

**LENDING POLICY OF NEPALESE COMMERCIAL BANKS
(A CASE OF NEPAL INDUSTRIAL AND COMMERICAL BANK
LIMITED & HIMALAYAN BANK LIMITED)**

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RECOMMENDATION
This is to certify that the thesis

Submitted by:
NAWARAJ THAPA MAGAR

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

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*And found the thesis to be the original work of the student and written
according to the prescribed format. We recommend the thesis to be
accepted as partial fulfillment of the requirement for the degree of*

Master of Business Studies (MBS)

Viva-Voce Committee

Head, Research Department

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Member (External Expert)

DECLARATION

I hereby declare that the work reported in this thesis entitled “**Lending Policy of Nepalese Commercial Banks (A Case of Nepal Industrial and Commercial Bank Limited & Himalayan Bank Limited)**” submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of Master of Business Studies (MBS) under the supervision of **Lecturer Triratna Manadhar** of Shanker Dev Campus, T.U.

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Chapter I

Introduction

1.1 General Background

Lending simply means giving or allowing the use of temporarily on the condition that the same or equivalent will be returned back. In other words, Lending is providing (money or property) temporarily on condition that the amount/property borrowed is returned usually with interest fee. Similarly, lending means to allow someone to have possession of something on the understanding that is later returned in the same of equivalent form. In term of banking, lending refers granting the use of money by undertaking some assets as collateral which has to be repaid back with interest on or before a fixed date.

Lending is not only the most important function of banks; it also determines the future of banking institutions. The quality of loan, quality of borrower and quality of securities determines the health of any bank. The efficiency of a bank lies in how it multiplies the deposits of depositors. Hence, lending should be accompanied by some basic principles and practices. No banker would willingly give a loan, unless he has sufficient confidence in the borrower. Safety of funds, liquidity of funds, purpose of loan, security of loan, profitability spread of loan portfolio and compliance with national interests are some of the principles that a banker should follow while granting a loan. Lending policy also affects the profitability of a bank. If there is efficient lending policy, the bank will easily recover its loan and advances on due dates.

If bank's lending policy is efficient, it will gain interest that will grow the income of the bank. The interest incomes, which are gained from loan and advances directly affect the profit of the bank. So the profitability of bank largely depends on its lending policy.

Loans and advances are the most profitable of all the assets of a bank. Banks universally seek after the assets. These assets constitute primary source of income to banks. Here the banker is brought into direct relation with the public. His capacity and judgment and his usefulness to the community is judged by the way he leads the money left with him by the depositors. As a business institution, a bank aims at making a huge profit. Since loans and advances are more profitable than any other assets, he is willing to lend as much as of his funds as possible. But he has to be careful about the safety of such advances. The banker has to temper liberality with the

caution. If he is too liberal, he may easily impair his profits by bad debts and if he is too timid, he may fail to obtain an adequate return of the funds, which are confided to him for use. It is by his capacity in lending that a bank manager is judged.

Economic development of a country is impossible without the development of different sectors like agriculture, industry, trade, tourism etc. and development of these sectors needs a regular supply of financial resources. In developing countries there is always shortage of the capital for the development activities. It is not possible to handle and develop all the sectors by the government alone at a time. So, contribution from people in financial sector is a must for economic growth of a country.

Nepalese financial sector is largely dominated by the banking sector. It has been known for long that banking sector is the lifeline of a nation and its people. Banks play a vital role in the economic growth of a country. Banking, when properly organized, aids and facilitates the growth of trade and industry. In modern economy, banks are considered not as dealers in money but as the leaders of development. Banks are not just the storehouse of the country's wealth but are the reservoirs of resources necessary for economic development. Banks render valuable services to trade and industry. Banks help in the uniform development of the different regions in the country.

Banking concept has existed even in the ancient period when the goldsmith and the rich people used the receipts to common people promising of safekeeping of their valuable items and to return on the presentation of the receipts. The depositors would get back their gold and valuable after paying a small amount for safekeeping and saving.

Commercial banks are an integral part of the economy in all countries. They are the heart of financial sectors, which occupy an important place in the framework of the economy. They hold deposits of people, government and business units. They make funds available through their lending and investment activities to individuals, business and government sector. So, as they provide capital for the development of the industry, trade, business and services, they contribute a large portion to the economic growth of the nation. A healthy development of any commercial

bank depends upon its investment and lending policy. The sound policies help commercial banks to maximize quality of investment and achieve own objectives of profit maximization and social welfare. Such policy provides the bank several inputs through which they can handle their investment operation efficiently ensuring the maximum return with minimum exposure to risk, which ultimately leads the bank to the path of success. Thus, formulation of sound investment policies, efficient lending, coordination and planned efforts accelerate the pace of economic growth.

The essential functions of commercial banks may be summarized as borrowing and lending of money. They borrow money by taking all kinds of deposit and provide this money to those who are in need of it by granting overdrafts or fixed loan and by discounting bills of exchange or promissory notes. The pace of time has changed the portfolio of banking business from its primary functions. Nevertheless, the importance of lending in banking business is undoubtedly remained vital as it was in early days of this business. The classical economic functions of the bank and other financial intermediaries all over the world have remained virtually unchanged in modern times. What has been changed are the institutional structure, the instrument and the techniques used in performing those functions.

Investment in financial sense is placing of money in order for their use expecting a return or the participation in expected profits. But for manufacturing and trading firms the terms investment will be long term expenditures that aim at increasing return of efficiency or at building up goodwill thereby producing and increasing return over as period. Investment also seeks to manage their wealth effectively obtaining the most from it, while protecting it from inflation, taxes and other risks.

Investment by individuals, business and government involves a present sacrifice of income to get on expected on future benefit as a result investment raises an economy of nations. Investment usually involves putting money into a bet, which is not necessarily marketable in order to enjoy a series of return the investment is expected to yield. On the other hand speculation is usually a shorter run phenomenon. Speculators tend to buy assets with the expecting of a profit than can be earned from subsequent price change and sale. Investments are usually made expecting a certain stream of income, which has existed, will not change in the future.

Lending

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Evolution of Money and Bank

As a public enterprise, banking made its first beginning around the middle of 12th century in Italy and the bank of Venice founded in 1157 was the first public banking institution. Following then after Bank of Barcelona and Bank of Genoa were established in 1401 and 1407 respectively. The Bank of Venice and the Bank of Genoa continued to operate until the eighteenth century. With the expansion of commercial activities in northern Europe, there sprung up a number of private banking houses in Europe and slowly it spread throughout the world. In Nepal, modern banking started from the establishment of Nepal Bank Ltd.

In Nepal, development of banking is relatively recent. The record of banking system in Nepal gives detail account of mixture of slow and steady evolution in the financial and global economy of Nepalese life. Involvement of landlord, rich merchants shopkeepers and other individual money holder has acted as fence to institutional credit in presence of unorganized money market. In Nepalese chronicle it was recorded that the new era known as *Nepal Sambat* was introduced by Shankhadhar, a Sudra merchant of Kantipur in 879 or 880 A.D after having paid all the outstanding debts in the country. This shows the basic of money lending practice in ancient Nepal. Towards the end of 8th century, Malla King Gunkamdev had borrowed money to rebuild the Kathmandu valley. Malla regime was an evidence of banking activities. It is believed that financing for foreign trade with Tibet became quite popular during the regime of Malla. However the absence of regulatory measures, money lenders were known to have charged high rate of interest and extra on loans.

When "*Tejarath Adda*" established during the year 1877 A.D., it played vital role in banking system as regulatory and promotional organ. It helped the general public to provide credit facilities at a very low rate of 5% especially on the collateral of gold and silver. Hence the establishment of *Tejarath Adda* could be regard as pioneer foundation of banking in Nepal. The main defect of this institution sougheed as there were no other financial institutions set up and no effort to expand the services. Above all of defects the '*Adda*' didn't accept any deposit form public. After that again for a long time, several unorganized bankers continued to flourish as the sole provider of credit and services to the general public.

At the same time, the government started trade with India and Tibet and hence, the need of banking institution realized. This was strongly supported by the situation caused during 1934 A.D. earthquake where there was need of finance for reconstruction of KTM. During the year 1934 AD, first commercial bank of Nepal, Nepal Bank Ltd

established with the imperial Bank of India into existence under Nepal Bank act 1937 inaugurated by king Tribhuwan on November 1937. Nepal Rastra Bank, the central Bank of Nepal came into existence in 1956 under the Nepal Rastra Bank act 1955.

Rastriya Banijya Bank, the second commercial bank was established in 1965, being a largest commercial bank plays a major role in the economy, and the financial shapes of two old banks have a tremendous impact on the economy. That is reason why these banks still exist in spite of their bad position.

According to section 2 (a) of commercial bank act 1974 A.D. with opening of NABIL Bank in 1985 the door of opening commercial bank was opened to the private sector as the commercial bank grew up they stopped entertaining small project. Thus, scope of finance company emerged. Though in 2042 B.S. finance company act passed but private sector remained stonily silent till 2049 B.S. Nepal Housing and development finance company broke up the stonily silence on Shrawan 2049 B.S. The second came Nepal finance and saving company in Poush of same year. As of Ashad End 2069, altogether there are 32 Commercial Banks , 87 Development Banks, 79 Financial Institute, 16 Cooperatives (limited bank transaction only), 21 Micro Financial Dev. Bank and 36 NGOs (micro credit trans. only as of Chaitra 2067).

1.1.1 Brief Introduction of Concerned Banks

Nepal Industrial and Commercial Bank Ltd. (NIC Bank) commenced its operation on 21 July 1998 from Biratnagar. The Bank was promoted by some of the prominent business houses of the country. NIC Bank has an Authorized Capital of Rs. 1,600 million with paid-up capital of Rs. 1,311.55 million. The promoter group holds 51 % of paid-up capital amounting to Rs. 668.89 and remaining 49% amounting to Rs. 642.66 is held by the general public. The shares are listed with Nepal Stock Exchange. NIC Bank has over 34,000 shareholders. The shares of the Bank are actively traded in Nepal Stock Exchange with current market capitalization of about NPR 10,493 million.

NIC Bank was the first commercial bank in Nepal to have received ISO 9001:2000 certification for its Quality Management System standard in the year 2006. The Bank has recently been certified under the upgraded ISO 9001:2008 standards for the Bank's Quality System on Commercial Banking Activities for the first time in Nepal. Furthermore, NIC Bank became the 1st Bank in Nepal to be provided a line of credit by International Finance Corporation (IFC), an arm of World Bank Group under its Global Trade Finance Program, enabling the Bank's Letter of Credit and Guarantee to be accepted/ confirmed by more than 200 banks worldwide.

Reports Relating to NIC Bank:

Nepal Industrial & Commercial Bank Limited (NIC Bank) commenced its operation on 21 July 1998 from Biratnagar. The Bank was promoted by some of the prominent business houses of the country. The current shareholding pattern of the Bank constitutes of promoters holding 51% of the shares while 49% is held by the general public. NIC Bank has over 34,000 shareholders. The shares of the Bank are actively traded in Nepal Stock Exchange with current market capitalization of about NPR 10,493 million.

The Bank has grown rapidly with 36 branches throughout the country while several branches are planned to be opened this year. All branches are inter-connected through optical fiber as well as V-Sat and are capable of

providing real time on-line transactions.

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Himalayan Bank Ltd. (HBL) was established in 1993 in joint venture with Habib Bank Limited of Pakistan. Despite of the cut-throat competition in the Nepalese Banking sector, Himalayan Bank has been able to maintain a lead in the primary banking activities- Loans and Deposits. The first commercial bank of Nepal with maximum shareholding by the Nepalese private sector, was incorporated in 2049 (1992) by a few distinguished business personalities of Nepal in partnership with Employees Provident Fund and Habib Bank Ltd., one of the largest commercial banks of Pakistan. Besides commercial activities, the bank also offers industrial and merchant banking. The bank started its operation with the authorized capital of Rs. 100 million, issued capital of Rs. 65 million and paid up capital of Rs. 42.9 million.

Corporate Social Responsibility (CSR) holds one of the very important aspects of HBL. Being one of the corporate citizens of the country, HBL has always promoted social activities. Many activities that do a common good to the society have been undertaken by HBL in the past and this happens as HBL on an ongoing basis. Significant portion of the sponsorship budget of the Bank is committed towards activities that assist the society at large.

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Legacy of Himalayan lives on in an institution that's known throughout Nepal for its innovative approaches to merchandising and customer service. Products such as Premium Savings Account, HBL Proprietary Card and Millionaire Deposit Scheme besides services such as ATMs and Tele-banking were first introduced by HBL. Therefore, HBL stands for the innovations that bring

about in this country to help Customers besides modernizing the banking sector. With the highest deposit base and loan portfolio amongst private sector banks and extending guarantees to correspondent banks covering exposure of other local banks under HBL's credit standing with foreign correspondent banks.

All Branches of HBL are integrated into Globus (developed by Temenos), the single Banking software where the Bank has made substantial investments. This has helped the Bank provide services like 'Any Branch Banking Facility', Internet Banking and SMS Banking. Living up to the expectations and aspirations of the Customers and other stakeholders of being innovative, HBL very recently introduced several new products and services. Millionaire Deposit Scheme, Small Business Enterprises Loan, Pre-paid Visa Card, International Travel Quota Credit Card, Consumer Finance through Credit Card and online TOEFL, SAT, IELTS, etc. fee payment facility are some of the products and services. HBL also has a dedicated offsite 'Disaster Recovery Management System'. Looking at the number of Nepalese workers abroad and their need for formal money transfer channel; HBL has developed exclusive and proprietary online money transfer software- HimalRemitTM. By deputing own staff with technical tie-ups with local exchange houses and banks, in the Middle East and Gulf region, HBL is the biggest inward remittance handling Bank in Nepal. All this only reflects that HBL has an outside-in rather than inside-out approach where Customers' needs and wants stand first.

1.2 Statement of problem

After 2046 B.S. government has adopted privatization and liberalization policy. Due to that policy, in these days commercial banks, development banks and other financial companies are commencing its operation in increasing. Thus, to establish sound lending policy is a major issue in commercial banking sector during these days.

The core banking business is mobilizing the deposit and utilizing it for lending to industry. Lending business is generally encouraged because it has the effect of funds being transferred from the system to productive purposes that result into economic growth. However, lending also carries credit risk, which arises from the failure of borrow to fulfill its contractual obligation during the course of transactions.

Lending is the major source and building better lending position is the major strategy of every commercial bank. It is necessary to assess the appropriate lending policy in commercial banks for performance effectiveness. There is lack of such scientific and empirical research that could identify the issues of lending policy of commercial banks. In this regard, the performance of Nepalese commercial banks is to be analyzed in terms of their credit.

A very unhealthy activity is happening in the banking business. After the loan is provided by the bank, regular inspection and monitoring are not made to know whether the debtor has used the loan in productive or not. Due to This reasons, there is great amount of unrecovered bank loan. Banks only depend upon the direction and guidelines of Nepal Rastra Bank but they don't have clear view and have not formulated their own organized Lending policy.

The main focus of this study will be towards the Lending practices of the banks. They are Himalayan Banks Ltd. and Nepal Industrial and Commercial Bank Ltd. These studies basically deal with the following issues of the banks.

- a. Are the available fund properly utilized or not?
- b. What is the relationship between total investment, deposit, loan & advance and net profit?
- c. What is the position of return on Loan and Advance, Total Working Fund and Equity etc.?
- d. What is the position of Growth rate of total deposit, loan and advance, total investment and net profit?
- e. What is the position of Trend of deposit, loan and advance, investment and net profit?

1.3 Objectives of the study

The basic objective of this study will focus on the lending policy and strategy follow by the bank with reference to Himalayan Bank Ltd. and NIC Bank Ltd. Specifically, this study focuses on following:

- a. To analyze the trend of deposits, investments, net profit, and loan and advances.
- b. To examine the asset utilization system, profitability and risk position of commercial banks under study.
- c. To assess the deposit utilization trends and its projection for the future.
- d. To evaluate the growth ratios of loan and advances and total investment with respective growth rate of total deposit and net profit.

1.4 Scope of the Study

In the context of Nepal, there is less availability of research works, journals and articles in the field of Lending policy and activities of commercial banks as well as other financial institutions. As it is a well known fact that the commercial banks can affect the economic condition of the whole country, the effort is made to highlight the lending policy of commercial banks expecting that the study can bridge gap between deposits and lending activities. On the other hand, the study would provide information to the management of the bank that would help them to take corrective action. Further, this study can also be used as reference material by the shareholders, investors, researchers, government organizations and non-government organizations.

1.5 Significance of the study

Suitable strategy plays vital role in a bank for their sustain existence. The study will be helpful to aware the shareholder regarding lending policies of their banks. This study of **Lending Policy of Nepalese Commercial Banks (A Case of Nepal Industrial and Commercial Bank Limited and Himalayan Bank Limited)** in reference to two major banks will provide a useful feedback to academic institutions, bank employees, trainees, investors, policy making bodies, and those concerned with banks in the formulation of appropriate strategies for improving the performance of banks.

1.6 Limitation of the study

These studies will simply a study for the partial fulfillment of MBS degree, which has to be finished within a short span of time. This is not far from several limitations, which weaken the objective of the study. In order to make study more specific, the study has been conducted with few limitations while conducting it can be disclosed as below:

- a. The secondary data of the latest 5 years are only taken into consideration and hence conclusion drawn confines to the limited period only.
- b. Since the study is based upon the secondary data provided by the concerned bank the findings are more or less the approximate due to unavailability of primary data.
- c. Out of the numerous affecting factors only those factors related with lending activities are considered.
- d. Out of 32 commercial banks, only 2 banks are taken into account to do the comparative study. Hence, the findings cannot be generalized to all commercial bank.
- e. In this study only selected tools and technique are used.

1.7 Research Methodology

Nature of study

The structure of this research will construct by both the descriptive and explanatory design. The research design is basically descriptive. Ratio Analysis, Correlation Analysis and Comparative Analysis of the ratios have been done for analyzing the results. Explanatory design will followed by review of past journals, books and annual reports as well as related schedules and consultation with bank's official to suffice the quantitative and qualitative information regarding the stated objectives.

Tools Used

Some simple statistical tools – such as diagrams, tables, charts, etc. - have been used during the course of study. Likewise, accounting tools and statistical tools such as ratio analysis, correlation analyses etc have also been used. Besides, some rapid appraisal techniques – such as semi-structured and key informant interviews, cause and effect analysis, etc. - have also been used to gather qualitative information from different individuals, including government officials, financial sector professionals, business organizations, non-governmental organizations, among others.

Primary Information and Data Sources

Primary information and data have been gathered from different financial sector professionals and institutions.

Secondary Information and Data Sources

Secondary information and data have mostly been gathered from www.nrb.org.np, website of related banks, other relevant websites, different relevant financial institutions like commercial banks, the BIS. Likewise, information and data have also been collected and assimilated from relevant past thesis, reports and research works.

1.8 Organization of the study

This study organized into five sections, each section deals with the specific aspects of the study that will be as follows:

Chapter I: Introduction

The first chapter will be introductory chapter which contains the following topics:

1. General Background
2. Statement of the Problem
3. Objectives of the Study
4. Scope of the Study
5. Significance of Study
6. Limitations of the Study
7. Organization of the Study

Chapter II: Review of Literature

The second chapters will Review of Literature which deals with the study of related articles, journals, and reports. This chapter includes following topics:

1. Conceptual/Theoretical Review
2. Review of Books and Articles
3. Review of Thesis
4. Research Gap

Chapter III: Research Methodology

This chapter will deals with the research methodology used in this study. The third chapter concentrates on Research Methodology i.e. techniques that are applied to collect and analyze the data. It consists of the following topics:

1. Introduction
2. Research Design
3. Nature and Source of Data
4. Data Collection Procedure
5. The Population and Sample
6. Analysis of Data

Chapter IV: Data Presentation and Analysis

The fourth chapter will be Presentation and Analysis of Data, which consists of financial tools and statistical tools used in the analysis of data. Financial tool mainly consists of ratio analysis, which involves liquidity ratio, asset management ratio, profitability ratio, risk ratio, and growth ratio. Statistical tools used in the analysis of data involve co-relation analysis, trend analysis, and test of hypothesis. This chapter will also provide major findings of the study.

1. Analysis of financial ratio
2. Analysis of statistical tools

Chapter V: Conclusions and Recommendations

The fifth chapter, which will be also the concluding chapter, covers Summary, Conclusion and Recommendation, and provides some valuable suggestions to the selected Banks. The major findings of the study have been presented in brief for convenience of the readers and implication of such findings has been stated as recommendation. This section will also incorporate an outlet for future research.

Chapter II

Review of Literature

This chapter is basically concerned with review of literature relevant to lending and investment policy of commercial bank in Nepal. Review of literature is the process of learning and understanding the concept of related area thoroughly. Every study is very much based on the past knowledge. The previous study cannot be ignored because they provide the foundation to the present study. This chapter provides knowledge about the development and progress made by the earlier scholars on the concerned field of study. It also establishes the study as a link in a chain of resource that is developing and emerging knowledge about concern field. Review of literature is basically a stock of available literature in the field of research. Therefore, this chapter has its own importance in this study. There must be continuity in research. This continuity in research is ensured by linking the present study with past research studies. This chapter highlights the literature that is available in concerned subject, research works, and relevant study on this topic, review of journals and articles and review of thesis work performed previously.

This chapter consists of four different sections. The *First Section* is the Conceptual/Theoretical Review, the *Second Section* consists of the Review Books and Articles the *Section Third* finally represents the Review of Thesis and the Section Fourth is the Research Gap.

2.1. Conceptual/Theoretical Review

Theoretical review presents the theoretical aspect of the study which is used to define the concept & meanings of different related terminology whereas research review focuses on the review of relevant past studies. It includes the meaning and Definition of Loan/Lending, Concept of Commercial Banks, NRB directives for investment policy, Concept and Characteristics of sound Lending and Investment Policy and Meaning of Some Important Terminology related to the study.

2.1.1 Meaning and Definition of Loan/Lending

“Lending is the essence of commercial banking; consequently the formulation and implementation of sound lending are among the next important responsibilities of bank 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 interest in any extension of credit. Of course, one primary functions of development in banking is deposit mobilization. Without the deposits coming from the public and savers bank will not have the resources to lend. With adequate resources, lending can have a wider average to meet the credit needs of all the sectors of the economy. Deposit and credit operate always together and each is interconnected. Unless there are advances, deposit cannot rise.” (Rao,1984).

“Loans are promises for future payments. When a banker makes an advance in a lump sum, which cannot be paid wholly or partly, and which the customer has permission to withdraw subsequently, it is called a loan. If the customer repays it, either wholly or partly, and wishes to have subsequent accommodation, the latter will be treated as a separate transaction to be entered into if the bank agrees to do so, and subject to such terms as it may want to impose.” (Srivastava, 2000).

“In the case in hand, there cannot be any dispute that the expression debt has to be given the widest amplitude to mean any liability which is alleged as dues from any person by a bank during the course of any business activities undertaken by the bank either in cash or otherwise, whether secured or unsecured, whether payable under a degree of order of any court or otherwise and legally recoverable on the date of application.”(Gupta, 2002).

“Loan is defined as a thing that is lent, specially a sum of money. Likewise debt means a sum of money owed to somebody. However in financial terms loans or debt means principal or interest available to the borrowers against the security. Debt means money that bank owes or will lend to individual or person.” (Ghimire, 2005)

Likewise the term loan is defined as a lending. Delivery by one party and received by another party, a sum of money upon agreement expressed or implied to repay it with or without interest. Anything furnished for temporary use to a person at his request, on that condition it shall be returned or its equivalent in kind, with or without compensation for its use. Loan includes:

- a) The creation of debt by the lenders payment of agreement to pay money to the debtor or to a third party.
- b) The creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately.
- c) The creation of debt pursuant to a lender credit card or similar arrangement.
- d) The forbearance of debt arising from a loan.

Further, the study added “debt means principal and interest provided to debtors by bank or financial institutions, with the pledge of immovable or movable property or other security or guarantee or without guarantee and the word also means over dues of the transaction beyond balance or fees, commission and interest incurred in that relation”. (Ghimire, 2005)

2.1.2. Concept of Commercial Bank

"Commercial Bank is a corporation which accepts demand deposits subject to check and makes short-term loans to business enterprises, regardless of the scope of its other services". (American Institute of Banking; 1972)

Commercial Bank Act 1975 AD defines, "A commercial bank is one which exchange money, deposits money, accepts deposits, grants loans and performs commercial banking functions and which is not a bank meant for co-operative, agriculture, industries or for such specific purpose".

Banks play an important role in the economic growth of any country. Banking, when properly organized, aids and facilitates the growth of trade and industry and hence of national economy. In the modern economy, banks are to be considered not as dealers but as the leaders of development. Banks are not just the storehouses of country's wealth but are the reservoirs of resources necessary for the economic development. Commercial banks are those financial institutions which play the role of financial intermediary in collection and disbursement of funds from surplus unit to deficit unit.

The function of commercial bank could be defined as to mobilize its deposits and other funds to profitable, secured and marketable sector so that it can earn good profit as well as it should be secured and can be converted into cash whenever needed. The main function of commercial bank is concerned with the accumulation of the temporarily idle money of the general public to advance it to deficit sections i.e. trade and commerce for expenditure. Its main functions are:

-) Accepting various types of deposits
-) Lending money in various productive sectors
-) Advancing Credits
-) Agency Services
-) Financing of Foreign Trade
-) Exchange foreign currency
-) Letter of credit (LC)
-) Guarantee
-) Remittance
-) Bills
-) Others

Hence, a commercial bank can be defined as a "Financial departmental store", which renders a host of financial services besides taking deposits and giving loans.

2.1.3 NRB Directives for Lending Policy

The following directives have been issued with regard to investment of financial resources of a licensed institution having exercised the powers conferred by Section 79 of the Nepal Rastra Bank Act, 2002.

i. Implementation of Investment Policy and Procedures upon Approval

The licensed institutions shall implement the policies and procedures regarding the investment in Government of Nepal securities, Nepal Rastra Bank bonds, and other corporate bodies' share and debentures only upon the approval of investment policy and procedures by the Board of Directors.

ii. Provision for Investment in Government of Nepal Securities and Nepal Rastra Bank Bonds:

There shall be no restriction as to investment by the licensed institutions in the securities of Government of Nepal and Nepal Rastra Bank bonds.

iii. Provisions for Investment in Shares and Debenture of Corporate Bodies

) Licensed Institutions shall invest only in the shares and debentures of corporate bodies listed in the Nepal Stock Exchange after the public issues of shares. Provided that, where the investment has been made in the shares and debentures of corporate bodies which are not listed in the stock exchange, and if such listing is not completed within one year from the date of investment, a provision of equivalent to the whole amount of such investment be provided and credited to Investment Adjustment Reserve by creating such reserve fund. The outstanding amount in such Reserve shall not be utilized for any other purpose till the said shares and securities of the corporate body are listed. With respect to investment in newly opened corporate body that where such company is not listed in stock exchange within two years from the date of operation or investment being made, a provision of equivalent to the whole amount of such investment be provided and credited to Investment Adjustment Reserve.

) While carrying out projects such as land development, land purchase and housing construction for residential purpose and sale and management of such houses and land pursuant to clause (ad) of sub-Section (2) of Section 47 of the Banks and Financial Institutions Act, 2006 by the class "B" licensed institutions and pursuant to clause (u) of sub-Section (3) of the same Section of the same Act, licensed institution shall not invest more than twenty-five percent of the core capital of immediately preceding month.

-) While investing in housing construction and land development by a licensed institution, it may invest an amount not exceeding ten percent of the core capital maintained immediately preceding month. If found to have been invested more than the limit, the core capital shall be maintained having deducted the amount equal to the exceeded investment from the core capital. While making such investment, investment shall be made only in the building construction and land development companies that have been incorporated as public companies.
-) Licensed institutions may invest in shares and securities of any one corporate body up to 10 percent of its core capital maintained at immediately preceding trimester and not exceeding the cumulative amount of such investment in all the companies by more than 30 percent of its core capital. Similarly, while investing in shares and debentures of corporate bodies by a licensed institution, investment shall be made not exceeding 10 percent of the paid up capital of the institution in which the investment is being made and not exceeding 25 percent of the same in case of investment made in class "D" institutions. Any amount of investment made in excess of this limit, for the purpose of calculation of the capital fund, shall be deducted from the Core capital fund.
-) Chairperson/member of a parent company shall not be allowed to be the chairperson or number of the subsidiary company. In case of Directors who are Directors in the subsidiary company prior to issuance of these Directives on May 10, 2010, he/she shall have to move from it before the upcoming first general meeting of the parent company or within one year of issuance of this directive, whichever is earlier.

iv. Arrangement for Underwriting of Share and Debentures

-) For "A" Class licensed institutions, there is no limit prescribed for underwriting the shares and debentures. In respect of "B" and "C" Class financial institutions, they may underwrite to the extent of their core capital as follows:

Class of Licensed Institution	Any one organized Institution	All corporate bodies (Cumulative)
"B" Class	Up to 20 percent of its	Up to 100 percent of its

	core capital	core capital
"C" Class	Up to 10 percent of its core capital	Up to 50 percent of its core capital

Provided that, in case the class "B" and "C" licensed institution is going to underwrite shares and debentures of an institution licensed by this Bank, the provision of underwriting only up to the prescribed limit of its core capital shall not be mandatory.

J Where situation arises, owing to under subscription of the underwritten shares according to (1) above, requiring the licensed institution to acquire such shares, the same shall be disposed within one year from the date of underwriting. Failing to which, the amount of investment, for the purpose of calculation of the capital fund, shall be deducted from the Core capital fund.

v. Provision for Review of Investment Portfolios

Licensed institutions shall review its investment portfolios on half-yearly basis. With respect to such review, a statement from the Internal Auditor of the licensed institution certifying that the investments are made according to the existing investment policy and according to this Directives be obtained and shall also be approved by the management of the institution within 1 (one) month from the close of the half yearly period. A copy of the approval of the management of the institution shall be submitted within Falgun 15 (end of February) and Bhadra 15 (end of August) of each fiscal year to this Bank's Bank and Financial Institutions Regulation Department and concerned Supervision Department.

vi. Valuation of Shares and Debentures

The investments of the licensed institutions in shares and debentures shall be separated company wise according to Directives Form No. 8.1, 8.2 and 8.3. It shall be shown in its assets having evaluated it semiannually based on the purchase price or the market price, whichever is lesser.

Provided that, where the market price of any company's shares or debenture falls below the cost price, the difference amount has to be debited to the Profit and Loss Account and credited to provision for loss in investment account. Moreover, while evaluating investment, it shall have to be evaluated according to the provision made in Points 2 and 2.B.3 (Investment Policy) of Directives No. 4/067 and the details thereof shall be prepared in the format of Nepal Rastra Bank Directive form No. 8.2.

vii. Provisions Relating to Purchase/Investment in Fixed Assets (House/Land) For Own Purpose

The banks of financial institutions incorporated and in operation under the B to F1A shall be allowed to purchase/invest in the fixed assets. (house/land) for the self purpose in the case they meet the following terms and conditions:

- (a) Entire pre-operating expenses of the bank/financial institution is written off.
- (b) The first general meeting is completed upon issue of shares to general public as refund to in the Memorandum of Association/Articles of Association.
- (c) The institution is in profit at the time of purchase of the property.
- (d) The capital fund is adequate according to the Directives issued by this Bank. Moreover, in case of purchase of investment in the fixed assets without meeting the said terms and conditions; the amount equivalent to that to be deducted while calculating the core capital fund.

viii. Additional Arrangement Regarding Investment

) Licensed institutions shall not invest in any shares, securities and hybrid capital instruments issued by any other institution of "A", "B" and "C" class licensed by this Bank.

Provided that, this clause is not applicable in case of share investment in class "D" institution and income of share investment with approval from this Bank.

) The core capital maintained in the Directives relating to investment means, the core capital maintained at the immediately preceding trimester except specifically stated otherwise.

ix. Actions for Non-Compliance of Directives on Investment

Action under Sections 99 or 100 of Nepal Rastra Bank Act, 2002 may be initiated for non-compliance of the Directives by the licensed institutions relating to investment.

x. Repeal and Saving:

The following Directives issued by this Bank heretofore have been repealed: -

) Provisions relating to investment made in the Unified Directives, the Directives issued under Directive No. 8/066 and all circulars issued until mid-July, 2010 relating to the matters under this subject.

) Actions taken under the Directives repealed pursuant to sub-clause (1) shall be deemed to have taken under these Directives.

2.1.4. Characteristics of Sound Lending and Investment Policy:

The income and profit of the bank rely upon its lending procedure and investment of funds on different securities. The greater the credit created by a bank, the greater will be the profitability. A sound lending policy is not only prerequisite for banks profitability but also crucially significant for the promotion of commercial saving of a backward country like Nepal.

The factors that banks must consider for sound lending and investment policies are explained as under:

Liquidity:

People deposit money at bank in different account with confidence that the bank will repay their money when they are in need. To maintain such confidence of the depositors, the bank must keep this point in mind while investing its excess funds in different securities or at the same time of lending so that it can meet current or short-term obligations when they become due for payment.

Profitability:

Commercial banks invest on those sectors that derive the maximum income. Hence, the investment or granting of loan and advances by them are highly influenced by profit margin. Basically, the profit of commercial bank depends upon the interest rate of the bank, volume of loan provided, time period of loan and nature of investment on different securities. A good bank is one which invests most of its funds in different earning assets standing safely from the problem of liquidity i.e. keeping cash reserves to meet day-to-day requirements of the depositors.

Purpose of Loan:

It is very important to remind that most of the banks' failures in the world are due to shrinkage in the value of loan and advances. The first substantive question a banker must examine is how loan proceeds will be used. If the loan purpose conflicts with commercial policy, such as loan for some speculative purpose not acceptable to the banker such loans should not be processed. If customers misuse their borrowings, there is risk involved in repayment and the bank will incur heavy bad debts. Detailed information about the plan and scheme of project should be collected and examined before lending.

Diversification:

Diversification of loans helps to sustain loss as if securities of some company deprived then there may be appreciation in the securities of other companies. Dispersion reduces the risk of recovery. Investment and credit concentrated on same geographical region, same sector of business and few customers increase the risk. Hence the policy should fix a cap on all these aspect. As the saying goes "A bank should not put all its eggs in the same basket". Therefore, in order to minimize the risk, a bank should diversify its investment in different securities. This diversification or portfolio investment helps to earn good return and at the same time minimize the risks and uncertainty.

Safety and Security:

Banks should buy investment rated securities only. It should abstain from investing its fund in those securities, which are subject to greater depreciation and fluctuation for example common stock, since a little difference may result in a great loss. It must not advance its funds to speculative business, which may earn millions in a minute or may become bankrupt the next minute. Since risk is overpriced during recession and under priced during boom banks should invest in medium grade and high-grade securities during recession and boom respectively.

Legality:

A commercial bank must follow the rules and regulations and statutory directives issued by Nepal Rastra Bank, Ministry of Finance and others while issuing securities and mobilizing their funds. In Nepal, NRB restricts financial institution licensed by it to invest in securities of each other.

2.1.5 Meaning of Some Important Terminology:

Deposits

Deposits are the main source of fund of the financial institution. It is the sum totals of money collected from the depositors in various accounts. Deposits denote the amounts deposited in current, saving, or fixed account of a bank or financial institution. Deposit is the main resource of fund that a bank uses for the generation of profit. Hence, the competence of the bank depends on its ability to attract deposits. Deposit being the borrowed amount from the depositors or from general public, it constitutes the liability of bank. The deposits of the bank are influenced by the following factors:

-) Types of customer
-) Interest rate paid on the deposits
-) Types and ranges of services delivered by bank
-) Management accessibility of customers
-) Physical facilities of bank

In addition to the above, the existing economic conditions put forth a decisive influence on the amount of deposit the bank receives.

Loan & Advances:

Loan & advance is the primary basis of income and most profitable assets to a bank. A bank comes one step ahead to lend as they constitute the larger part of revenue. At the same time, bank has to be more cautious in granting loans and advances as they may not be realized at a short period of time and they bear the chance of turning into bad debt. Hence a bank is keener on lending money for a short time. Loan and advance is provided against the personal security of the borrower or against the security of the immovable and movable properties. Bank grants loans in various forms such as overdraft, cash credit, direct loans and discounting bills of exchange. Advances are amount of money, which are paid or lent before any actual benefit has been derived. It could be expenses of future period paid in advance, advance for current supplies or advances against acquisition of capital assets. Earnings from loan and advances occupy a major space in income statement of the bank. Loans from commercial banks are secured against the assets of the borrower.

Interest

Interest is that additional money charged on borrowings i.e. paid by borrowers to bank or paid by bank to the depositors. It is an opportunity cost on sacrificing the saving own state for certain period.

Non- performing loan

Non-performing Loan (NPL) means an outstanding loan not repaid i.e. neither payment on interest or principal are made. In case of the banks the loans and advances are the assets as the banks flow loans from the funds generated through shareholders equity, money deposited by the people and fund having through the borrowings. Hence the term NPL means the loans and advances that are not performing well: thus, all the irregular loans and advances can be termed as NPL.

Assets:

Assets, representing economic resources are the valuable possessions owned by the firm. These possessions should be capable of being measured in monetary terms. Assets are the future benefits. They represent: (a) stored purchasing power (e.g. cash), b) money claims (e.g. receivables stock) and (c) tangible and intangible assets that can be sold or used in business to generate earnings. Tangible items include land and building, plant and equipment or stocks of materials and finished goods and all such other items, which have physical value. Intangible items do not have physical existence, but they have value to the firm. They include patents, copyrights, trade name or goodwill. Assets may be current asset or long-term assets. Current assets are those assets that are expected to be converted into cash within the accounting period. Long-term assets normally include fixed assets, long-term investment and other non-current assets that are held for longer periods for use in business.

Balance Sheet:

Balance sheet is one of the most significant financial statements, which is prepared at the end of each accounting period that indicates the financial condition or the state of affairs of a business at a given moment of time. More specifically, balance sheet contains information about the assets, liabilities and ownership equity capital

Other Uses of Fund

Commercial banks must maintain the bank balance with Nepal Rastra Bank as prescribed by the government. At the same time, they need to maintain cash balance in local currency in the vault of the bank and some part of the fund is used for the bank balance in foreign bank.

2.2 Review of Books and Articles

Bank is a financial institution which deals with money and substitute for money (deposit, credit, credit instruments, etc.). Trembling and inconsistent flow of credit harms the economy and the profitability of the bank. So, the prime objective of a bank should be collection of fund and its utilization in good investments such as diverse and safe investment. Here, opinions of different authors from their books are summarized.

Pyakuryal (1987) has conducted a study entitled “*Workshop on Banking and National Development*” writes the present changing context calls for a substantial revitalization of the resource. How much they have gained over the years depends chiefly on how far they have been able to utilize their resources in an efficient manner. Therefore, the task of utilization of resources is as much crucial as the mobilization. The under utilization of resources not only results in loss of income but also goes further to discourage the collection of deposits. Thus in paper has emphasized on proper utilization of mobilized resources and profitability increment.

Similarly, Shrestha (1988) in this study “*A Study on Deposits and Credits of CBs in Nepal*” concluded the credit deposit ratio would be 51.30%, other things remaining the same in 2004 A.D., which was the lowest under the period of reviews. So, it is strongly recommended that the CBs should try to give more credit entering new field as far as possible. Otherwise, they might not be able to absorb even its total expenses.

Bajracharya (1990) has mentioned in article “*Monetary Policy and Deposit Mobilization in Nepal*” the mobilization of domestic savings is one of the prime objectives of the monetary policy in Nepal. For this purpose, CBs stood as the active and vital financial intermediary for generating resources in form of deposit of the private sector. So far, providing credit to the investors is a different aspect of the economy.

Singh (1991) in research paper “*Nepalma Adhunik Banking Byabastha*” has made an attempt to highlight some of important indicators which have contributed to the efficiency and performance of other CBs in the field of CBs. Finally sing concluded that the establishment of CBs a decade ago marks beginning of modern banking era in Nepal. The joint venture banks have brought many new banking techniques such as computerization, hypothecation, consortium finance and modern fee base activities into the economy. There are indeed significant milestones in the financial development process to the economy.

Shrestha (1997) in research paper “*Lending operation of commercial banks of Nepal and its impact on GDP*” has presented with the objectives to make an analysis of contribution of commercial banks’ lending to the Gross Domestic Product (GDP) of Nepal. Set hypothesis that there has been positive impact of lending of commercial banks to the GDP. In research

methodology considered GDP as the dependent variable and various sectors of lending via agriculture, industrial, commercial service and social sectors as independent variables. A multiple regression technique has been applied to analyze the contribution.

Pradhan (1999) has pointed out some major issues in local CBs in comparison of recently established joint venture banks through article "*Nepalma Banijya Bank: Upalabdhi तथा Chunauti.*" The study deals with the whole CBs system of Nepal in respect of their performance and profitability. Some of findings relevant to study are summarized below:

-) The deposit collection rate of local banks is very poor in comparison to joint venture banks.
-) The patterns of deposit are also different between these banks. The rate of current deposit in local banks is 9.34% only where as in the same joint venture banks is 52.6% but the fixed deposit is very high in local banks.

Some suggestion to improve the Nepalese financial sector such as:

The financial institutions especially CBs have to identify new areas of investment to increase loan and advances in reducing the liquidity position. With the rapid growth in the number of banks and financial institutions, deposit insurance scheme is a must. The principal reason for introducing such deposit insurance should be one of the social justices rather than economic justification in order to protect the interest of the small depositors. In this condition, this scheme should be expedited to implement.

Karki (2000) has summarized some of the challenges through article "*Nepalese Financial Sector: Challenges and Some Solution*". According to the Karki, the financial sector is facing the major challenges of high NPL of the banking sector which comes around 18 percent of the total loan but if the loan classification is made according to least international practice, it is assumed to exceed 30%. Credit demand is being met largely by non-institutional source i.e. private money lender, merchant, trader, individual and landlord at very high rate of interest which is two to three times higher than that of institutional source, this shows that the unorganized financial sector is playing a major role in the Nepalese economy. The liquidity position of the banking sector is rated as high as 24%, but the productive sector of the economy is starved by credit crunch. This has created a paradoxical situation in the banking sector.

Pradhan (2005/06) in his article “*The Importance of Loan Information Center and its Activities*”, published in NRB Annual Publication says that the loan information center was established to fulfill the necessity of a company working in relation to information related to loan. He further adds that the negative trends like delaying the payment of principals and interest, deficient loan approval procedure, lack of constant inspection of projects, lack of coordination between banks have aided in the increase of NPL ultimately affecting the national economy negatively. He recommended the banks help the loan information center by following the directives of NRB and utilizing the information obtained from the center so that positive changes can be witnessed.

Koirala (2006), in his well article, “*Credit Culture of Commercial Banks in Nepal*”, has concluded that the unorganized money lenders in Nepal never loose. They used to assess the record of accomplishment of potential borrowers ad innocent characters termed as the best borrower. The bank, on the other hand, is an institution established to support and improves development process of a nation. The Politician and the staff have been responsible for the existence of huge volume of NPA in state owned commercial banks. In order to improve the situation, there is a need to evolve a more acceptable working system backed by cooperation and realization by the banks employees as well as the politicians and stakeholders, who can influence in bank operations.

Zerith (2008), in her article “*Loan Portfolio Management*”, affirmed that to manage the loan portfolios, bankers must understand not only the risk posed by each credit but also how the risks of individual loan and portfolio are interrelated. These interrelationships can multiply risk many times beyond what it would be if the risks were no related. Until recently, few banks used modern portfolio management concepts to control credit risk. Now, may banks view the loan portfolio in its segments and as a whole and consider the relationship among portfolio segments as well as among loans. These practices provide management with a more complete picture of the banks’ credit risk profile and with more tools to analyze and control the risk.

The multiple analyses have shown that all the variables except service sector lending have positive impact on GDP. Thus, in conclusion, accepted the hypothesis i.e. there has been positive impact on GDP by lending of CBs in various sectors of economy, except service sector investment.

2.3. Review of Thesis

Earlier to this study, the several researchers have done various studies regarding Lending policy. In this topic, it is tried to review the thesis that are supposed to be important and relevant for the study, which have been conducted by previous researchers

Baniya (2007), has conducted a study entitled “*Efficiency of Lending Policy of Commercial Banks*” where main objectives of this study was to assess the lending procedure adopted by selected commercial banks. The research findings shows that low level of lending policy and practices significantly affects the performance of the bank. It was observed from the result that the trend of performing loan of LBL as in fluctuating whereas KBL has increasing trend. Non-performing loan of both banks was found in fluctuating trend. There was no set of policy applied against non-performing loan during the study period. Findings shows that non-performing loan has significant effect in beginning years of the study period on both banks but this effect was dropped in following years. It indicates that both banks suffered earlier cumulative effects in profitability. It was found from the result that lending effectiveness of KBL was found better as compare to LBL in many situations. KBL has managed successfully to convert their liability into asset. KBL is successful to collect cheaper deposit than LBL. KBL has low interest expenses to total expenses than LBL. It can be said that due to increase in cost of the deposits, the volume of interest expenses ratio has been increasing. The deposit mixture of KBL carries the lowest level of interest bearing deposits in its deposit mixture. This indicates that KBL has the most successful in collecting cheapest fund. LBL has relatively sound and better liquidity position than KBL. In contrast, a high ratio of non-earning cash and banks balances may be unfit which indicates the bank’s unavailability to invest its fund in income generation sector. LBL is also able to earn high interest on its total interest income in comparison to KBL. KBL is strong to mobilize the loan and advances & overdraft to earn interest than LBL. The volume of non-performing loan resulted low bad interest turnover in KBL which shows the better position than LBL. The overall result indicated that the fund collection system of KBL was observed better whereas investment position of MBL was better.

In a follow-up study, Tuladhar (2000), has conducted a study entitled “*Comparing lending policy between Nepal Grindlays Bank Limited (Present Standard Chartered Bank) and all other joint venture bank of Nepal*” taking present SCB and all other joint venture of bank. This study aimed to evaluate the liquidity, efficiency of assets management and profitability position.

This study’s specific objectives were as follows.

- i. To study the fund mobilization and investment policy with respect to fee-based off-balance sheet transaction and fund based on balance sheet.
- ii. To evaluate the growth ratios of loan and advances and total investment with respective growth rate of total deposit and net profit.
- iii. To evaluate the trends of deposit utilization towards total investment and loan and advanced and its projection for next five years

The major finding of study were as follows:

- i. Towards which sector should JVBs invest 28.37% respondents emphasized in education sector whereas 26.24% respondents gave emphasis on poverty stricken and deprived sector. Moreover 18.44% 16% and 4.25 % respondents gave emphasis on industrial, tourism, agricultural and construction respectively. Towards increasing minimum threshold balance and reducing interest rate 50% respondents said that the bank do not have enough investment opportunities. Consequently 33% said that banks are discouraging lower level depositor indirectly, 10% respondents said that bank have

already enough deposits and collections. Moreover 7 % respondents said that it might be due to other reasons in accordance of bank own thought.

- ii. The liquidity position of NGBL was consistent and better than Nepal Arab Bank Limited and Himalayan Bank Limited (HBL). The mean of cash and bank balance to current ratio of NGBL was less than that of Nepal Arab Bank Limited and HBL. But the variability of the ratio during the study period was more consistent than the other two banks.
- iii. Loan and advances found that the mean of the ratio of NGBL was less than Nepal Arab Bank Limited and HBL. Investment on government securities to working fund ratio of NGBL had the highest mean ratio than Nepal Arab Bank and HBL during the study period.
- iv. The mean of return on working fund ratio NGBL exceeded both Nepal Arab Bank Limited and HBL whereas in case of return on loans and advanced ratio, NGBL made largest profit than Nepal Arab Bank Limited and HBL during the study period. The mean of total interest earned on total working fund ratio of NGBL was slightly less than Nepal Arab Bank Limited and HBL, but the rate of earning with respect to working fund was more consistent than that of Nepal Arab Bank Limited and HBL. Growth ratio of NGBL regarding total deposits was found very lower than HBL and slightly lower than Nepal Arab Bank Limited and net profit of NGBL seemed to be satisfactory towards Nepal Arab Bank but very high in case of HBL.

Similarly, Adhikari (2010) has conducted a study entitled “*A Comparative Analysis on Investment Policy of Leading Commercial Bank (with special reference of NABIL, SCB and HBL)*” The main objective of the study was to analyze the relationship between total investment, deposit and loan and advance and net profit and outside asset and their comparative study in between the respective banks. Other objective includes studying the asset management system, profitability and risk position of the respective banks. The study concluded that the investment policy of Nepal Investment Bank was not good with comparison to other CBs in every respect. The study found that at times, bank focused much of its attention to one sector leaving other sectors untouched. So, this study recommended touching all the sectors and balancing effectively so as to have the optimal performance of the bank.

The study further found in the study that HBL's loan and advances to total deposit ratio is higher than that of SCB and NABIL but its stability is not consistent than that of other two banks. To overcome this situation, HBL was strongly recommended to follow liberal lending policy and invest more and more percentage of total deposit in loan and advances and similarly maintain more stability on the investment policy.

Rana (2007), has conducted a study entitled "*Efficiency of Lending Policy of Commercial Banks*" selected two commercial banks EBL and MBL. The main objectives of study are to assess and explore the lending procedure and efficiency adopted by selected commercial banks. This study result showed that the trend of performing loan was increasing and non-performing loan was fluctuating in EBL whereas the trend of performing loan was increasing and non-performing loan was decreasing in MBL. In the same way, loan loss provision was found in increasing trend in both banks. This shows that MBL is successful to manage loan portfolio than EBL. It was found that non-performing loan has significant effect on profitability in beginning years of the study period on both banks. But this effect was dropped in following years. It indicates that both banks suffered earlier cumulative effects in profitability.

Similarly, the result of lending efficiency shows that both banks have average level in lending policy. Comparatively, it was found that deposit mobilization (collection of deposit is better in EBL than MBL) whereas system of lending loan is better than MBL than that of EBL. This shows that MBL is highly dependent on lending and investing activities. MBL is also found strong to mobilize fund for earning interest than EBL. The result of correlation of coefficient shows that in case of EBL, there was significant effect of total deposit and non-performing loan on total loan and it was also found that the increasing level of loan significantly affect to increase the net profit volume but the result shows that non-performing loan has no significant effect on net profit. It means that the loan is the indicator for determining net profit. In case of MBL, it was found that there was significant relationship between total loan and total deposit, total loan and net profit but the effect of non-performing loan on total loan and net profit was found significant. It means that the position of non-performing loan was found quite better during the study period.

Rana (2012) has conducted a thesis entitled "*Investment Policy of Nepalese Commercial Banks*" taking two commercial banks HBL & NIC. The main objectives if the study were to analyze the trend of deposits, investments, net profit, and loan and advances of these two banks. The study has found the growth ratio of loan and an advance of HBL is better than NIC bank.

The major findings of the study are as follows:

- i. The mean ratio of cash and bank balance to current asset of NIC is higher ratio than that of the HBL and its ratios are more consistent than that of HBL.
- ii. NIC Bank has the highest loan and advance to current asset ratio and its coefficient of variation is in the lowest than HBL indicating uniformity in comparison to HBL.
- iii. HBL has the highest mean ratio of investment on shares and debentures to total working fund than NIC Bank whereas NIC Bank is inconsistent and unstable in terms of investment on shares and debentures than HBL.

- iv. In average, HBL has the higher ratio of return on loan and advance than that of NIC Bank and however both Bank's return on loan and advance has been found in fluctuating trend.
- v. In average, HBL has the lowest liquidity risk ratio comparatively than the NIC bank. Similarly, its ratios are more homogeneous than that of and NIC Bank. At the same time, HBL also has the highest coefficient of variation in comparison to NIC Bank indicating liquidity risk of HBL is high.
- vi. Coefficient of correlation between deposit and loan & advance of NIC Bank is found to be lower than that of HBL. This indicates poor position of NIC Bank in mobilizing deposit as loan & advances. In case of both banks, there is significant relationship between deposit and loan & advance

2.4 Research Gap:

In this way, researchers have studied about the lending policy of Banks from different angles. Obviously, the conclusion that they present also varied according to focus, size of the sample and the methodology they followed, but very limited researchers have studied about the technical analysis of lending policy in Nepalese context. It is therefore, this study has made an attempt to indicate the efficiency of lending policy of concerned banks to give certain professional opinion in order to contribute in practical side of lending policy and side by side carrying its academic purpose by revalidating the tools and techniques available in the field of analysis of lending policy.

Chapter III

Research Methodology

3.1. Introduction

Research methodology describes the systematic methods and process applied in the entire aspect of the study focus of data, data gathering instrument and procedure, data tabulating and processing and methods of analysis. It is really a method of critical thinking by defined and redefining the problems, formulating hypothesis or suggested solution and collecting and organizing and evaluating data, making deduction and making conclusions.

The main objective of this study is to examine and evaluate the lending practices and efficiency of the selected commercial banks. In order to reach and accomplish the objectives of the study, different activities are carried out and an appropriate methodology has been followed. Thus, this chapter aims to present and reflect the methods and techniques carried out during the study. It includes research design, Nature and Sources of Data, Data Collection Procedure, Population and Sample, Analysis of data processing and analytical tools used.

3.2. Research Design

A research design refers to the conceptual structure within which the research is conducted. The research design is the arrangement of conditions for collection and analysis of data in a manner that aim to combine relevance of the research purpose with economy in procedure. Research design in the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to objective of this study. It is the process which gives us an appropriate way to reach research goal. It includes definite procedures and techniques which guide in sufficient way for analyzing and evaluating the study.

This study mainly depends on the secondary data. The research process includes collecting, verifying and evaluating the past evidence systematically and objectively to reach the final conclusion. Some statistical and financial tools have been adopted to examine factors in this study and descriptive and analytical research designs have also been used. The analytical Research Design has been adapted to the subjects into parts dealt with each part in turn. The fourth chapter has been the most analytical. Besides the afore-said designs, Comparative method has also been used to compare the investment condition of the two banks. It has also been tried to show the contrast between the two banks in their adaptation of different position of investment and lending.

3.3. Nature and Sources of Data

The data presented in this study are of secondary type. The annual reports of the concerned banks are the major sources of the data for the study. However, besides the annual reports of the subjected banks, the following sources of data are being used in the respective corner of the study:

- a. NRB reports
- b. Various publications dealing in the subject matter of the study
- c. Various articles published in the Newspapers

3.4. Data Collection Procedure

Most of the data and information used in the study is collected from secondary source. Some of other related data are borrowed from related annual report of related. Different tools of information like Magazine Newspaper, Radio, Television, Encyclopedias, and websites are used as main sources of information and data. For this study, maximum secondary data are downloaded from official websites of Himalayan Bank Ltd and NIC Bank Ltd.

3.5. Population and Sample

There are all together 32 commercial banks functioning in Nepal (mid July 2012), which is the size of the population. Out of them, 2 leading private commercial banks HBL and NIC Bank Ltd are considered as samples to carry out this research.

3.6. Analysis of Data

To achieve the desired objective of the study, various statistical and financial tools have been used. The data extracted from the financial statements of the concerned financial institutions are processed and tabulated in various tables and charts to find the results of the study. Various mathematical tools like ratio analysis, arithmetic mean, coefficient of variation etc. are used to find out the strength and weakness of the concerned financial institutions.

3.6.1 Financial Tools

Financial tools are used to examine the financial strengths and weaknesses of the bank. Ratio analysis is one of the important tools that have been used in the study. Although there are many ratios, only those ratios have been covered in this study, which are related to the lending efficiency of the bank. The lending efficiency of the bank in term of quality and turnover is measured under the following ratios:

3.6.1.1 Ratio Analysis

Ratio analysis is a powerful tool of financial analysis. Ratio analysis is a technique of analysis and interpretation of financial statement, to evaluate the performance of an organization by creating the ratio from the figures of different accounts consisting in balance sheet and income statement is known as ratio analysis. (Dangol, 2052)

The term ratio refers to the numerical or quantitative relationship between two variables. The rationale of ratio analysis lies in the fact that it makes related information comparable. A ratio is calculated by dividing one item of the relationship with the other. The primary purpose of ratio is to point out area for further investigation. Ratio helps the researcher to make quantitative judgment about the firm's financial position and performance. For the purpose of the study, following ratios are calculated and analyzed and interpreted:

A. Liquidity Ratio:

Liquidity is the ability to meet the anticipated and contingent cash needs. Cash needs arise from deposit withdrawals, liability maturity and loans disbursements (new loans and the drawdown of outstanding lending commitments). It is the measurement of speed with which a bank's assets can be converted into cash to meet deposit withdrawal and other current obligations. Liquidity ratios are used to judge the ability of the bank to meet its short-term liabilities that are likely to mature in the short period of time. From them, much insight can be obtained into present cash solvency of the bank and its ability to remain solvent in the event of adversities. However, an excessive liquid asset refers to the idle and unproductively of the firm.

The conventional measures of liquidity ratio in Nepalese banking industry have less significant relevancy. Due to Lack of investment opportunity and excess liquidity in the Nepalese economy demands low liquidity position for our financial institutions. Since, the commercial banks are

concentrating on major liquid population, the present scenario of banking demands on low rate of liquidity. As a financial analytical tool, the following liquidity ratio has been used:

i. Current Ratio

It is none other than the ratio of current assets and current liabilities. Current assets are those assets, which can be converted into cash within short span of time, usually no exceeding one year. Current liabilities are those obligations which are payable within a short period. The ratio is calculated as:

Mathematically,

$$\text{Current Ratio} \times \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current assets of a bank usually include cash balance, balance with Nepal Rastra Banks, Balance with banks/financial institutions, money at call and short notice, investments, loan and advance, bills purchased, interest receivable and other miscellaneous current assets. Similarly current liabilities include borrowings, deposit accounts, bills payable, short-term loans, tax provision, dividend payables and other miscellaneous current liabilities.

ii. Cash and Bank Balance to Total Deposit Ratio

They are the most liquid of current assets to pay off depositors immediately. This ratio is calculated by dividing cash and bank balance by total deposits.

Mathematically,

$$\text{Cash \& Bank Balance to Total Deposit Ratio} \times \frac{\text{Cash \& Bank Balance}}{\text{Total Deposit}}$$

Cash and bank balance includes cash balance, balance with Nepal Rastra Bank and money at call & short notice etc. The total deposits consists of saving deposits, final deposits, call deposit and certificates of deposits etc. A higher ratio indicates greater ability of banks to meet their deposits and vice-versa.

iii. Cash and Bank Balance to Current Asset Ratio

This ratio measures the proportion of most liquid assets, i.e. cash and bank among the total current assets of the bank. Higher ratio shows the bank's ability to meet the demand for cash.

Mathematically,

$$\text{Cash \& Bank Balance to Current Assets Ratio} \times \frac{\text{Cash \& Bank Balance}}{\text{Current Assets}}$$

iv. Investment on Government Securities to Current Asset Ratio

This ratio is used to find the percentage of current assets invested in government securities, i.e. Nepal government's treasury bills, Nepal government's saving bonds and Nepal government's others securities. Commercial banks are interested to invest some portion of their collected fund in government securities as they are risk-free and can easily sold in the market.

Mathematically,

$$\text{Investment in Government Securities to current Asset Ratio} \times \frac{\text{Total Investment in Government Securities}}{\text{Current Assets}}$$

v. Loans and Advances to Current Asset Ratio

The major portion of a bank's asset side of the balance sheet includes loan and advances. Loan and advance comprise of loan and advance, credit overdraft, bills purchased and discounted. In this research study, total loan and advances have been taken into consideration. It shows the percentage of total loan and advances to current assets.

Mathematically,

$$\text{Loan and Advances to Current Asset Ratio} \times \frac{\text{Total Loan and Advances}}{\text{Current Assets}}$$

B. Assets Management Ratio

Asset management ratio measures how carefully a firm is managing its assets. These ratios are designed to answer this question: Does the total amount of each type of assets as regarded on the balance sheet seem reasonable, how high, too low, in view of current assets and operating levels? Either a company or a bank must borrow or obtain funds from other sources to acquire assets. If it has too many assets its interest expenses will be too high and hence its profits will be low; on the other hand, if assets are too low, profitability sales may be lost.

The following ratios are used under this asset management ratio:

i. Loans and Advances to Total Deposit Ratio

This ratio is calculated to find out how successfully the selected banks are utilizing their total deposits on loan and advances to generate profits. A higher ratio is indicative of better utilization of total deposits, but the same

might not hold true from liquidity point of view. It is computed by dividing total loan and advances by total deposits.

Mathematically,

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

ii. Total Investment to Total Deposit Ratio

This ratio shows the utilization of firm's deposits on investment in government securities and purchasing shares and debentures of other companies. A high ratio is indicative of high success in mobilization of deposits in investments and vice-versa. This ratio can be calculated by dividing total investment by total deposits.

Mathematically,

$$\text{Total Investment to Total Deposit Ratio} = \frac{\text{Total Investment}}{\text{Total Deposits}}$$

iii. Loans and Advances to Total Working Fund Ratio

The major portion of a banks' asset side of the sheet includes loan and advances. It is also the major component of the total working fund. This ratio shows the ability of a bank to canalize its assets in the form of loan and advances to earn higher profits. A high ratio indicates better mobilization of fund as loan and advances and vice-versa.

Mathematically,

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

Where total working fund includes all assets of balance sheet items i.e. current assets, net fixed assets and other miscellaneous assets

iv. Investment on Govt. Securities to Total Working Fund Ratio

This ratio shows the percentage of total working fund invested in government securities. In other words, this ratio measures the extent to which the banks have been successful in mobilizing their total working fund on different type of government securities. The logic behind Investment on government securities by banks is to diversify the risk by not putting all the eggs in the same basket. This is also beneficial in the sense that banks are assured of adequate liquidity. A high ratio indicates better mobilization of funds as Investment on government securities and vice-versa. This ratio can be calculated by dividing total amount of investment in government securities by the total working fund.

Mathematically,

$$\text{Investment in Government Securities} \times \frac{\text{Investment in Govt. Securities}}{\text{Total Working Fund}}$$

v. Investment on Shares & Debentures to Total Working Fund Ratio

This ratio shows the percentage of total working fund invested in purchasing shares and bonds & debentures of other companies. Investment on shares and debentures to total working fund measures the extent to which the banks have been successful in mobilizing their total assets on shares and debenture of other companies to generate income. A high ratio indicates high portion of investment on shares and debentures out of total working fund and vice-versa. This ratio is calculated by dividing the total amount of Investment in shares & debenture of other companies by total working fund.

Mathematically,

$$\frac{\text{Investment on Shares \& Debentures to Total Working Fund Ratio}}{\text{Working Fund Ratio}} \times \frac{\text{Investment in Shares \& Debentures}}{\text{Total Working Fund}}$$

C. Profitability Ratio

Profitability ratios are calculated to measure the effectiveness and smooth operation of an organization in terms of profit. It is the device to indicate the financial performance of any institution. This proves that higher the profitability ratio, better the financial performance of bank or vice versa. The profitability ratios are calculated to measure the overall efficiency of a firm in terms of profit earning and performance. Profit is one of the major indicators of efficient performance of banks. One of the major objectives of banks is to earn profit, so profit is very crucial for the survival of banks. To meet various objectives like, maintaining good liquidity position, meet internal obligations, expansion of banking services, finance short- term government needs, commercial banks need to earn sufficient profit. A higher profit ratio shows higher efficiency of a bank. Profitability ratio can be evaluated through following different ratios

i. Return on Loans and Advances Ratio

Return on loan and advances ratio indicates how efficiently the bank has utilized its resources in the form of loan and advances to generate good return. It measures the earning capacity of a commercial bank. This ratio is calculated by dividing net profit by loan and advances.

Mathematically,

$$\text{Return on Loan \& Advances Ratio} \times \frac{\text{Net profit / Loss}}{\text{Total Loan and Advances}}$$

ii. Return on Total Working Fund Ratio

It is also known as return on asset. The ratio measures the overall profitability of all working funds, i.e. total assets. A firm or a financial institution has to earn satisfactory return on assets or working fund for its survival. The ratio can be computed as:

Mathematically,

$$\text{Return on Total Working Fund Ratio} = \frac{\text{Net profit / Loss}}{\text{Total Working Fund}}$$

iii. Return on Equity Ratio

This ratio measures how efficiently the banks have used the funds of owners.

Mathematically,

$$\text{Return on Total Equity Ratio} = \frac{\text{Net profit / Loss}}{\text{Total Equity Capital}}$$

iv. Total Interest Earned to Total Working Fund Ratio

This ratio is calculated to find the percentage of interest earned to total assets. This ratio reflects the extent to which banks are successful in mobilizing their assets to generate high income. This ratio presents the earning capacity of a bank on its total working fund. Higher ratio indicates better performance or proper utilization of total assets in the form of interest earned on its working fund. This ratio is calculated by dividing total interest earned by total working fund.

Mathematically,

$$\text{Total Interest Earned to Total Working Fund Ratio} = \frac{\text{Total Interest Earned}}{\text{Total Working Fund}}$$

v. Total Interest Paid to Total Working Fund Ratio

This ratio measures the percentage of total interest expenses against total working fund. A high ratio is indicative of higher interest expenses on total working fund. This ratio is calculated by dividing by total interest paid by total working fund.

Mathematically,

$$\text{Total Interest Paid to Total Working Fund Ratio} = \frac{\text{Total Interest Paid}}{\text{Total Working Fund}}$$

vi. Total Interest Earned to Total Operating Income Ratio

This ratio is measured to find out the ratio of interest income with operating income of the bank. It shows how efficiently the banks have mobilized their resources in interest bearing assets i.e., loan and advances investment in government securities. Total operating income includes interest income, commission fees & discount,

dividend income, foreign exchange income etc. This ratio shows the magnitude of interest income in total income. It is calculated by dividing total interest earned by net operating income.

Mathematically,

$$\text{Total Interest Earned to Total Operating Income Ratio} = \frac{\text{Total Interest Earned}}{\text{Total Operating Income}}$$

D. Risk Ratio

Risk means uncertainty, variability of return, which is inherent in any investment portfolio of a business enterprise. Risk is an important element since investment with greater risk requires higher return than investments with lower risk. Risk ratios measures the degree of risk involved in various financial operations. The possibility of risk involved in bank's financial operations makes the bank investment a challenging task. As the notion goes, "no risk no gain", therefore, if a bank expects high return on its investment it must be prepared to accept the risk and manage it efficiently.

The following risk ratios are used to analyze and interpret the financial data and investment policy.

i. Credit Risk Ratio

Normally, every credit is good at the time it is sanctioned. Most of the bank failures are due to shrinkage in the value of loan and advances. Loan is a risky asset and risk of non-repayment of loan is known as credit risk or default risk. Credit risk ratio measures the possibility of loan going into default. While sanctioning loans banks measure credit risk involved in the project. Credit risk is calculated by dividing total loan and advances by total assets.

Mathematically,

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

ii. Liquidity Risk Ratio

Liquidity risk of the bank defines its liquidity needs for deposit. Cash and bank balance are the most liquid of all the assets and are considered bank's liquidity sources. Deposits on the other hand refer to the liquidity needs of banks.

This ratio measures the risk associated with the liquid assets i.e. cash and bank balance that are kept to satisfy the cash demand of customers. A higher ratio shows that the banks has sufficient cash to meet its current obligations i.e. lower liquidity risk, but that may have an adverse impact on the profitability position of the bank. A trade off between liquidity and profitability must be maintained. This ratio is calculated by dividing cash and bank balance by total deposit.

Mathematically,

$$\text{Liquidity Risk Ratio} = X \frac{\text{Total Cash \& Bank Balance}}{\text{Total Deposits}}$$

iii. Growth Ratio

The growth ratios represent how the commercial banks are maintaining their economic and financial condition. As a conventional rule, a higher ratio is preferable. A high ratio indicates better performance of the banks and vice-versa. The following growth ratios directly related to the fund-mobilization and investment of the banks are calculated:

- a) Growth ratio of total deposit
- b) Growth ratio of loan and advances
- c) Growth ratio of total investment
- d) Growth ratio of net profit

3.6.2. Statistical Tools

A. Standard Deviation:

The Standard Deviation measures the absolute dispersion. It is said that higher the value of standard deviation, the higher the variability and vice versa. Karl Pearson introduced the concept of Standard Deviation in 1823 and this is denoted by the symbol of small Greek Letter σ (read as “Sigma”).

The formula for the calculation of the Standard Deviation is as:

$$S.D(\sigma) = \sqrt{\frac{(\sum x - \bar{x})^2}{N}}$$

B. Coefficient of Variation:

The Standard Deviation calculated in the above formulas gives us an absolute measure of dispersion. Hence, where the mean value of the variables is not equal, it is not appropriate to compare two pairs of variables based on standard deviation only. The coefficient of variation measures the relative measures of dispersion, hence capable to compare two variables independently in terms of their variability.

The Coefficient of Variation (C.V.) is given by the following formula and this gives the percentage.

$$\text{Coefficient of Variation (C.V.):} \quad \frac{\sigma}{\bar{X}} \times 100$$

C. Measures of Correlation:

We examine the relation between the various variables. The correlation between the different variables of the financial institutions is compared to measure the performance of these financial institutions. The correlation coefficient between two variables describes the degree of relationship between those two variables. The reliability of the value of Coefficient of Correlation is measured by Probable Error.

Correlation refers to the degree of relationship between two variables. If between two variables, increase or decrease in one cause increase or decrease in another, then such variables are correlated variables. Thus, measures of correlation calculate the mathematical relationship between two variables. “The measures of correlation called the correlation coefficient or correlation index summarizes in one figure the direction and degree of correlation”

The Karl Pearson Coefficient of Correlation is given by the following formula:

$$\text{Coefficient of Correlation (r)} = \frac{(\sum x - \bar{x}) (\sum y - \bar{y})}{N \sigma_x \sigma_y}$$

Where,

σ_x = Standard Deviation of Series X

σ_y = Standard Deviation of Series Y

N = Number of Pairs of Observations

And,

$$\text{Probable Error of “r” (P.Er.)} = 0.6745 \frac{\sigma_r}{\sqrt{N}}$$

The Karl Pearson Coefficient of Correlation (r) always falls between –1 and +1. The value of correlation in minus signifies the negative correlation and in plus signifies the positive correlation. As the value of correlation coefficient reaches near to the value of zero, it is said that there is no significant relationship between the variables.

The coefficient of correlation shall be interpreted based on probable error (P.Er). If the value of correlation is greater than 6 times the value of probable error, the correlation coefficient is deemed as significant and reliable. If the value of correlation coefficient is less than probable error, the correlation coefficient is said to be insignificant and there is no evidence of correlation.

D. Trend Analysis:

Trend analysis is an analysis of a firm’s financial ratios over time. This measures the change of data over a period of time. This reveals whether the firm’s ratios are improving or deteriorating over time. Under segment, current and projected trend values of loan & advance to total deposit ratio and investment to total deposit ratio are calculated.

Trend equation:

$$Y = a + bx$$

where,

y = dependent variable

x = independent variables

$$\text{if } x = 0, \quad a = \frac{\sum y}{n} \text{ \& } b = \frac{\sum xy}{\sum x^2}$$

Under this topic we analyze

- i) Trend Analysis of total deposits.
- ii) Trend Analysis of loan and advances.
- iii) Trend Analysis of total investment.
- iv) Trend analysis of net profit.

of HBL & NIC Bank from F/Y 2007-2008 to F/Y 2011-2012. It also aids in making forecasting for the next five years up to 2013-2014.

Chapter IV

Data Presentation and Analysis

This is the most important chapter of the study since all the collected data are processed, presented and analyzed here. This is an analytical chapter, where an attempt has been made to analyze and evaluate major financial items, which have an impact on investment management and fund mobilization of HBL and NIC Bank. The outcome of the study solely depends upon this chapter. Financial and statistical tools mentioned in the previous chapter are used here for interpretation. For the sole purpose, interpretations are categorized into two headings:

1. Analysis of financial ratio
2. Analysis of statistical ratio

4.1. Analysis of Financial Ratio

Financial analysis involves identifying the financial strength and weakness of the organization by presenting the relationship between items of the balance sheet. For the purpose of this study, ratio analysis has been mainly used for the analysis of data. The ratios are designed and calculated to highlight the relationship between financial items and figures. It is notable that all types of financial ratios are not studied here. Only those ratios are calculated and analyzed which are very much important in the point of view of fund mobilization of a commercial bank. The important ratios that are studied for this purpose are:

4.1.1 Total Assets to Liability Ratio

Banks create credit through loans and advances and multiply their assets much more times than their liability permits. This ratio measures the ability of a bank to multiply its liability into assets. The higher ratio of total assets to liability is favorable as it increases overall capacity of the organization. The following table shows the ratio of total assets to liability of selected commercial banks during the study period.

i. Current Ratio

Current ratio shows the relationship between current assets and current liabilities. Current assets are those assets which can be converted into cash within the short period of time, normally not exceeding one year.

Current liabilities are those obligations which are payable within a short span of time.

$$\text{Current Ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Table No.1
Current Ratio of Himalayan and NIC Banks Limited

Fiscal Year	Current Ratio		Current Assets		Current Liabilities	
	HBL	NIC	HBL	NIC	HBL	NIC
2007-08	1.08	1.09	35449.46	15044.24	32,802.54	13735.31
2008-09	1.07	1.09	38377.93	18491.31	35,710.25	16890.38
2009-10	1.07	1.09	41655.25	20012.14	38,777.92	18344.38
2010-11	1.07	1.09	45548.71	21735.59	42240.72	19892.03
2011-12	1.04	1.05	53059.06	25173.92	51104.43	24067.98

Table No.2
Mean, Standard Deviation and Coefficient of Variation

Banks	Mean	Standard Deviation	Coefficient of Variation
HBL	1.06	0.013	1.48%
NIC	1.08	0.016	1.20%

(As per schedule 1)

Here current ratios of HBL and NIC banks are analyzed. The table no.1 indicates that the current assets of two commercial banks have met the current liabilities during the five-year period.

The result shows that current ratios of the HBL have the fluctuation trend of current ratios but current ratios of NIC have the constant in five years. In average, HBL has maintained the lower current ratio than NIC. HBL has the highest coefficient of variation of 1.48% between two banks which proves its inconsistency.

ii. Cash and Bank Balance to Total Deposit Ratio

This ratio measures the proportion of the most liquid assets i.e. cash and bank balance among the total asset of the bank. Higher ratio proves the bank’s ability to meet the demand for cash.

Cash and Bank Balance to Total Deposit Ratio =

$$\frac{\text{Cash and bank balance}}{\text{Total deposit}}$$

Table no.3
Cash and Bank Balance to Total Deposit Ratio

Fiscal Year	Ratio (%)		Cash & Bank Balance		Total Deposit	
	HBL	NIC	HBL	NIC	HBL	NIC
2007-08	4.55	9.11	1448.14	1192.35	31842.79	13084.69
2008-09	8.79	9.38	3048.53	1461.15	34682.31	15579.93
2009-10	10.28	13.06	3866.49	2086.13	37611.20	15968.92
2010-11	7.24	9.11	2964.65	1677.06	40920.63	18394.43
2011-12	13.33	12.46	6362.30	214613	47731.00	22111.85

Table No.4
Mean, Standard Deviation and Coefficient of Variation

Banks	Mean	Standard Deviation	Coefficient of Variation
HBL	8.84	2.74	30.97%
NIC	10.64	1.87	17.55%

(As per schedule 1)

The same figure in the table shows the percentage of cash and bank balance to total deposit ratio position of the two banks and they all have the fluctuating trend in this regard. During the five-year period, NIC has maintained the highest ratio than HBL. Hence, NIC has the highest average too. In average, NIC has the highest cash and bank balance to total deposit ratio than HBL Bank. It proves the liquidity position of NIC is better in this regard. On the other hand, HBL has lowest mean ratio and its coefficient of variation is 30.97% which is higher comparatively than NIC. Hence, it can be explained that HBL has the poor maintenance of its liquidity which indicates the poor performance of the bank.

iii. Cash and Bank Balance to Current Asset Ratio

This ratio measures the proportion of most liquid assets i.e. cash and bank balance among the total current asset of bank. Higher ratio shows the bank's ability to meet the demand for cash.

$$\text{Cash and Bank Balance to Current Asset Ratio} = \frac{\text{Cash and bank balance}}{\text{Current asset}}$$

Table no. 5

Cash and Bank Balance to Current Asset Ratio

Fiscal Year	Ratio (%)		Cash & Bank Balance		Current Asset	
	HBL	NIC	HBL	NIC	HBL	NIC
2007-08	4.09	7.93	1448.14	1192.35	35449.46	15,044.24
2008-09	7.94	7.90	3048.53	1461.15	38377.93	18,491.31
2009-10	9.28	10.42	3866.49	2086.13	41655.25	20,012.14
2010-11	6.50	7.70	2964.65	1677.06	45548.71	21735.59
2011-12	12.00	10.95	6362.30	214613	53059.06	25173.92

Table No.6

Mean, Standard Deviation and Coefficient of Variation

Banks	Mean	Standard Deviation	Coefficient of Variation
HBL	7.96	2.51	31.51%
NIC	8.98	1.46	16.21%

(As per schedule 1)

Contents of the table show that cash and bank balance to current asset ratios are in fluctuating trend during the five-year period. NIC Bank has maintained a highest ratio of 10.95% in the FY 2011-12. Similarly, HBL Bank has maintained the highest ratio of 12.00% in the FY 2011-12 too. In average, NIC has higher ratio than that of the HBL and states NIC is better in this regard. HBL has lower average ratio and its coefficient of variation between ratios is 31.51%, which is comparatively higher than of NIC Bank. It shows that HBL is unstable and inconsistent than NIC. Hence, it shows its inability to manage the withdrawal from the customers.

iv. Loan and Advance to Current Asset Ratio

Loan and Advances include short and long term, overdraft, and revolving overdraft, standby credit, line of credit and other lending.

$$\text{Loan and Advance to Current Asset Ratio} = \frac{\text{Loan and advance}}{\text{Current ratio}}$$

Table no.7

Loans and Advance to Current Asset Ratio

Fiscal Year	Ratio (%)		Loans & Advance		Current Asset	
	HBL	NIC	HBL	NIC	HBL	NIC
2007-08	55.00	74.88	19,497.52	11,264.68	35449.46	15,044.24
2008-09	64.60	73.98	24,793.16	13,679.39	38377.93	18,491.31
2009-10	67.17	63.62	27,980.63	12,732.01	41655.25	20,012.14
2010-11	69.30	68.70	31566.98	14933.94	45548.71	21735.59
2011-12	65.90	68.49	34965.43	17242.31	53059.06	25173.92

Table No.8

Mean, Standard Deviation and Coefficient of Variation

Banks	Mean	Standard Deviation	Coefficient of Variation
HBL	64.39	5.41	8.41%
NIC	69.93	4.29	6.14%

(As per schedule 1)

The table shows that loan and advance to current asset ratios are in fluctuating trend but HBL has increasing trend in the last five years. NIC has maintained the highest ratio of 74.88% in the FY 2007-08. Likewise, HBL has the highest ratio 69.30 % in the FY 2010-11. Comparing the mean ratios, NIC Bank has the highest ratio of 69.93% than HBL Bank whereas coefficient of variation is in lower.

v. **Loan and Advance to Total Deposit Ratio**

This ratio assists to find out how successfully the banks are utilizing their total deposits on loans and advances for profit generating purpose. Greater the ratio implies the better utilization of total deposits. The ratio is computed as:

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

Table no.9 Total deposit

Loan & Advance to Total Deposit Ratio

Fiscal Year	Ratio (%)		Loans & Advance		Total Deposit	
	HBL	NIC	HBL	NIC	HBL	NIC
2007-08	61.23	86.09	19,497.52	11,264.68	31,842.79	13,084.69
2008-09	71.49	87.80	24,793.16	13,679.39	34,682.31	15,579.93
2009-10	74.39	79.73	27,980.63	12,732.01	37,611.20	15,968.92
2010-11	77.14	81.18	31566.98	14933.94	40920.63	18394.43
2011-12	73.25	77.98	34965.43	17242.31	47731.00	22111.85

Table No.10

Mean, Standard Deviation and Coefficient of Variation

Banks	Mean	Standard Deviation	Coefficient of Variation
HBL	71.50	6.03	8.43%
NIC	82.56	3.73	4.52%

(As per schedule 1)

Looking at the bank's performance, loan and advance to total deposit ratios are in fluctuating trend of NIC Bank where as HBL have the increasing trend in the last five years. In average, NIC Bank has the higher ratio of 82.56% in comparison to 71,50% of HBL. In this regard, NIC Bank is better indicating its strong position regarding the mobilization of total deposit on loan and advance and acquiring high profit in compared

to the NIC Banks but higher ratio does not necessary mean it is better in terms of liquidity as loan and advance is not as liquid as cash and bank balance and HBL may have utilized high portion of their deposit in various investment and cash and bank balance.

vi. Total Investment to Total Deposit Ratio

Investment is one of the major credits created to earn profit. This implies the utilization of a bank’s deposit on investment in government securities, shares and debenture of other companies and banks. A high ratio is the indicator of high success to mobilize the banking fund as investment and vice versa. The ratio is computed as:

$$\text{Total Investment to Total Deposit Ratio} = \frac{\text{Total investment}}{\text{Total deposit}}$$

Table no.11
Total Investment to Total Deposit Ratio

Fiscal Year	Ratio (%)		Total Investment		Total Deposit	
	HBL	NIC	HBL	NIC	HBL	NIC
2007-08	41.89	17.67	13,340.18	2,311.47	31,842.79	13,084.69
2008-09	25.12	19.42	8,710.69	3,026.02	34,682.31	15,579.93
2009-10	22.45	30.98	8,444.91	4,946.78	37,611.20	15,968.92
2010-11	21.43	26.46	8,769.94	4,868.91	40,920.63	18,394.43
2011-12	21.02	18.06	10,031.58	3,992.73	47,731.00	22,111.85

Table No.12
Mean, Standard Deviation and Coefficient of Variation

Banks	Mean	Standard Deviation	Coefficient of Variation
HBL	26.38	8.07	30.58%
NIC	22.52	3.71	16.46%

(As per schedule 1)

It is clear from the table no.11 and 12 that the total investment to total deposit ratios of the two banks is in fluctuating trend during the 5 year period of study.

The mean value of HBL is higher than that of NIC Bank however; coefficient of variation between the ratios is lower at 16.46% clearly indicating stability of investment policy of NIC Bank than that HBL. HBL has its higher ratio during the FY 2007-08 is 41.89% whereas NIC Bank has its higher ratio of 30.98% during the 2009-10. In the same way HBL has lower ratio during the FY 2011-12 of 21.02% and NIC Bank has its lower ratio of 17.67% in the FY 2007-08.

vii. Loan and Advance to Total Working Fund Ratio

Loan and advance is the major element in the total working fund (total asset) which indicates the ability of a bank to channelize its deposit in the form of loan and advance to earn the utmost return. This ratio is computed by dividing loan and advances by total working fund. The following table exhibits the ratio of loan and advances to total working fund of HBL and NIC Bank during the study period has been shown:

$$\text{Loan and Advance to Total Working Fund} = \frac{\text{Loan and advance}}{\text{Total working fund}}$$

Table no.13

Loans and Advance to Total Working Fund Ratio

Fiscal Year	Ratio (%)		Loans and Advance		Total Working Fund	
	HBL	NIC	HBL	NIC	HBL	NIC
2007-08	3.26	2.16	635.87	243.06	19,497.52	11,264.68
2008-09	3.04	2.32	752.83	317.43	24,793.16	13,679.39
2009-10	1.82	3.53	508.80	449.84	27,980.63	12,732.01
2010-11	2.83	3.31	893.11	495.70	31,566.98	14,933.94
2011-12	2.74	2.27	958.64	391.78	34965.43	17242.31

Table No.14

Mean, Standard Deviation and Coefficient of Variation

Banks	Mean	Standard Deviation	Coefficient of Variation
HBL	2.74	0.72	26.18%
NIC	2.72	0.60	22.21%

(As per schedule 1)

The table illustrates that both banks has the fluctuating trend in the last five years. NIC has the highest return of 3.53% in the FY 2009-10 and HBL has the highest return of 3.26 in the FY 2007-08. In average, HBL has the higher return ratio than that of NIC Bank with 2.74% in comparison to 2.72% of the NIC. The coefficient of variation of HBL Bank is higher than of NIC. So, it can be concluded that HBL is in the highest position in earnings from loans and advances in relation to the NIC banks.

In average, NIC Bank has maintained higher loan and advance to total working fund ratio than that of HBL indicating betterment in this regard. HBL has higher coefficient of variation suggesting of less uniformity and resulting higher risk.

viii. Credit Risk Ratio:

This ratio is very much important to bank to examine the project i.e. the risk involved in it to avoid default or non- payment of loan before making investment. This ratio measures the risk behind making investment or granting loan. Because of unavailability of data of performing assets; ratio is calculated with the help of loan and advance and total assets. This ratio is computed as:

$$\text{Credit Risk Ratio} = \frac{\text{Total Loan \& Advance}}{\text{Total Asset}}$$

Table no.15
Credit Risk Ratio

Fiscal Year	Ratio (%)		Loans and Advance		Total Asset	
	HBL	NIC	HBL	NIC	HBL	NIC
2007-08	53.90	73.92	19,497.52	11,264.68	36,175.53	15,238.74
2008-09	63.04	72.95	24,793.16	13,679.39	39,330.13	18,750.63

2009-10	65.50	62.69	27,980.63	12,732.01	42,717.12	20,309.33
2010-11	67.54	67.60	31,566.98	14,933.94	46,736.20	22,090.38
2011-12	64.32	67.41	34965.43	17242.31	54364.43	25579.53

Table No.16
Mean, Standard Deviation and Coefficient of Variation

Banks	Mean	Standard Deviation	Coefficient of Variation
HBL	62.86	5.16	8.20%
NIC	68.91	4.29	6.22%

(As per schedule 1)

During the five-year period of study, HBL and NIC Bank's is fluctuating trend. HBL and NIC Bank have the highest credit risk ratio of 73.92% and 72.95% in the FY 2007-08 and 2008-09 respectively. The table no.15 and 16 clearly depicts NIC has the higher average ratio than that of HBL which does mean HBL has higher credit when compared to NIC Bank. However, the coefficient of variation of HBL is higher than that of NIC Bank.

ix. Growth Ratio

Under this section, growth ratio of Total Deposit, Total Investment, Loan and Advance and Net Profit are calculated.

Growth ratio represents how well the CBs are maintaining their economic and financial status. Higher the ratios, better the executing of the bank and vice versa. Under this title, four types of ratios are studied. They are directly related to the fund mobilization and investment of CB. These ratios are:

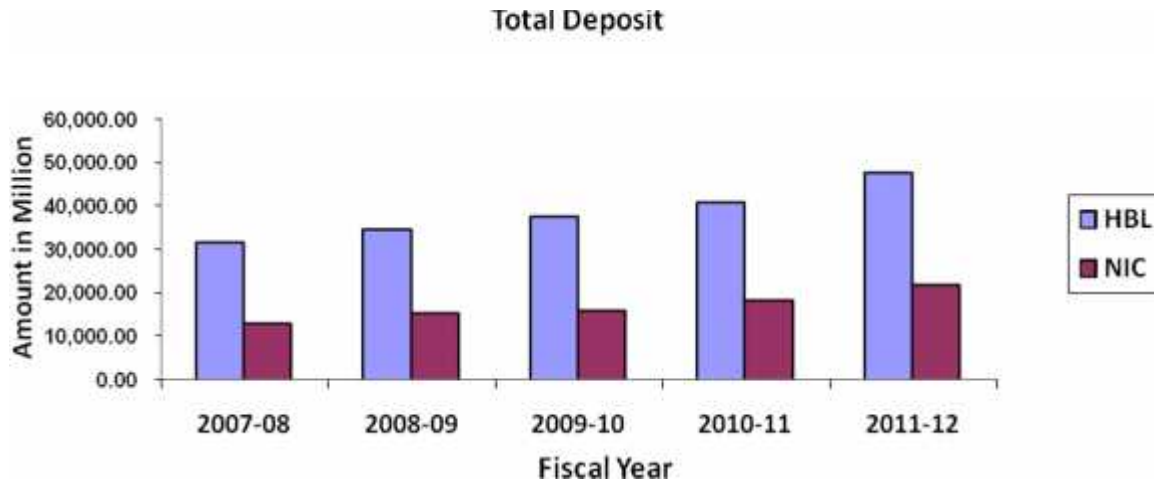
I. Growth Ratio of Total Deposit:

Table no.17
Growth Ratio of Total Deposit

Banks	Fiscal Years					Growth Ratio (%)
	2007-08	2008-09	2009-10	2010-11	2011-12	
HBL	31,842.79	34,682.31	37,611.20	40920.63	47731.00	10.65
NIC	13,084.69	15,579.93	15,968.92	18394.44	22111.85	14.02

(As per schedule 2)

Chart No.I



The table no.17 and chart No. I shows the comparative growth rate of total deposit of two banks. The growth ratio of HBL is much higher with 10.65% than that of NIC with 14.02%. This concludes that HBL performance in collection of deposit is better year-by-year in comparison to NIC.

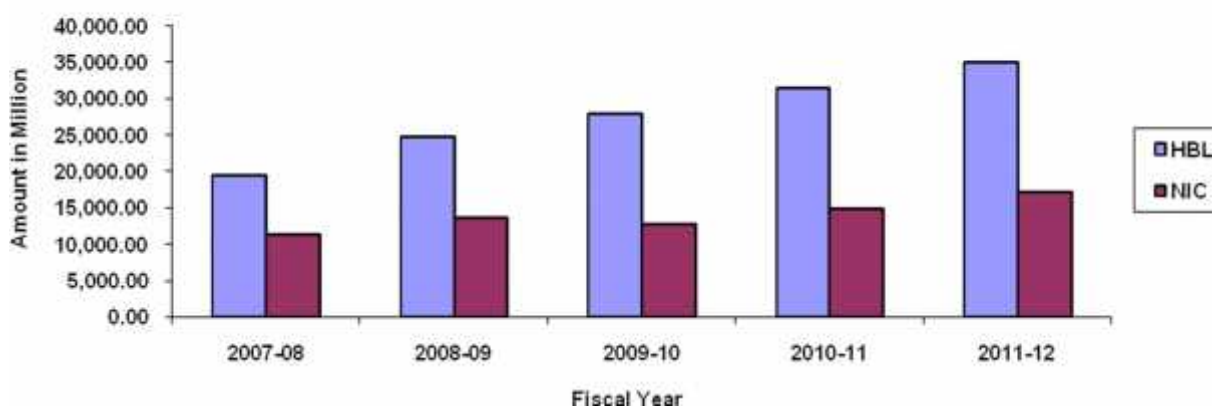
II. Growth Ratio of Loan and Advance:

Table no.18
Growth Ratio of Loan and Advance

Banks	Fiscal Years					Growth Ratio (%)
	2007-08	2008-09	2009-10	2010-11	2011-12	
HBL	19,497.52	24,793.16	27,980.63	31,566.98	34,965.43	15.72
NIC	11,264.68	13,679.39	12,732.01	14,933.94	17,242.31	11.23

(As per schedule 2)

Chart No. II
Loan and Advance



The comparative table no.18 and chart no. II depicts the growth rate of loan and advance during the five-year period of two banks. It is clear from the table that growth ratio of HBL is better than that of NIC. This does conclude that HBL has performed better in terms of granting loan and advance in compared to NIC banks during these five years.

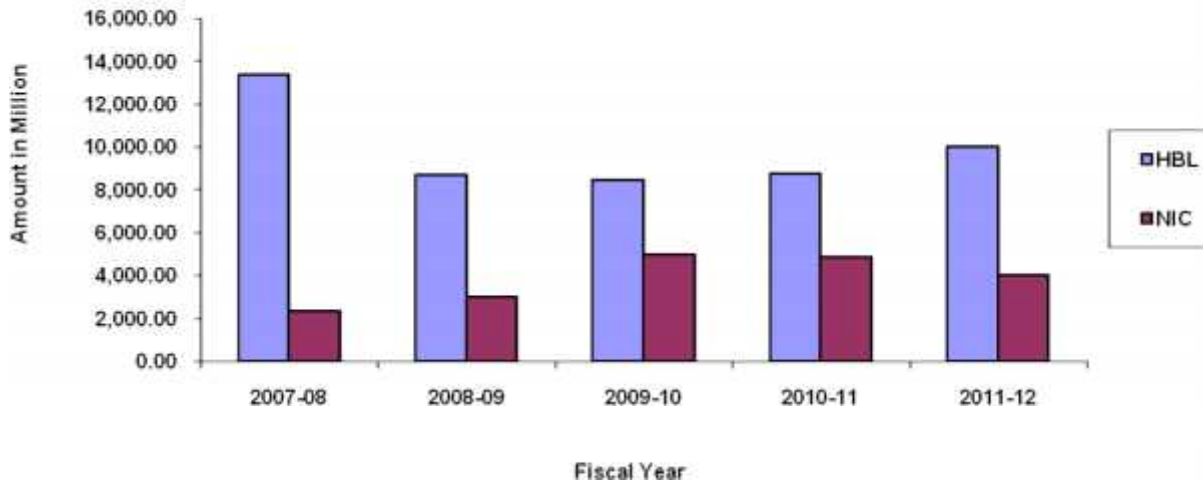
III. Growth Ratio of Total Investment:

Table no.19
Growth Ratio of Total Investment

Banks	Fiscal Years					Growth Ratio (%)
	2007-08	2008-09	2009-10	2010-11	2011-12	
HBL	13,340.18	8,710.69	8,444.91	8,769.94	10,031.58	(6.88)
NIC	2,311.47	3,026.02	4,946.78	4,868.91	3,992.73	14.64

(As per schedule 2)

Chart No. III
Total Investment



The table no.19 and chart no. III reflects the growth rate of investment of each bank is at increasing trend year-by-year. Comparatively, the growth ratio of NIC Bank 14.64% is higher than that of HBL (6.88%) and this signifies that investment of NIC Bank is enhanced than of the HBL

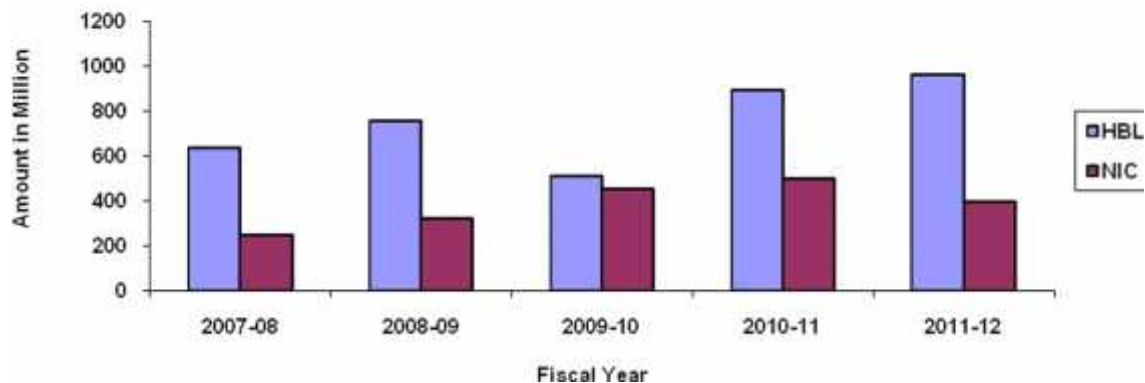
IV. Growth Ratio of Net Profit:

Table 20
Growth Ratio of Net Profit

Banks	Fiscal Years					Growth Ratio (%)
	2007-08	2008-09	2009-10	2010-11	2011-12	
HBL	635.87	752.83	508.80	893.11	958.64	10.81
NIC	243.06	317.43	449.84	495.70	391.78	12.67

(As per schedule 2)

Chart No. IV
Net Profit



The table no.20 and chart no. IV shows the comparative table of growth rate of net profit of both banks. NIC Bank has higher growth ratio of 12.67% than that of HBL 10.81%. This indicates NIC Bank has maintained better net profit during these five years when compared to the HBL.

4.2 Analysis of Statistical Tools

In order to achieve the objective of this study, some essential statistical tools are used such as Trend Analysis, Coefficient of Correlation Analysis, Standard Deviation, and Coefficient of Variation.

4.2.1 Trend Analysis:

Under this segment, current and projected trend values of loan & advance to total deposit ratio and total investment to total deposit ratio of NIC bank and HBL are calculated from FY 2006-07 to 2012-13 as per schedule 3 and 5.

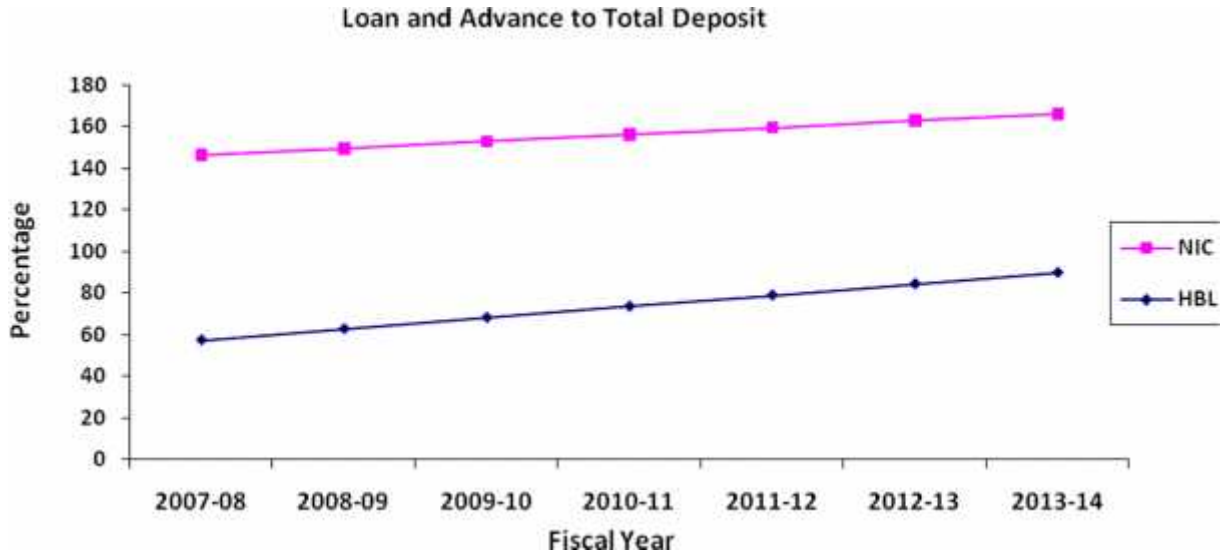
Table no.21
Current and Projected Trend Values of Loan and Advance to Total Deposit

Years	Banks	
	HBL	NIC
2007-08	57.30	89.05
2008-09	62.73	86.88
2009-10	68.16	84.72

2010-11	73.59	82.56
2011-12	79.02	80.40
2012-13	84.45	78.24
2013-14	89.88	76.07

(As per schedule 3 & 5)

Chart No. V



The table no. 21 and chart no. V depict that projected trend values of HBL is increasing trend and projected trend values are in decreasing trend for NIC Bank. This trend of ratio does signify that HBL and NIC Bank may use more than 89.88% and 76.07% of their total deposit in providing loan and advance up until FY 2012-13.

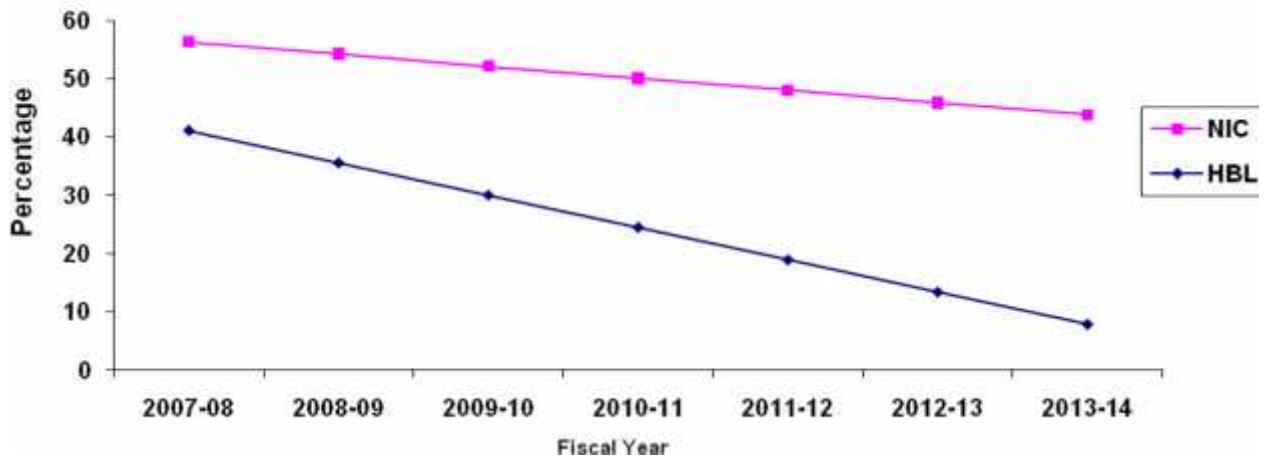
Table no.22
Current and Projected values of Total Investment to Total Deposit

Years	Banks	
	HBL	NIC
2007-08	41.10	15.19
2008-09	35.58	18.64
2009-10	30.05	22.08
2010-11	24.52	25.53
2011-12	18.99	28.97
2012-13	13.46	32.42
2013-14	7.94	35.86

(As per schedule 4 & 6)

Chart no.VI

Total Investment to Total Deposit



The table no.22 and chart no.VI shows that the present and projected trend values are in decreasing trend for HBL and in increasing trend for NIC Bank. The ratio of HBL on total investment to total deposit will be 7.94 for the FY 2012-13.

It does mean that HBL may not use its deposit in investment in the upcoming years as per trend. NIC Bank may use more than 35% of their deposit in investment in various sectors. Thus, it can be concluded that HBL's investment policies are predicted to be decreased.

4.2.2 Coefficient of Correlation Analysis:

Under this analysis, Karl Pearson coefficient of correlation is used to uncover the relationship between total deposit and loan and advance, total deposit and total investment and outside asset and net profit.

i. Coefficient of correlation between Total Deposit and Loan & Advance:

Coefficient of correlation (r) between Deposit and Loan & Advance measures the degree of relationship between these two variables. The main objective of correlation analysis between deposit and loan & advance is to find out whether deposit is significantly used as loan & advance or not.

Table no.23

Coefficient of Correlation between Total Deposit and Loan and Advance

Evaluation Criteria	Banks	
	HBL	NIC
R	0.9932	0.9815
r ²	0.9864	0.9633
P.E. r	0.0018	0.005
6 P.E. r	0.0108	0.003

(As per schedule 7 & 9)

Here, deposit is the independent variable (x) and loan & advance is dependent variable (y). The main objective of computing 'r' between these two variables is to justify whether deposit is significantly used as loan & advance or not. The table no.43 shows the value of 'r', P.E. r, and 6 P.E. r between deposit and loan & advance of HBL with comparison to NIC Bank during the study period of 2006-07 to 2010-11. From the table no.43 in respect to HBL, it is found that coefficient of correlation between deposit and loan & advance is 0.9932. It shows the positive relationship between these two variables. Furthermore, when we consider the value of coefficient of determination (r^2), it is 0.9864 which does mean only 98.64% of the variation in the dependent variable is explained by the independent variable. At the same time, considering the value of 'r' and comparing it with '6 P.E. r', we find that 'r' is much more than value of '6 P.E. r' which does mean that the value of 'r' is significant. Hence, there is significant relationship between deposit and loan & advance of HBL. This indicates that HBL is very successful to mobilize its deposit appropriately.

In case of NIC Bank it is found that coefficient of correlation between deposits and load and advances of NIC Bank is 0.9815, which explains the positive relationship between these two variables. The values of " r^2 " are 0.9633 which indicates 96.33% of variation in the dependent variable (loans and advances) has been explained by independent variable (deposits). Further, the values of "r" are higher than 6P.E.r which shows the significant value of "r" of NIC bank. Hence we could say that there is significant relationship between deposit and loan and advances. The bank has use the appropriate policy to mobilize its deposit on loan and advances

The value of "r" is significant in all cases the banks having positive relationship between deposit and loan and advances, all the banks have properly utilized the deposit to grant loan and advances. The relationship is significant as their values of 'r' are higher than '6 P.E. r' and the value of r^2 shows high percent in the dependent variable which has been explained by the independent variable. This indicates that HBL and NIC Bank are very successful in mobilizing their deposit properly.

ii. Coefficient of Correlation between Total Deposit and Total Investment.

Coefficient of correlation (r) between Deposit and Total Investment measures the degree of relationship between these two variables. The main objective of correlation analysis between deposit and total investment is to find out whether deposit is significantly used as investment or not.

Table no.24
Coefficient of Correlation between Total Deposit and Total Investment

Evaluation Criteria	Banks	
	HBL	NIC
R	(0.7839)	0.8974
r^2	0.1645	0.8053
P.E. r	0.0520	0.0263
6 P.E. r	0.3120	0.1578

(As per schedule 8 &10)

Here, deposit is the independent variable (x) and total investment is dependent variable (y). The main objective of computing 'r' between these two variables is to justify whether deposit is significantly used as total investment or

not. The table no.24 shows the value of 'r', P.E. r, and 6 P.E. r between deposit & total investment of NIC bank with comparison to HBL during the study period 2007-08 to 2011-12. From the table no.24 in respect to NIC Bank, coefficient of correlation between deposits and total investment is 0.8974 which explains positive relationship between these two variables. The value of "r²" is 0.8053 which indicates 80.53% of variation in the dependent variable (total deposit) has been explained by independent variable (total investment). Further, the value of "r" is higher than 6P.Er which shows that the significant value of "r". Hence, we could say that there is significant relationship between total deposit & total investment. The bank is successful to mobilize its deposit on deposit and investment.

In case of HBL Coefficient of correlation between deposits and total investment is (0.7839) which shows the negative relationship between those two variables. The value of "r²" is 0.1645 which means 16.45% in the dependent variable has been explained by independent variable i.e. deposit. Further analysis shows that the value of "r" is lower than value of 6p.Er i.e - 0.7839 < .3120 which indicates that the value of r is insignificant. It means there is no significant relationship between deposits & total investment. Likewise the bank has not taken policy of maximizing the use of their deposit as investment.

So, in conclusion NIC Bank has the positive relationship between deposit and total investment and HBL has negative relationship. Since the value of 'r' is higher than value of '6 P.E.r' of NIC Bank the relationship is significant. Similarly, the value of 'r' is less than values of '6 P.E. r', of HBL the relationship is not significant and the value of r² shows less percent in the dependent variable which has been explained by the independent variable. This indicates that NIC Bank is successful in maximizing the investment of the investment of its deposit and HBL and NIC Bank are not successful in maximizing the investment of its deposit.

Chapter V

Conclusion and Recommendations

Extend of development of any country is demonstrated by the development of the financial sector of that country. The financial sector comprises of Banks, Co-operative Societies, Insurance companies, and Finance companies. And integrated and speedy development of any country is possible only when a competitive financial service reaches every nook and corner of the country and its people. “Bank is an establishment for depositing, withdrawing and borrowing money” (Oxford English Dictionary). In general terms, banks are institutions that pool to gather the scattered savings of the people and arrange for its productive use. Banks, as a manager collects, disperses and controls the flow of the money. Banks collects fund from the public who has savings and it disperses the same fund to the persons who are in need of it.

The facts and matters needed for various parts of the study have been discussed in the previous chapters. Obviously, analytical part is the core of the study that formulates the comparative analysis of various aspects of the investment of the commercial banks with the assistance of some important financial as well as statistical tools.

After completion of the basic analysis needed for the study, the final and most important task of the researcher is to procure finding issues and gaps of the study and recommend for further development which would be significant to the top management of the bank to initiate action and achieve the desired result. The purpose of the researcher is not only to draw attention to errors but also to rectify them and show directions for further progression and enhancement.

5.1. Major Findings of the Study

The main findings of the secondary data are derived on the basic analysis of financial data of HBL and NIC Bank which are given below.

5.1.1 Liquidity Ratios

The liquidity ratios of HBL and NIC Bank reveal that:

- i. In average, the current ratio of NIC is higher than that of HBL Bank. At the same time, HBL's ratios also seem to be more variable than that of the NIC bank.
- ii. In average, NIC has the highest cash and bank balance to total deposit ratio than HBL. HBL has the poor maintenance of its liquidity which indicates the poor performance of the bank than NIC.
- iii. The mean ratio of cash and bank balance to current asset of NIC is higher ratio than that of the HBL and its ratios are more consistent than that of HBL.
- iv. In average, HBL has the higher ratio of government securities to current asset than NIC Bank, which means that HBL has invested as much of its current assets than the HBL. It also has the lowest coefficient of variation which indicates its stability.
- v. NIC Bank has the highest loan and advance to current asset ratio and its coefficient of variation is in the lowest than HBL indicating uniformity in comparison to HBL.

5.1.2. Asset Management Ratios

The asset management ratios of HBL and NIC Bank reveal that:

- i. In average, NIC Bank has the higher ratio of loan and advance to total deposit in comparison to HBL indicating its strong position regarding the mobilization of total deposit on loan and advance.
- ii. The mean ratio of total investment to total deposit of HBL is higher than that of NIC Bank. It also has good variability of ratios in this case.
- iii. In average, NIC Bank has maintained higher loan and advance to total working fund ratio than that of HBL. HBL has higher coefficient of variation suggesting of less uniformity and resulting higher risk.

- iv. NIC has the lowest mean ratio of investment on government securities to total working fund than the HBL indicating its poor performance. NIC has the highest coefficient of variation also indicating more variability than HBL.
- v. HBL has the highest mean ratio of investment on shares and debentures to total working fund than NIC Bank whereas NIC Bank is inconsistent and unstable in terms of investment on shares and debentures than HBL.

5.1.3. Profitability Ratios

The profitability ratios of HBL and NIC Bank reveal that:

- i. In average, HBL has the higher ratio of return on loan and advance than that of NIC Bank and however both Bank's return on loan and advance has been found in fluctuating trend.'
- ii. The mean ratio of return on total working fund of NIC is higher than of HBL. NIC's return on working fund is more efficient than that of HBL.
- iii. The mean ratio of return on equity of HBL is higher than of NIC Bank and its coefficient of variation is the lowest too which does signify its consistency.
- iv. In average, NIC Bank has the highest total interest earned to total working fund ratio in compared to HBL. Hence, NIC Bank is more successful towards the goal of earning interest income with higher earning power.
- v. The mean ratio on HBL is lower which means NIC Bank has not paid higher interest. C.V. of HBL is higher than that of NIC Bank which shows that NIC is less consistent.

- vi. In average, NIC Bank has the higher ratio of total interest earned to total operating income than HBL. NIC Bank is in better position regarding the mobilization of interest bearing assets such as loan and advance and investment.

5.1.4. Risk Ratios

The risk ratios of HBL and NIC Bank reveal that:

- i. NIC Bank has the higher average credit risk ratio than that of HBL. HBL has the lowest credit risk ratio among the two banks where as NIC has the lowest coefficient of variation.
- ii. In average, HBL has the lowest liquidity risk ratio comparatively than the NIC bank. Similarly, its ratios are more homogeneous than that of and NIC Bank. At the same time, HBL also has the highest coefficient of variation in comparison to NIC Bank indicating liquidity risk of HBL is high.

5.1.5. Growth Ratios

The growth ratios of HBL and NIC Bank reveal that:

- i. The growth ratio of total deposits of NIC is higher at 14.02% than that of HBL Bank at 10.65% concluding NIC's better performance in collection of deposit every year.
- ii. The growth ratio of loan and advance of HBL is extremely better with 15.72% than that of NIC Bank with 11.23%.
- iii. The growth ratio of total investment of NIC Bank 14.64% is higher than that of HBL (6.88%).
- iv. NIC Bank has higher growth ratio of net profit of 12.67% than that of HBL (10.81%).

From the above analysis, it can be concluded that HBL's operation with regards to collection of deposit, granting of loan and advance is comparatively better and in terms of net profit and total investment, NIC Bank is better.

5.1.6. Trend Analysis

Trend analysis of the study period and its projection for the next five years for loan and advance to total deposit and total investment to total deposit of HBL and NIC Bank reveals that:

- i. Trend values of loan and advance to total deposit of two banks, i.e. HBL is increasing trend and NIC Bank is decreasing which does mean HBL is using large portion of its deposits and NIC is using low portion of its deposits toward providing secured loans and advance.
- ii. Trend values of total investment to total deposit of HBL are decreasing which does indicate negative investment policy of the banks. Comparatively, NIC Bank is ahead in investing more portion of its deposit in the potential sectors.

5.1.7. Co-efficient of Correlation Analysis

Coefficient of correlation analysis between different variables of HBL and NIC Bank reveals that:

- i. Coefficient of correlation between deposit and loan & advance of NIC Bank is found to be lower than that of HBL. This indicates poor position of NIC Bank in mobilizing deposit as loan & advances.. In case of both banks, there is significant relationship between deposit and loan & advance.
- ii. Coefficient of correlation between deposit and total investment of NIC is found to be higher than the HBL. This indicates NIC is more successful in mobilizing deposit as total

investment. On the other hand, HBL is not so successful in maximizing the investment of their deposit.

5.2. Recommendations

After going over the analysis and findings, following recommendations are made in order to overcome the weakness and inefficiency and make better policy on fund utilization and investment.

5.2.1 Liquidity Position

- i. The liquidity position of a bank can be affected by external as well as internal factors which include interest rates, investment situation, supply and demand position of deposits and loans, central bank's instruction, the lending policies, capability of management, strategic planning, and funds flow situation. As HBL has maintained the ratio of cash and bank balance to total deposit lower than that of and NIC Bank, it is recommended to increase cash and bank balance to meet current obligations and loan demand.
- ii. Government securities such as treasury bills, bonds, saving certificates, etc. are safest medium of investment as they are risk-free and highly liquid in nature. The study reveals that NIC has not invested more funds in government securities and so is recommended to invest more funds in this sector and not making them idle.

5.2.2 Asset Management Position

- i. To achieve success in competitive banking environment, deposit must be utilized as loan and advances. Carelessness in utilizing this asset could be one of the main reasons of failure. It is found that NIC's loan and advance to total deposit is lower than HBL which indicates it has not properly used its fund as loan and advance. Hence, NIC is recommended to follow liberal policy.

- ii. Commercial bank needs to mobilize its funds in different sectors such as purchasing share and debentures of other financial and non-financial companies. This is required in order to achieve success and also to promote financial and economic development of the country through industrialization and commercialization. Out of total working fund, HBL has invested more of its funds as total investment. NIC Bank is recommended to invest their more portions in different kinds of companies in different sectors.
- iii. Loan default in commercial bank is a result of various factors such as political influences, lack of the necessary skills of project appraisal, improper collateral evaluation, irregular supervision and lack of entrepreneurship attitude. Political and administrative elements are highly prevailing in each and every sectors of Nepalese investment. Commercial banks always keep a distance from these influences.
- iv. Banks can gain more net profit if it can reduce its non-performing asset (NPA). They experience many difficulties in recovering loans and their large amount of loan is being blocked as NPA. Therefore, there is an urgent need to work out a suitable mechanism through which the default loans can be recovered. So, the two banks are suggested to implement a sound collection policy including procedure which ensures rapid identification of delinquent loans, immediate contact with burrower, and continued follow-up until loan is recovered and legal procedure if required.
- v. Regarding NPA, the bank must focus on credit risk management. The thorough analysis of the project and feasibility studies before granting credit facility can reduce the default. In addition to this, corporate morals and strong corporate culture with high degree of awareness of credit risk should be present. Hence, adequate policies and procedures need to be established.

5.2.3 Profitability Position

- i. HBL and NIC Bank being the banks of private sector, they cannot keep away their eyes from the profit motive. They should be more careful in increasing profit in a real sense to

maintain the confidence of shareholder, depositors, and customers. Hence they need to form a committee to identify the reasons behind the sharp decline in profit over the years and adopt various measures to improve its profitability. All the two banks have the fluctuating total income and so they have not been able to gain the optimum profit. So, they are recommended to decrease the expenses by controlling the operating expenses as well as by collecting the interest free deposits.

5.2.4 Risk Position

- i. Portfolio management of bank assets basically means allocation of funds into different components of banking assets having different degrees of risk and varying rate of return in such a way that the conflicting goal of maximum yield and minimum risk can be achieved. So, portfolio condition should be examined from time to time and attention should be given to maintain equilibrium in the portfolio condition as far as possible. The bank should make continuous efforts to explore new, competitive and high yielding investment opportunities to optimize its investment portfolio.
- ii. In the present scenario when there is high liquidity in the market and most of the commercial banks are flooding towards the retail banking, these three banks should also come up with innovative and competitive rates to grab the market position. The most effective weapon for achieving this target would be to apply very simple procedure and prompt decision on the credit request.
- iii. HBL and NIC need to adopt innovative approach for marketing in the light of growing competition in the banking sector. The business of the bank should be customer oriented. They should strengthen and activate their marketing function as it is an effective tool to attract and retain the customers. For this purpose, the bank should formulate new strategies of serving customers in a more convenient and satisfactory way by optimally utilizing the modern technology and offering new facilities to the customers at competitive prices.