively.

Similarly, considering the value of 'r' of NABIL, EBL and LBL and comparing it with 6P.E. (r) i.e. 0.035, 0.006 and 0.6713 respectively, we can find, it is greater than the value of 6P.E. (r) which reveals the value of 'r' is significant. One the other hand, we can say that there is significant relation between total deposit and loan and advances of all these commercial banks. After analyzing, the conclusion can be draw that NABIL, EBL and LBL are successful to grant loan and advances to mobilize the collected deposits in a proper way.

b) Correlation between Loan and Advances and Interest Income form Loan and Advance

The correlation between total loan & advances and interest income form loan & advances measures the degree of relationship between these two variables. Loan and advances is independent variable(x) and interest income from loan and advances is dependent variable(y). The relationship between these two variables describes the degree of relationship between loan and advances and net income from loan &

Advance. The 4.20 show the value of 'r', 'r²', P.E. (r) between loan and advances and interest income form from loan and advances of banks.

Table 4.20

Correlation between Loan & Advances and Interest Income from LA

Banks	Evaluation Criterions			
	R	R ²	P. E.(r)	6P.E.(r)
NABIL	0.9964	0.9929	0.0022	0.013
EBL	0.9787	0.9578	0.0128	0.076
LBL	0.9883	0.9768	0.007	0.042

(Sources: Appendix- 17, 18 and 19)

The table given above shows the value of 'r', 'r²', P.E. (r) and 6P.E. (r) between loan and advances and interest income from loan and advances of NABIL, EBL and LBL. We found that coefficient of correlation (r²) of loan and advances and interest incomer from loan and advances of NABIL, EBL and LBL is 0.9964, 0.9787 and 0.9883 respectively. It shows that the high degree of positive relationship between two variable loan and advances and interest income from loan and advances. The value coefficient of determination (r²) of NABIL, EBL and LBL is 0.9929, 0.9578 and 0.9768 respectively. That means 99.29%, 95.78% and 97.68% of variation in the dependent variable has explained by independent variable respectively.

Similarly, considering the value of 'r' of NABIL, EBL and LBL and comparing it with 6P.E. (r) i.e. 0.013, 0.076 and 0.042 respectively, we can find, it is greater than the value of 6P.E(r) which reveals the value of 'r' is significant. On the other hand, we can say that there is significant relation between loan and advances and interest income from loan and advances of these commercial banks.

After analyzing, the conclusion can be drawn that NABIL, EBL and LBL are successful to grant loan and advances to mobilize the collected deposits in a proper way. That means if loan and advances is increase then interest income from loan and advances also increase in same way.

c) Correlation between Total Deposit and Net Profit

The coefficient of Correlation between total deposit and net profit measures the degree of relationship between these two variables. Here total deposit (x) is

independent variable and net profit (y) is dependent variable. The main objectives of computing between total deposit and net profit are to justify whether net profit is significantly correlated with total deposit or not. The table 4.21 show the value of 'r', 'r²', P.E.(r) and 6P.E. (r) between total deposit and net profit of commercial banks.

Table 4.21
Correlation between Total Deposit and Net Profit

Banks	Evaluation Criteria			
	R	R ²	P. E.(r)	6P.E.(r)
NABIL	0.9388	0.8813	0.0358	0.2147
EBL	0.9964	0.9928	0.0013	0.013
LBL	0.7022	0.4931	0.1529	0.92

(Sources: Appendix- 20, 21 and 22)

The table given above show the value of 'r', 'r²', P.E.(r) and 6P.E.(r) between total deposit and net profit of NABIL, EBL and LBL. We found that coefficient of correlation (r) of total deposit and net profit of NABIL, EBL and LBL is 0.9388, 0.9964 and 0.7022 respectively. It shows the NABIL, EBL and LBL have high degree of positive relationship between two variable total deposit and net profit. The value of coefficient of determination (r²) of NABIL, EBL and LBL is 0.8813, 0.9928 and 0.4931 respectively. That means 88.13%, 99.28% and 49.31% of variation in the dependent variable (net profit), has explained by independent variable (total deposit) respectively.

Similarly, considering the value of 'r' of NABIL and EBL and comparing it with 6P.E. (r) i.e. 0.2147 and 0.013 respectively, we can find, it is greater than the value of 6P.E.(r) which reveals the value of 'r' is significant. On the other hand, we can say that there is significant relation between total deposit and net profit of these two commercial banks. But LBL bank 6P.E. (r) is 0.92. We can find the LBL coefficient of correlation (r) is lesser then the value of 6P.E (r) which reveals the value of "r" is insignificant. So we can say that there is insignificant relation between total deposit and net profit of LBL bank.

After analyzing the conclusion can be drawn that NABIL and EBL are successful to grant their deposit to generate the profit in a proper way or there exists a significant

relationship between total deposit and net profit of NABIL and EBL. But the LBL was unable to mobilize its deposit to generate profit.

d) Correlation between Total Assets and Net Profit

The coefficient of correlation between the total assets and net profit measures the degree of relationship between them. Here a total asset was taken as independent variable (x) and net profit is taken as dependent variable (y). The main purpose of calculating coefficient of correlation between these two variables is to justify where total assets are significantly used to generate profit or in other words, whether these variables are significantly correlated or not. The table- 4.22 show the value of ‘r’, ‘r²’, P.E. (r) and 6P.E. (r) between total assets and net profit of commercial banks.

Table 4.22
Correlation between Total Assets and Net Profit

Banks	Evaluation Criteria			
	R	R ²	P. E.(r)	6P.E.(r)
NABIL	0.9418	0.8870	0.0340	0.2046
EBL	0.9945	0.989	0.0034	0.021
LBL	0.8260	0.6822	0.096	0.575

(Sources: Appendix- 23, 24 and 25)

The table given above shows the value of ‘r’, ‘r²’, P.E. (r) and 6P.E. (r) between total assets and net profit of NABIL, EBL and LBL. We found that coefficient of correlation (r) of total assets and net profit of NABIL, EBL and LBL is 0.9418, 0.9945 and 0.8260 respectively. It shows the NABIL, EBL and LBL have high degree of Positive relationship between two variable total assets and net profit.

Coefficient of determination (r²) of NABIL, EBL and LBL is 0.8870, 0.9890 and 0.6822 respectively. That means 88.70%, 98.90% and 68.22% of variation in the dependent variable (assets), has explained by independent variable (net Profit) respectively.

Similarly, considering the value of ‘r’ of NABIL, EBL and LBL comparing it with 6P.E. (r) i.e. 0.2046, 0.021 and 0.575 respectively, we can find the NABIL, EBL and LBL banks 6P.E. (r) are lower then its coefficient of correlation (r) which reveals the

value of 'r' is significant. Conclusion can be drawn that the NABIL, EBL and LBL were able to mobilize its assets to generate profit.

e) Correlation between Loan and Advances to Net Profit

The coefficient of correlation between total loan and advances to net profit measures the degree of relationship between these two variables. Loan and advances is independent variable (x) and total net profit is dependent variable(y). The relationship between these two variables describes the degree of relationship between loan and advances and net income. The table – 4.23 shows the value or 'r', r^2 , P.E. (r) and 6P.E. (r) between loan and advances and net profit of commercial banks.

Table 4.23
Correlation between Total Loan and Advances to Net Profit

Banks	Evaluation Criteria			
	R	R ²	P. E.(r)	6P.E.(r)
NABIL	0.9677	0.9365	0.0191	0.1150
EBL	0.9955	0.9908	0.0028	0.0165
LBL	0.8228	0.6771	0.09740	0.5245

(Sources: Appendix- 26, 27 and 28)

The table given above shows the value of 'r', r^2 , P.E. (r) and 6P.E. (r) between total loan and advances and net profit of NABIL, EBL and LBL. We found that coefficient of correlation (r) of total loan and advances and net profit of NABIL, EBL and LBL is 0.9677, 0.9955 and 0.8228 respectively. It shows the NABIL, EBL, and LBL have high degree of positive relationship between two variable total loan and advances and net profit. The value of coefficient of determination (r^2) of NABIL, EBL and LBL is 0.9365, 0.9908 and 0.6771 respectively. That means 93.65%, 99.08% and 67.71% of variation in the dependent variable (net Profit), has explained by independent variable (loan and advances) respectively.

Similarly, considering the value of 'r' of NABIL, EBL and LBL and comparing it with 6P.E(r) i.e. 0.1150, 0.0165 and 0.5245 respectively, we can find the NABIL, EBL and LBL banks 6P.E. (r) are greater then its coefficient of correlation (r) which reveals the value of 'r' is significant. On the other hand, we can say that there is

significant relation between loan and advance and net profit of NABIL, EBL and LBL.

Conclusion can be drawn that NABIL, EBL and LBL are successful to grant their assets to generate the profit in a proper way or there exists a significant relationship between total loan and advances and net profit of those banks.

f) Correlation between Deposit and Interest Income

The coefficient of correlation between deposit and interest income measured the relationship between these two variables. Total deposit is independent variable (x) and interest income is dependent variable (y). The objective of calculation 'r' between these two variables is to justify whether total deposit is significantly used to interest income or not. The table 4.24 shows the value of 'r', 'r²', P.E. (r) and 6P.E. (r) between total deposit and interest income of commercial banks.

Table 4.24
Correlation between Total Deposit and Interest Income

Banks	Evaluation Criteria			
	R	R²	P. E.(r)	6P.E.(r)
NABIL	0.9717	0.9441	0.0169	0.101
EBL	0.9980	0.9961	0.00115	0.0070
LBL	0.8305	0.6898	0.0935	0.5615

(Sources: Appendix- 29, 30 and 31)

The table given above shows the value of 'r', 'r²', P.E. (r) and 6P.E. (r) between total deposit and interest income of NABIL, EBL and LBL. We found that coefficient of correlation (r) of total deposit and interest income of NABIL, EBL and LBL is 0.9714, 0.9980 and 0.8305 respectively. It shows the NABIL and EBL and LBL have high degree of positive relationship between two variables total deposit and interest income. The value of coefficient of determination (r²) of NABIL, EBL and LBL is 0.9441, 0.9961 and 0.6898 respectively. That means 94.41%, 99.61% and 68.98% of variation in the dependent variable (interest income), has explained by independent variable (total deposit) respectively.

Similarly, considering the value of 'r' of NABIL, EBL and LBL and comparing it with 6P.E(r) i.e. 0.101, 0.0070 and 0.5615 respectively, we can find the NABIL, EBL and LBL banks 6P.E. (r) are greater than its coefficient of correlation (r) which

reveals the value of 'r' is significant. On the other hand, we can say that there is significant relation between total deposit and interest income of NABIL, EBL and LBL. Conclusion can be drawn that NABIL, EBL and LBL are successful to grant their total deposit to generate the interest income in a proper way or there exists a significant relationship between total deposit and interest income of those banks. When deposits increase the interest income subsequently increased but when it is fall, the interest income also fell.

g) Correlation between Loan and Advance and NPL

This correlation measures the degree of relationship between loan and advances and non-performing loan. Loan and advances is independent variable (y) and non-performing loan is dependent variable (x). The objective of computing coefficient of correlation between loan and advance and non-performing loan is to find out whether non-performing loan is significantly correlated with loan and advances or not. Table 4.25 shows the value of 'r', 'r²', P.E. (r) and 6P.E. (r) between loan and advance and non-performing loan of three commercial banks.

Table 4.25

Correlation between Loan & Advances to Non-Performing Loan

Banks	Evaluation Criteria			
	R	R ²	P. E.(r)	6P.E.(r)
NABIL	0.7548	0.5698	0.1298	0.7788
EBL	(0.1796)	0.0322	0.2920	1.7516
LBL	(0.2443)	0.0597	0.2837	1.7018

(Sources: Appendix- 32, 33 and 34)

The table given above shows the value of 'r', 'r²', P.E. (r) and 6P.E. (r) between total deposit and interest income of NABIL, EBL and LBL. We found that coefficient of correlation (r) of loan and advances and non-performing loan of NABIL, EBL and LBL is 0.7548, -0.0245 and -0.2443 respectively. It shows the NABIL have high degree of positive relationship between two variable loan and advances and non-performing loan. If loan and advances increase then non-performing loan also increase of NABIL .EBL and LBL have negative correlation between loan and advances and non-performing loan. It is good for these two banks. The value of coefficient of determination (r²) of NABIL, EBL and LBL is 0.5698, 0.0322 and 0.0597 respectively. That means 56.98%, 3.22% and 5.97% of variation in the

dependent variable (non-performing loan), has explained by independent variable (loan and advances) respectively.

Similarly, considering the value of 'r' of NABIL, EBL and LBL and comparing it with 6P.E(r) i.e. 0.7788, 1.7516 and 1.7018 respectively, we can find the NABIL coefficient of correlation(r) is lesser than the value of 6P.E.(r) which reveals the value of 'r' is significant. This significant result is bad for NABIL banks because it increase non-performing loan. EBL and LBL bank confinement (r) is higher than the value of 6P.E. (r) which reveals the value of 'r' is insignificant. On the other hand, we can say that there is insignificant relation between total loan and advances and non-performing loan of these banks.

Conclusion can be drawn that EBL and LBL are successful to grant their loan and advances to decrease their non-performing loan. But NBIL was unable to manage their loan and advances.

4.6 Regression Equation Analysis

Regression analysis is a mathematical measure of the average relationship between two or more variable in terms of the original units of the data. Thus, it can be said that regression is the estimation or predication of variable's value from the given of other variable's value.

In regression analysis, there are two variable (i) dependent and (ii) independent. The value of the variable, which is to be estimated or predicted or influenced, is called dependent variable. It is also called regressed or explained variable. The variable which is used for predication or which is given is called independent variable. It is also called regress or predictor or explanatory variable.

a) Regression Analysis between Loan and Advance on Total Deposit

The table 4.26 shows the regression equation of loan and advances on total deposit of NABIL, EBL and LBL. Where total deposit is independent variable (x) and loan and advances is dependent variable (y).

Table 4.26

Regression Equation between Total Deposit and Loan and Advances

Banks	Regression equation of Loan and Advance on Total Deposit	Value of Constant (a)	Regression coefficient (b)
NABIL	$Y = -1014.78 + 0.74x$	-1014.78	0.74
EBL	$Y = 31.89 + 0.74x$	31.89	0.74
LBL	$Y = -1209.75 + 1x$	-1209.75	1

(Sources: Appendix: - 35, 36 and 37)

Regression equation of loan and advances on total deposit of NABIL is $Y = -1014.78 + 0.74x$ is positive. In other words, one million increases in total deposit then loan and advances also increase by Rs. 0.74 million of NABIL. The value of constant (a) is relatively high. Regression equation of loan and advances of total deposit of EBL is $Y = 31.89 + 0.74x$ is positive. In other words, one million increase in total deposit then loan and advances also increase by Rs. 0.74 million of EBL. The value of constant (a) is relatively high.

Regression equation of loan and advance on total deposit of LBL is $Y = -1209.75 + 1x$ is positive. In other words, one million increases in total deposit then loan and advance also increases by Rs. one million of LBL. Therefore, NABIL, EBL and LBL have positive or favorable relationship between total deposit and loan and advance. Deposit is able to increase the loan and advances.

b) Regression Equation between Total Interest Expenses on LA

The table 4.27 shows the regression equation of total interest expenses on Loan and Advance of commercial banks. Negative relation between these two variables will be favorable for this case. Where loan and advances is independent variable (x) and total interest expenses is dependent variable (y).

Table 4.27

Regression Equation between Total Interest Expenses on Loan and Advances

Banks	Regression equation of loan and advance on total deposit	Value of constant (a)	Regression coefficient (b)
NABIL	$Y = -303.31 + 0.05x$	-303.31	0.05
EBL	$Y = -17.62 + 0.04x$	-17.62	0.04
LBL	$Y = 152.06 + 0.02x$	152.06	0.02

(Sources: Appendix: - 38, 39 and 40)

Regression equation of total interest expenses on loan and advances of NABIL is $Y = -303.31 + 0.05x$ is positive. In other words, one million increases in total loan and advance then total interest expenses also increases by Rs. 0.05 million of NABIL. The value of constant (a) is relatively high. Same as EBL equation is $Y = -17.62 + 0.04x$ is positive. If EBL increase its loan and advances by one million total interest expenses increases by Rs. 0.04 million.

Regression equation of total interest expenses on loan and advances of LBL is $Y = 152.06 + 0.02x$ is positive if they increase there loan and advances by one million then interest expenses also increase by Rs. 0.02 million. Therefore, NABIL, EBL and LBL have positive relationship between total deposit and loan and advances.

c) Regression Equation between Interest Incomes from LA on Total LA

The table – 4.28 shows the regression equation of interest income from Loan and advances on total loan and advances of NABIL, EBL and LBL. Where the interest income from loan & advances is dependent variable (y) and total loan and advances is independent variable (x).

Table 4.28

Regression Equation between Interest Incomes from LA on LA

Banks	Regression Equation of Loan and Advance on Total Deposit	Value of constant (a)	Regression coefficient (b)
NABIL	$Y = -335.28 + 0.09x$	-335.28	0.09
EBL	$Y = -130.47 + 0.08x$	-130.47	0.08
LBL	$Y = 115.63 + 0.07x$	115.63	0.07

(Sources: Appendix: - 41, 42 and 43)

Above table shows that, regression equation of income form loan and advance on loan and advance of NABIL is $Y = -335.28 + 0.09x$. The positive relationship between these two variables indicates that the one million increase in the loan and advances will also increasing average about Rs. 0.09 million in interest income form loan and advances. Some way in EBL regression equation is $Y = -130.47 + 0.08x$ and positive relationship between those two variables if loan and advances increase by one million then interest income from loan and advance also increase by Rs. by 0.08 million.

Regression equation of interest income from loan and advances on loan and advances of LBL is $Y = 115.63 + 0.07x$. The positive relationship between two variables indicates that the one million increases in the loan and advances will also increasing about Rs. 0.07 million of interest income from loan and advances of LBL.

d) Regression Equation between NPL on Loan and Advances

The Table – 4.29 shows the regression equation of non-performing loan on loan and advances of commercial banks. Where loan and advances is independent variable (Y) and non-performing loan is dependent variable (x). The negative relationship of these two variables is favorable

Table 4.29

Regression Equation between Non-Performing Loans on Loan & Advances

Banks	Regression Equation of Loan and Advance on Total Deposit	Value of constant (a)	Regression coefficient (b)
NABIL	$Y = 116.84 + 0.0033b$	116.84	0.0033
EBL	$Y = 123.62 + 0.0002b$	123.62	0.0002
LBL	$Y = 860.15 + (0.038)$	860.15	(0.038)

(Sources: Appendix: - 44, 45 and 46)

Regression equation of non-performing loan on loan and advances of NABIL and EBL are $Y = 116.84 + 0.0033b$ and $Y = 123.62 + 0.0002b$ is positive respectively. If loan and advance is increase by one million then non-performing loan will be increase by Rs. 0.0003 million and Rs. 0.0002 million of NABIL and EBL banks. And LBL bank regression equation of non-performing loan is $Y = 860.15 + (0.038)$ is negative which reveals the negative relationship between these two variables. These negative relationship show the LBL banks is able to manage their loan and advances is effectively way.

4.7 Trend Analysis and projection for Next Five Years

In this chapter we shall examine the trend analysis of topic total deposit, loan and advances, net profit, non-performing loan and interest income from loan and advances and forecasted for next five years. The measures of trend analysis exhibits the behaviors of given variables in series of time. The performance of any commercial banks does not carry consistency overall, the period and several factor cause the increase or decrease in the volume of various item of commercial bank lending and its operation. The projections are based on following assumptions,

-) The bank will run in the present position.
-) The economy will be remaining in the present stage.
-) NRB will not change its guidelines to commercial banks.
-) The main assumption is that other things will remain unchanged.
-) The forecast will be true only when the limitation of least square method is carried out.

a) Trend Analysis of Total Deposit

Deposit is one very sensitive liability of commercial bank. Its trend and behaviors are determined by various seasonal and cyclical factors. Here the trend values of total deposit of commercial banks have calculated for five year from 2004/05 to 2008/09. Then forecast for next five year up to 2013/14 have done. The table 4.30 shows the trend value of ten years of three banks.

Table 4.30
Trend Analysis of Total Deposit of NABIL, EBL and LBL

(Rs. In million)

Fiscal Year	NABIL		EBL		LBL	
	Amounts	% Change	Amounts	% Change	Amounts	% Change
2004/05	13690.38	-	8552.30	-	4249.26	-
2005/06	19499.27	42.430	14214.72	66.209	4823.73	13.519
2006/07	25308.16	29.790	19877.14	39.835	5398.20	11.909
2007/08	31117.05	22.953	25539.56	28.487	5972.67	10.642
2008/09	36925.94	18.668	31201.98	22.171	6547.14	9.618
2009/10	42734.83	15.731	36864.40	18.148	7121.61	8.774
2010/11	48543.72	13.593	42526.82	15.360	7696.08	8.067
2011/12	54352.61	11.966	48189.24	13.315	8270.55	7.464
2012/13	60161.50	10.687	53851.66	11.75	8845.02	6.946
2013/14	65970.39	9.655	59514.08	10.51	9419.49	6.495

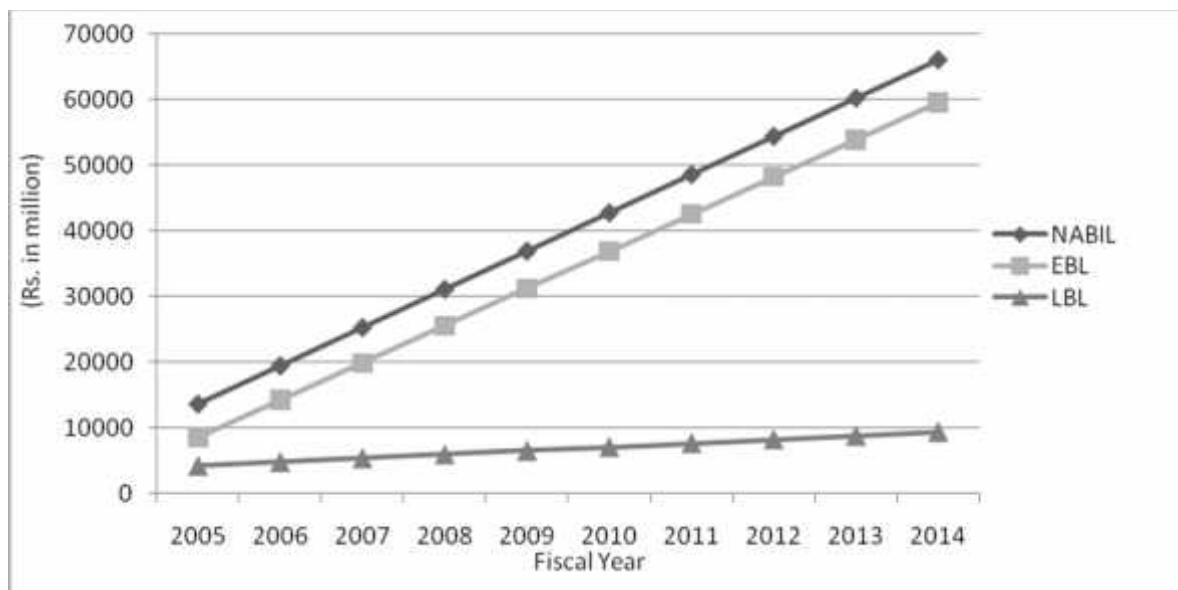
(Source: Appendix: 47)

The volume amount of deposit of all three commercial banks is in increasing trend. With the comparison today, if other things remain same, the total deposit of NABIL bank will be increase by 29044.45 million and reach to Rs. 65970.39 million in years 2013/14 which is highest among the study period. Similarly the total deposit of EBL bank will be increases by Rs. 28312.1 million and reach to Rs. 59514.08 million in years 2013/14. Likewise the total deposit of LBL bank will be increase by Rs.

2872.35 million in years 2013/14. In other side, growth rate of total deposit of all these three banks are going to decrease each and every years.

From the above analysis it is found the total deposit position of EBL is comparatively lower than NABIL and is better in comparison to LBL. Figure 4.14 show the trend line of trend value of total deposit of these three banks.

Figure 4.12
Trend Values of Total Deposit of NABIL, EBL and LBL



b) Trend Analysis of Loan and Advances

Here the trend value of loan and advances of commercial banks have calculated from 2004/05 to 2008/09. Then forecast for next five year upto 2013/14 have done. The trend lines represent the lending behaviors of commercial banks. The volume amount of loan and advances of all three commercial banks is in increasing trend. Increasing trend of loan and advances indicates that in the future commercial banks are able to generate more profit from their lending activity. However, the growth rate is decreasing per year. With the comparison today, if other things remain same, the total loan and advances of NABIL bank will be increase by Rs. 44625.03 million and reach to Rs. 47316.94 million in years 2013/14 which is highest among the study period.

Similarly the total loan and advances of EBL bank will be increase by Rs. 21120.6 million and reach to Rs. 44347.66 million in years 2013/14. Likewise the total loan and advance of LBL bank will be increase by Rs. 3706.46 million and reach to Rs.

9397.45 million in years 2013/14. In other side, growth rate of total deposit of three commercial banks is going to decrease each and every year.

Table 4.31

Trend Analysis of Loan and Advances of NABIL, EBL and LBL

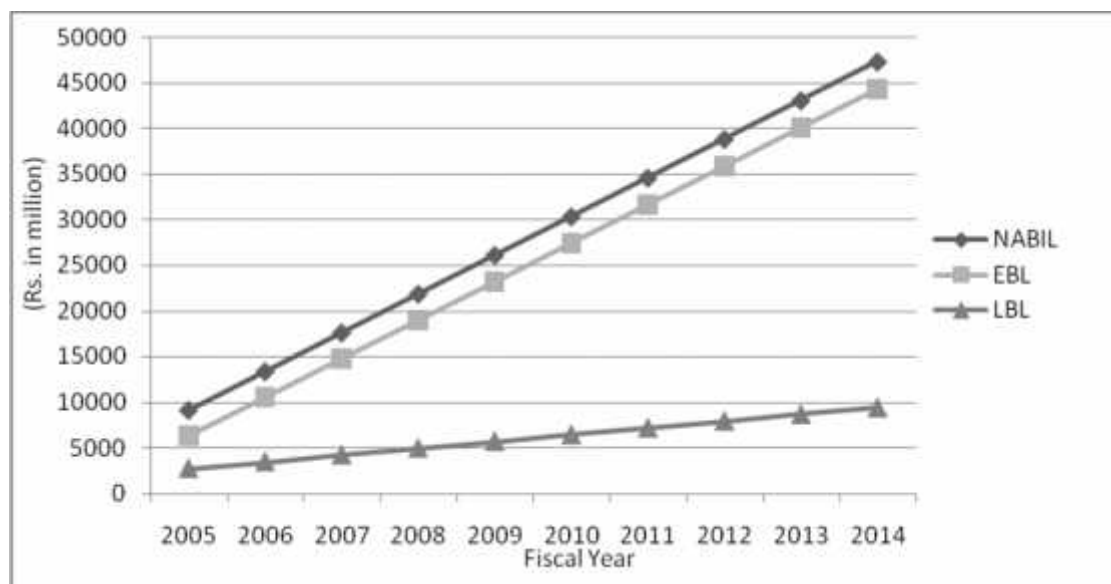
(Rs. In million)

Fiscal Year	NABIL		EBL		LBL	
	Amounts	% Change	Amounts	% Change	Amounts	% Change
2004/05	9111.89	-	6330.58	-	2725.84	-
2005/06	13356.90	46.588	10554.70	66.726	3467.13	27.195
2006/07	17601.90	31.781	14778.82	40.021	4208.42	21.381
2007/08	21846.91	24.117	19002.94	28.582	4949.71	17.614
2008/09	26091.91	19.431	23227.06	22.229	5691.00	14.976
2009/10	30336.92	16.269	27451.18	18.186	6432.29	13.026
2010/11	34581.92	13.993	31675.30	15.388	7173.58	11.525
2011/12	38826.93	12.275	35899.42	13.336	7914.87	10.334
2012/13	43071.93	10.933	40123.54	11.767	8656.16	9.366
2013/14	47316.94	9.856	44347.66	10.52	9397.45	8.564

(Source: Appendix: 48)

Figure 4.13

Trend Values of Loan and Advance of NABIL, EBL and LBL



From the above analysis it is found the total loan and advances position of NABIL bank is better position than other remaining banks. Above figure 4.15 shows the trend line of trend value of total loan and advances of these three banks.

c) Trend Analysis of Non-Performing Loan

Trend value Non-Performing Loan of commercial banks has calculated of from 2004/05 to 2008/14. Then forecast for next five year upto 2013/14 have done. The trend line represents the non-performing loan behaviors of commercial banks. The decreasing trend line is favorable for commercial banks. Decreasing trend show the managing of loan and advances. The table 4.32 shows the trend value and growth rate of non-performing loan of commercial banks.

Table 4.32
Trend Analysis of NPL of NABIL, EBL and LBL

(Rs. In million)

Fiscal Year	NABIL		EBL		LBL	
	Amounts	% Change	Amounts	% Change	Amounts	% Change
2004/05	139.73	-	124.19	-	482.44	-
2005/06	178.33	27.625	124.47	0.225	924.71	91.674
2006/07	174.12	-2.361	109.32	-12.172	782.35	-15.395
2007/08	204.16	17.252	124.70	14.069	800.81	2.360
2008/09	170.93	-16.276	166.40	33.440	545.99	-31.820
2009/10	199.92	16.960	155.21	-6.725	708.22	29.713
2010/11	208.75	4.417	163.68	5.457	708.54	0.045
2011/12	217.57	4.225	172.14	5.169	708.86	0.045
2012/13	226.39	4.054	180.61	4.920	709.18	0.045
2013/14	235.22	3.900	189.07	4.684	709.50	0.045

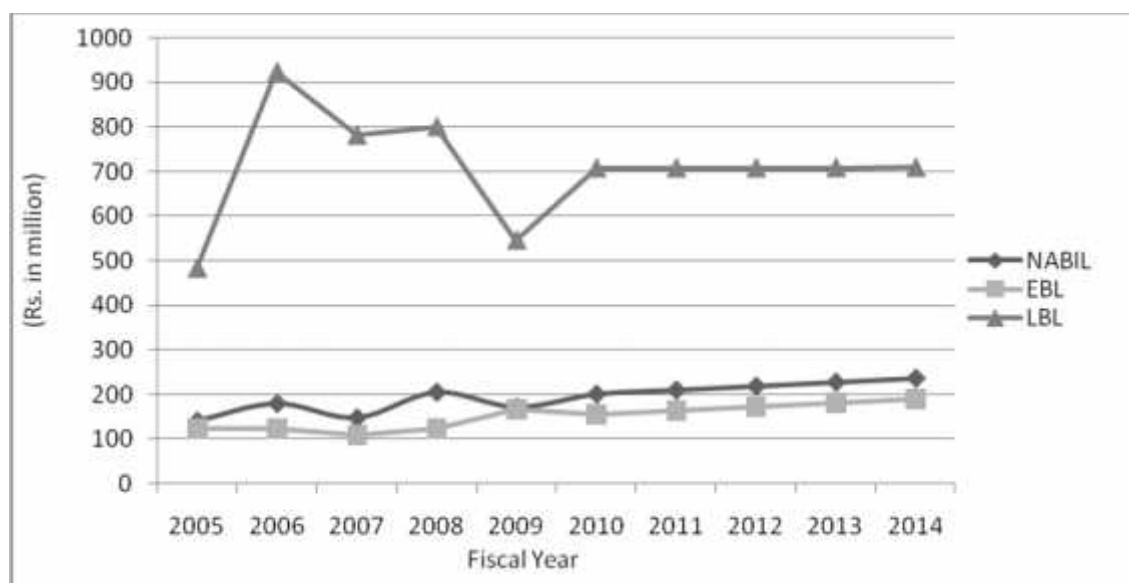
(Sources: Appendix: 49)

The value of NPL is in increasing trend. This is the cause of increasing of loan and advances each year. In other side, the growth rate of NPL is in decreasing trend. This decreasing trend of growth rate of NPL is very well significant for the commercial banks. This will increase their profit and mobilization their assets efficiently. With the comparison today, if other things remain same, the total NPL of NABIL bank will be increase by Rs. 36 million and reach to Rs. 235.22 million in years 2013/14. Similarly

the total NPL of EBL bank will be increase by Rs. 23.01 million and reach to Rs. 186.89 million in years 2013/14. Likewise the total NPL of LBL bank will be increase by Rs. 263.40 million and reach to Rs. 709.50 million in years 2013/14. From the above analysis it is found the NPL position of all three banks are not better position. Figure – 4.14 shows the trend line of trend value of NPL of these three banks.

Figure 4.14

Trend values of NPL of NABIL, EBL and LBL



d) Trend analysis of Net Profit

Trend values of net profit of commercial banks have calculated from 2004/05 to 2008/09. There it was forecasted for next five year upto 2013/14 have been done. The trend line represents the net profit behaviors of NABIL, EBL and LBL commercial banks.

Table 4.33

Trend Analysis of Net Profit behaviors of NABIL, EBL and LBL

(Rs. In million)

Fiscal Year	NABIL		EBL		LBL	
	Amounts	% Change	Amounts	% Change	Amounts	% Change
2004/05	493.66		131.87		-468.48	
2005/06	607.48	23.056	243.92		-249.30	-46.785
2006/07	721.29	18.735	355.97	84.970	-30.13	-87.914
2007/08	835.10	15.779	468.02	45.937	189.05	-727.448

2008/09	948.91	13.628	580.07	31.477	408.23	115.938
2009/10	1062.72	11.994	692.12	23.941	627.41	53.690
2010/11	1176.54	10.710	804.17	19.317	846.58	34.933
2011/12	1290.35	9.673	916.22	16.189	1065.76	25.890
2012/13	1404.16	8.820	1028.27	12.23	1284.94	20.566
2013/14	1517.97	8.105	1140.32	10.90	1504.11	17.057

(Source: Appendix: 50)

The table 4.43 shows the trend value of net profit of NABIL, EBL and LBL banks. NABIL, EBL and LBL net profit is in positive trend in each and every year. Each and every year growth rate of net profit is decreasing trend. NABIL bank is in better position among the three banks and rest two banks are quit good position. They all are increase volume of total amount of profit and decrease net profit ratio every year.

Figure 4.15

Trend values of Net Profit of NABIL, EBL and LBL

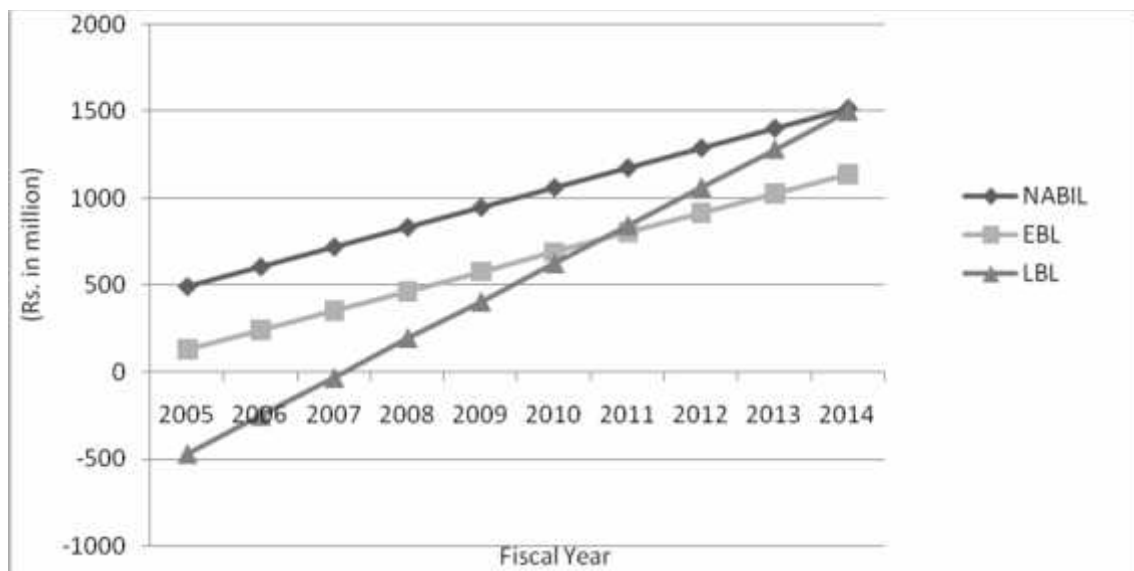


Figure 4.15 shows the decreasing trend line of growth rate and increasing trend line of total volume of net profit.

e) Trend Analysis of Interest Incomer from Loan and Advances

The trend value of interest income from loan and advances of commercial banks have calculated from 2004/05 to 2008/09. Then forecast for next five year upto 2013/14 have done. The trend line represents the interest income from loan and advances behavior of banks.

The table 4.34 shows the trend value of interest income from loan and advances of NABIL, EBL and LBL. The volume of interest income from loan and advances is increasing each year. In other side, the growth rate of interest income from loan and advances is decreasing per year. With the comparison today, if other things remain same, the total interest income from loan and advances of NABIL bank will be increase by Rs. 3324.03 million and reach to Rs. 3855.22 million in years 2013/14. Similarly the total interest income from loan and advances of EBL bank will be increase by Rs. 1629.99 million and reach to Rs. 3324.03 million in years 2013/14 which is highest among the study period. Likewise the total interest income from loan and advances of LBL bank will be increase by Rs. 272.45 million and reach to Rs. 807.52 million in years 2013/14.

Table 4.34

Trend Analysis of Interest Income from Loan & Advances

(Rs. In million)

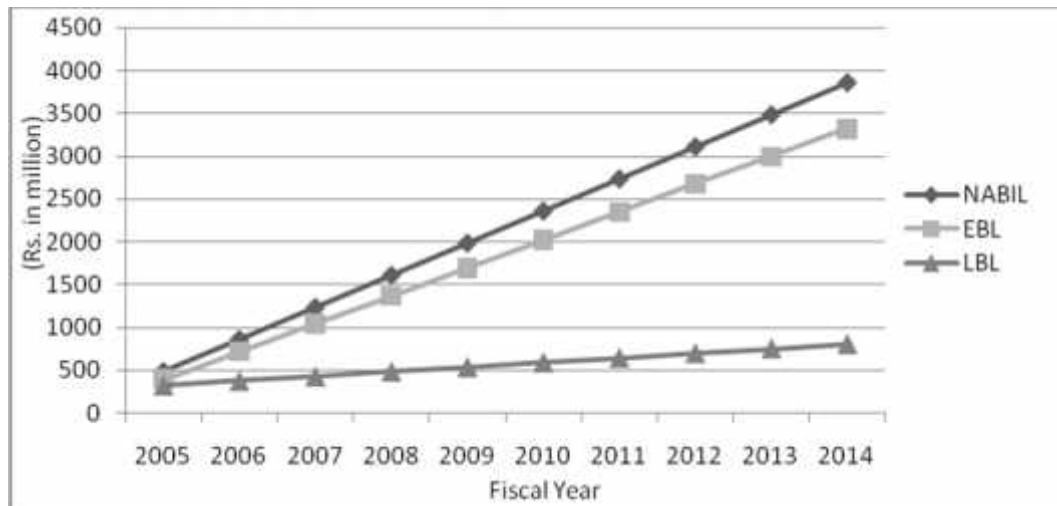
Fiscal Year	NABIL		EBL		LBL	
	Amounts	% Change	Amounts	% Change	Amounts	% Change
2004/05	488.63	-	390.05	-	317.29	-
2005/06	862.70	76.555	716.04	83.576	371.76	17.167
2006/07	1236.76	43.359	1042.04	45.528	426.23	14.652
2007/08	1610.83	30.246	1368.04	31.285	480.70	12.779
2008/09	1984.89	23.222	1694.04	23.830	535.17	11.331
2009/10	2358.96	18.846	2020.04	19.244	589.64	10.178
2010/11	2733.02	15.857	2346.03	16.138	644.11	9.238
2011/12	3107.09	13.687	2672.03	13.896	698.58	8.457
2012/13	3481.15	12.039	2998.03	12.2	753.05	7.797
2013/14	3855.22	10.746	3324.03	10.84	807.52	7.233

(Source: Appendix: 51)

Figure 4.16 shows the trend line of interest income from loan and advances of NABIL, EBL and LBL.

Figure 4.16

Trend values of Interest Income from LA of NPL of NABIL, EBL and LBL



4.8 Major Finding of the Study

The completion of basic analysis leads forward to the important task for the researcher which is to enlist the findings issues and gaps of the study. The findings of the study are derived of the basis of analyzing financial data of the sample bank NABIL, EBL and LBL are presented as follows:

- 1) EBL and NABIL banks have lowest credit risk. Lowest ratio indicates the bad performing of these two banks. They are unable to utilize their total assets as loan and advances. LBL is in better position among these three banks. LBL was able to utilize its assets in the form of loan and advances.
- 2) The mean ratio of loan & advances and investment to total deposit of whole NABIL, EBL and LBL bank is higher then 85%. That means loan & advances and investment to total deposit ratio of these commercial banks above the standard. They have lowest deposit expenses.
- 3) EBL and LBL are able to mobilize their deposit in right way. Their mean ratio is 74.30% and 77.40% respectively. These two banks are able to get more profit from their loan and advances. NABIL bank was unable to utilize its deposits among three banks.
- 4) EBL bank has lower CV among these three banks. EBL bank was success to collect non interest bearing deposit than other banks. LBL have lowest risk than other banks because its standard deviation is 1.4% which is lower than other banks, but its CV is higher.
- 5) Cash and bank balance to total deposit ratio of EBL is above 12% so they able to maintain their ratio. NABIL and LBL banks are lower than 12% ratio which indicated that those banks did not maintain their ratio.

- 6) NABIL bank was able to manage its deposit in lower cost. So that NABIL can use its deposit in efficiency way and get more profit. EBL have the average ratio. LBL bank has higher cost of deposit.
- 7) NABIL and EBL banks are able to manage their loan loss provision i.e. their ratio was less then 1% but LBL is unable to manage its loan and advances and makes effort for timely recover loan.
- 8) Loan and advances to total interest income ratio of NABIL, EBL and LBL was 68.44%, 75.38% and 92.49% respectively. NABIL have the lowest ratio among these three banks. NABIL bank was unable to get more income from their lending. EBL and LBL are success to utilize their lending for generating profit.
- 9) Interest suspense ratio LBL has the lowest ratio among these three banks. LBL bank was able to collecting more interest income from their lending. NABIL and EBL were unable to collected interest income for their landing. LBL is successfully generating profit among then other two banks.
- 10) NABIL and EBL bank have higher capital risk ratio. That means they are success to mobilize their capital fund. So that they are able to get high return from their capital fund. LBL has lowest capital risk ratios
- 11) NABIL and EBL bank was able to mobilize their assets effectively and they are able to get profit. NABIL return on assets higher then other commercial banks. LBL have the negative return from its assets.
- 12) The average mean return on loan and advances of NABIL, EBL and LBL are 6.81%, 6.96% and 10.32% respectively. LBL banks have the higher return from its loan. NABIL and EBL banks get more return from their loan.
- 13) NABIL and EBL are able to get highest profit in the study period. LBL was suffering for loss. LBL average net profit is negative. LBL was bearing loss in the year 2005 and 2006. It makes his net profit is negative.
- 14) NABIL and EBL bank was able to maintenance its NPL among the three commercial banks. Their NPL ratio is in decreasing trend but LBL was badly suffering from NPL from the last five year. NPL of LBL was above the international standard.
- 15) Priority sector lending was classified into five sectors. NABIL and EBL give main priority to lending in service sector. Domestic industries sector occupied second position. Agriculture occupied least among for lending.

- 16) According to the sectors wise lending area, major portion of the loan portfolio of these banks was distributed to production sector and wholesale and retail sector. Lending to wholesale and retailer was second choice of these banks in last five year. Services industries were able to tap some position of total loan and advances.
- 17) According to the securities wise lending area, main portion of the loan portfolio of the NABIL and EBL was distributed to guarantee to securities. Fixed account receipt was covering some portion of total loan. Government securities and non government securities were able to tap only few portions of total loan and advances.
- 18) It shows the high degree of positive coefficient of correlation(r) between two variable loan and advances and total deposit of these bank. NABIL, EBL and LBL are successful to grant loan and advances to mobilize the collected deposits in a proper way.
- 19) It shows the high degree of positive coefficient of correlation(r) between two variable loan and advances and interest income from loan and advances. There is also significant relation between loan and advances and interest income from loan and advances of NABIL, EBL and LBL banks. That means if loan and advances is increase then interest income from loan and advances also increase in same way.
- 20) Those three banks have high degree of positive relationship between two variable total deposit and net profit. NABIL, EBL and LBL are successful to grant their deposit to generate the profit in a proper way or there exists a significant relationship between total deposit and net profit of those banks. But LBL correlation(r) is lower than $6P.E(r)$ so LBL is unable to mobilize there deposit in proper way.
- 21) There are high degree of positive coefficient of correlation(r) between two variable total assets and net profit. It is also significant relation between two variables of NABIL, EBL and LBL banks. That means if total asset is increase then net profit also increase in same way.
- 22) Positive coefficient of correlation(r) shows that there is significant relationship between two variable loan and advance and net profit. NANIL, EBL and LBL are successful to grant their assets to generate the profit in a proper way or

there exists a significant relationship between total loan and advances and net profit of those banks.

- 23) NABIL, EBL and LBL have high degree of positive relationship between two variable total deposit and interest income. There is significant relation between them. If total deposits increase the interest income subsequently increased but when it is fall, the interest income also fell.
- 24) NABIL have high degree of positive relationship between two variable loan and advance and non-performing loan. If loan and advance increase then non-performing loan also increases of NABIL. Conclusion can be drawn that EBL and LBL are successful to grant their loan and advances to decrease their non-performing loan. But NBIL was unable to manage their loan and advances.
- 25) Regression equation of non-performing loan and advance on loan and advances of LBL is negative which reveals the negative relationship between these two variables. These negative relationship show the LBL bank is able to manage their loan and advance is effectively way. But other two banks regression is positive it indicates they are suffering form non-performing loan after five years.
- 26) The volume amount of deposit of all three commercial banks is in increasing trend. Total deposit position of EBL is comparatively lower than NABIL and is better in comparison to LBL. It shows the increasing trend of deposit make the more profit in coming future.
- 27) The volume amount of loan and advances of all three commercial banks is in increasing trend. Increasing trend of loan and advances indicates that in the future commercial banks are able to generate more profit from their lending activity. However, the growth rate is decreasing per year. The total loan and advance position of NABIL bank is better position then other two banks.
- 28) The value of non-performing loan is in increasing trend. This is the cause of increasing of loan and advances each year. In other side, the growth rate of NPL is in decreasing trend it show significant result. This will increase their profit and mobilization their assets efficiently.
- 29) The volume of interest income from loan and advances is increasing trend each year. In other side, the growth rate of interest income from loan and advance is decreasing trend per year. With the comparison today, if other

things remain same, the total interest income form loan and advances of NABIL, EBL and LBL is increasing trend.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

The fifth chapter includes summary, conclusion and recommendation based on their findings. After the basic analysis the most important remaining part is to summarize and recommend. These findings and recommendation are very useful to top management to execute the decision.

5.1 Summary

The developments of commercial and industrial sector open the door of prosperity in the country. Bank promotes development uplifting the activities related to the financial situation. The recent peace process and stability also assures the prosperity in the whole economy activity.

Bank always fits itself into a economy with an important role of capital provider. The main function of bank is lending and borrowing. But the things have changed. The modern banking system provides many more advanced and new facilities, so the function of commercial bank musty push the national economy, mobilize the collected fund, canalize into productive sectors. These can easily achieve investment objective of gaining maximum return.

The terms investment covers a wide area of money transactions. Simply it has a concept of income, saving and other collected funds. These activities fall under the bank. The income and profit of the bank depends upon its lending procedure, lending

policy and investment of its fund utilized in different securities. The high credit created by bank results in higher profitability. In a developing country like Nepal the must play and disburse facilities all parts of country.

The income and profit of the NABIL, EBL and LBL depends upon its lending procedure, lending policy and investment policy of its fund utilize in different sectors. NABIL, EBL and LBL aren't able to utilize its deposits properly i.e. providing loan and advances for a profitable project, the reason behind it is lack of sound lending policy. The main objective of study is evaluating lending policy adopted by commercial bank of Nepal.

The study, which researcher have chosen "Lending Policy and Practices of commercial bank in Nepal", researcher think that most of the research regarding the banking policy is founding normally moving around the principle aspect again and again rather then filtering the actual situation. Normally, this studies focus on the lending policy of commercial banks. Researcher had consulted many book, articles, booklets and searching related thin in the internet. Researcher under took verbal interviews with different person who are related financial and non-financial institutions. During the period, researcher summarized whole task in five chapters including this chapter.

Regarding the lending policies of commercial banks there are basically five basic principles of the commercial banks follow while proving loans. Those principles are Liquidity, Safety and Security, Suitability, Diversification and Profitability. The main objective of commercial banks is to generate profit by providing quality service to clients

5.2 Conclusion

Three commercial banks are selected for this study. The review of available literatures helped to conduct a sound methodology which's used for the analysis and interpretation of data. The three sample banks are NABIL, EBL and LBL secondary data are used as the sources of data.

EBL and NABIL banks have lowest credit risk. Lowest ratio indicates the bad performing of these two banks. They are unable to utilize their total assets as loan and

advances. LBL is in better position among these three banks. LBL was able to utilize its assets in the form of loan and advances. The mean ratio of loan & advances and investment to total deposit of whole NABIL, EBL and LBL bank is higher than 85%. That means loan & advances and investment to total deposit ratio of these commercial banks above the standard. They have lowest deposit expenses. EBL and LBL are able to mobilize their deposit in right way. Their mean ratio is 74.30% and 77.40% respectively. These two banks are able to get more profit from their loan and advances. NABIL bank was unable to utilize its deposits among three banks. EBL bank has lower CV among these three banks. EBL banks were success to collect non interest bearing deposit than other banks. LBL have lowest risk than other banks because its standard deviation is 1.4% which is lower than other banks, but its CV is higher. Cash and bank balance to total deposit ratio of EBL is above 12% so they able to maintain their ratio. NABIL and LBL banks are lower than 12% ratio which indicated that those banks did not maintain their ratio.

NABIL bank was able to manage its deposit in lower cost. So that NABIL can use its deposit in efficiency way and get more profit. EBL have the average ratio. LBL bank has higher cost of deposit. NABIL and EBL banks are able to manage their loan loss provision i.e. their ratio was less than 1% but LBL is unable to manage its loan and advances and makes effort for timely recover loan. Loan and advances to total interest income ratio of NABIL, EBL and LBL was 68.44%, 75.38% and 92.49% respectively. NABIL have the lowest ratio among those three banks. NABIL bank was unable to get more income from their lending. EBL and LBL are success to utilize their lending for generating profit. Interest suspense ratio LBL has the lowest ratio among these three banks. LBL bank was able to collecting more interest income from their lending. NABIL and EBL were unable to collected interest income for their landing. LBL is successfully generating profit among then other two banks. NABIL and EBL bank have higher capital risk ratio. That means they are successfully mobilized their capital fund, So that they are able to get high return from their capital fund. LBL has lowest capital risk ratios NABIL and EBL bank was able to mobilize their assets effectively and they are able to get profit. NABIL return on assets higher than other commercial banks. LBL have the negative return from its assets.

The average mean return on loan and advances of NABIL, EBL and LBL are 6.81%, 6.96% and 10.32% respectively. LBL banks have the higher return from its loan. NABIL and EBL banks get more return from their loan. NABIL and EBL are able to get highest profit in the study period. LBL was suffering for loss. LBL average net profit is negative. LBL was bearing loss in the year 2005 and 2006. It makes his net profit is negative. NABIL and EBL bank was able to maintenance its NPL among the three commercial banks. Their NPL ratio is in decreasing trend but LBL was badly suffering from NPL from the last five year. NPL of LBL was above the international standard. Priority sector lending was classified into five sectors.

NABIL and EBL give main priority to lending in service sector. Domestic industries sector occupied second position. Agriculture occupied least among for lending. According to the sectors wise lending area, major portion of the loan portfolio of these banks was distributed to production sector and wholesale and retail sector. Lending to wholesale and retailer was second choice of these banks in last five year. Services industries were able to tap some position of total loan and advances. According to the securities wise lending area, main portion of the loan portfolio of the NABIL and EBL was distributed to guarantee to securities. Fixed account receipt was covering some portion of total loan. Government securities and non government securities were able to tap only few portions of total loan and advances.

It shows the high degree of positive coefficient of correlation(r) between two variable loan and advances and total deposit of these bank. NABIL, EBL and LBL are successful to grant loan and advances to mobilize the collected deposits in a proper way. It shows the high degree of positive coefficient of correlation(r) between two variable loan and advances and interest income from loan and advances. There is also significant relation between loan and advances and interest income from loan and advances of NABIL, EBL and LBL banks. That means if loan and advances is increase then interest income from loan and advances also increase in same way. Those three banks have high degree of positive relationship between two variable total deposit and net profit. NABIL, EBL and LBL are successful to grant their deposit to generate the profit in a proper way or there exists a significant relationship between total deposit and net profit of those banks. But LBL correlation(r) is lower than $6P.E(r)$ so LBL is unable to mobilize there deposit in proper way. There are high

degree of positive coefficient of correlation(r) between two variable total assets and net profit. It is also significant relation between two variables of NABIL, EBL and LBL banks. That means if total asset is increase then net profit also increase in same way. Positive coefficient of correlation(r) shows that there is significant relationship between two variable loan and advance and net profit. NABIL, EBL and LBL are successful to grant their assets to generate the profit in a proper way or there exists a significant relationship between total loan and advances and net profit of those banks. NABIL, EBL and LBL have high degree of positive relationship between two variable total deposit and interest income. There is significant relation between them. If total deposits increase the interest income subsequently increased but when it is fall, the interest income also fell. NABIL have high degree of positive relationship between two variable loan and advance and non-performing loan. If loan and advance increase then non-performing loan also increases of NABIL. Conclusion can be drawn that EBL and LBL are successful to grant their loan and advances to decrease their non-performing loan. But NABIL was unable to manage their loan and advances.

Regression equation of non-performing loan and advance on loan and advances of LBL is negative which reveals the negative relationship between these two variables. These negative relationship show the LBL bank is able to manage their loan and advance is effectively way. But other two banks regression is positive it indicates they are suffering form non-performing loan after five years.

The volume amount of deposit of all three commercial banks is in increasing trend. Total deposit position of EBL is comparatively lower than NABIL and is better in comparison to LBL. It shows the increasing trend of deposit make the more profit in coming future. The volume amount of loan and advances of all three commercial banks is in increasing trend. Increasing trend of loan and advances indicates that in the future commercial banks are able to generate more profit from their lending activity. However, the growth rate is decreasing per year. The total loan and advance position of NABIL bank is better position then other two banks. The value of non-performing loan is in increasing trend. This is the cause of increasing of loan and advances each year. In other side, the growth rate of NPL is in decreasing trend it show significant result. This will increase their profit and mobilization their assets efficiently. The volume of interest income from loan and advances is increasing trend

each year. In other side, the growth rate of interest income from loan and advance is decreasing trend per year. With the comparison today, if other things remain same, the total interest income form loan and advances of NABIL, EBL and LBL is increasing trend.

5.3 Recommendations

Recommendation refers to the suggestive measures derived from the findings of the study. On the basis of core analysis and findings the following recommendation can be useful to overcome the weaknesses and inefficiency of the sample banks NABIL, EBL and LBL. It also helps to improve the present fund mobilization and investment policy of NABIL, EBL and LBL.

-) NABIL bank lending was found poor then other two banks. So that NABIL bank has to utilize its deposit in the form of lending. On the other hand NABIL and EBL didn't seem good performance in mobilize there assets so we recommended that they mobilize there assets and get more profit but LBL was success to mobilize its total assets and get more profit.
-) LBL banks non-performing loan was found higher then international standard. It is advices that before providing the loan make sure that your clients is good character and able to repay its loan or may take the good collateral which is nearly two time more than your guaranteed.
-) Cash and bank balance to total deposit ratio of NABIL and LBL banks are lower than 12% which indicated that those banks did not maintain their ratio and liquidity position. We suggest that increase there cash and banks balance to meat daily cash need.
-) LBL have the negative return from its assets. Which affected by net profit so we recommend that LBL proper use assets to get more profit.
-) An interest expense of deposit of these banks was found high. So that EBL and LBL banks have to collect more non-interest bearing deposit to decrease their interest expenses.
-) LBL bank interest income form loan and advance to interest income ratio was found good. But its net profit was negative or very poor. So that they have to reduce their operation cost of loan and advance and NPL. Its increase their net profit.

-) Average profit of these banks is not satisfactory. If resources held idle, bank have to beard more cost and result would be lower profit margin. So portfolio condition of bank should be regularly revised from time to time. It should always try to maintain the equilibrium in the portfolio condition of the banks. These banks should use its funds in more portfolio sectors. It should utilize its risky assets and other funds and it should its express should try to collect cheaper fund.
-) The proportion of lending made by three banks in agriculture and domestic industries sector is decreasing despite increasing volume in LA of these banks. Since, the prosperity of national economy is highly dependent upon this sector, banks are recommended to increase its volume of lending in those sectors.
-) Deposit collection was in increasing trend. So that NABIL, EBL and LBL bank should be find out the new area for lending and investing to utilize their deposit. Otherwise they have to bear high deposit expenses in near future, which decrease there profit.