A STUDY OF CREDIT MANAGEMENT OF MACHHAPUCHCHHRE BANK LIMITED, POKHARA

Presented by

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RECOMMENDATION

This is to certify that the thesis

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

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VIVA – VOCE SHEET

We have conducted the Viva – Voce examination of the thesis

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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 and thesis to be accepted as partial fulfillment of the requirement for

Master's Degree in Business Studies (M.B.S.)

VIVA – VOCE COMMITTEE

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ABBREVIATIONS/ACRONYMS

AFM	:	Annual Generation Meeting
BFIs	:	Bank and Financial institutions
CAM	:	Credit Approval Memorandum
CIB	:	Credit Information Bureau
CEO	:	Chief Expectative Officer
CPM	:	Credit Expectative Officer
CRR	:	Cash Reserve Ratio
DV	:	Distress Value
FDR	:	Fixed Deposit Receipt
FIG	:	Figure
FIS	:	Financial Institution
FMV	:	Fair market value
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
GOV	:	Government
HBL	:	Himalayan Bank Limited
ICAN	:	Institute of Chatter Accountants of Nepal
FFRS	:	International Financial Reporting Stander
IMF	:	International Monetary Fund
ISA	:	International Stander n Auditing
JV	:	Joint Venture
Ltd	:	Limited
NABIL	:	Nabil Bank Limited

NBL	:	Nepal Bank Ltd.
NIBL	:	Nepal Investment Bank Ltd.
NPL	:	Non Performing Loan
NRB	:	Nepal Rastra Bank
PG	:	Personal Guarantee
RCC	:	Reinforced Cement Concrete
ROA	:	Return on Asset
RE	:	Return on equity
ROI	:	Return on Investment
SAARC	:	South Asian Association for Regional Corporation
SCBNL	:	Standard Chartered Bank Nepal Limited
MBL	:	Machhapuchchhre Bank Ltd.
SEBON	:	Security Exchange Board of Nepal
SLR	:	Statuory Liquidity Ratio
VDC	:	Village Development Committee

CHAPTER I

INTRODUCTION

1.1 General Background

The financial crisis that was seen after 2007 was the first major crisis after 2nd world war whose cause pertains to the sub-prime lending in US and subsequent non recovery of those credit in the real estate and as result almost all the developed countries suffered economic slow from which Europe has not recovered yet. This is evident from the welfare cut of develop economic like Spain in Europe and economic like Greece has faced still more problems. They started to cut down the welfare they had provided prior to the economic slowdown that started after 2007. With the start of the economic slowdown in the developed economics, in the beginning Nepalese economy was seen as if its impact will not be seen, however, soon there was boom in the real estate sector of the economy and it reached such a height that due to great rise in the praise there was no transitions in the real estate sector of the economy. This no transaction state was also fuelled by the directives issued by Nepal Rastra Bank(NRB). A central bank of Nepal looking at the inflation of credit creation made by the bank and financial institutions NRB sensed that the economy will fall apart unless a strict measured is taken for curving the booming of real estate sector of the economy, hence it issued directives like lending no more than 60% of fair market value(FMV)of land and building where lending is made of collateral as land and building. Further it put the ceiling on percentage of lending on real estate and housing loan. not alone that it put the bearer on lending and restricted bank and financial institution to make lending only up to 80% of capital and deposit sum together(2011).

Economy was further hit by the in share market and which has not been to recover yet. Share market has not been able to gain the confidence of the investors and hence the share market is still down like real estate of the economy. liquidity crisis in financial sector as well as bearish trend in stock market and still not showing any sign of gearing up made the confidence of the investor low, resulting in the decrease in aggregate demand (AD) thus the economic growth expanded only by 3.2% in 2008 and 0.8% in 2009. World economy has started to gain pace with different measure taken by government of develop economy like capital injection and other monetary measure taken by central banks of developed economics. However, due to apathy of government our economy did not show as sign of recovery. The problem of liquidity crunch raised the lending interest rate of bank and finance which almost became double and rise to more than 18% in finance and more than 15% in bank. Though the liquidity crunch has ceased yet the lending rate of bank and the finance and not gone down like excepted because mainly of high deposit cost tied up in fixed deposit at the time of liquidity crunch and another reason is credit deposit ratio put by the NRB . Even though the rate in the deposit has come down, Bank and finance are reluctant to decrease the rate (Bhandari, D.R. 2003).

1.1.1 Concept of Banking

Bank can be defined as an institution which collects deposits from natural or legal persons and channel then to needy investors or entrepreneurs in the form of loans and advances. They provide security to the money of the depositors and help then earn interest on the other wise idle money that would have stayed in their home. In loans and advances they provide to investors and entrepreneurs they will charge slightly higher rate of interest and earn profit. Actually the difference in rate of interest they take on loans and advances and rate of interest they pay on deposit is call spread of interest and that id what determines the profit of the bank. Higher the spread of interest higher will be the profit. A question may arise how will the banks be able to return the money to the depositors when they present cheques as they have lent the same to the investors and entrepreneurs? The thing is that they will not lend the whole amount to the investors but will keep certain part with them. At present, NRB has restricted bank not to lend more than 80% of the deposit they have collected plus capital they have invested. Hence they will be return money to the depositors when they present cheques. Moreover all the depositors will not need or ask for the whole amount they have deposited in the bank. However, in some instances when the credit of the bank goes bank and there is higher Non performing Loans (NPL) them they will not be able to return the deposit of the depositors when they ask for and hence the general public loss the faith in the bank and all the depositor will ask to return their deposit and this situation is termed as bank run.

Modern banks not only accept deposit and lend loan and advances but also perform number of complex activities like electronic fund transfer. Investment banking, forex transactions, merchant banking, insurance, treasury, financial advisory, credit rating, lease financing, export credit, consumer financing, managing retirement plans and lot more activities.

A bank is lot more different from other corporate organization as it deals with the most liquid asset, i.e. cash/money. The activities of the banks are highly monitored by the central bank of each nation and they are highly regulated by them (Bhandari, D.R. 2003).

Origin

The name bank is said to be derived from the Italian word banco which means desk or bench. During the time of Renaissance, Florentines bankers used to make their transactions above a desk covered by a green tablecloth and it is believed that the word bank was derived from this word banco as they used to collect deposit from public and make lending to needy investors. However, it is believed that there are traces of banking activities even in the ancient times. The word trace its origin back to the Ancient Roman Empire where moneylenders would set up their stall in the middle of enclosed courtyards called macella on a long bench called a banco from which the words banco and bank are derived.

There are few other words like "Back" in Germany and "Banke" in French that are also believed to the origin of the word bank. No matter whether the word Bank has been derived from any of the word that is mentioned above, but all these word means the same thing, joint stock companies that collect deposits and provide loan to the general public. The first bank casa de san Giorgio in Genoa was established in 1148 A.D.Bank of Venice was established in 1147A.D. IN 1401 bank of Barcelona was established in Barcelona. Modern bank started to take rapid speed from 17th century. In 1609; the bank of Amsterdam was established. Likewise in 1610A.D. Bank of Homburg was established in Germany. The first central bank was established in 1844A.D. (Lynch, Richard M. & Williamson robberWC 1992).

In context of Nepal the first bank is Nepal Bank Limited established in 1994 and the central Bank of Nepal, Nepal Rastra Bank (NRB) was established in 2013 only.

Definition

To further clarify the concept of bank, here are few standard definitions:

A bank is an institution which collects money from those who have in spare or who are saving it out of their income and lends this out to those who require it (Crowther, 2001:81).

A bank and financial institution is a business organization that receives and holds deposit of fund from others makes loans or extends credits and transfers funds by written order of depositors (Bhattacharya, Hrishikes, 2001).

Bank and financial institution 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 (Indian institute of banking and finance, 2005).

Commercial bank Act 2031 B.S. of Nepal has defend that a commercial bank is one which exchanges money, deposits money, accepts deposits, grants loans and performs commercial banking function and which is not a bank mean for cooperative, agriculture, industries for such specific purpose."However, the Bank and Financial Institutions Ordinance,2060 has merged the five banking acts including the commercial bank act,2031,which defines the bank with respect to their transactions. Later on the Ordinance has been replaced but Bank and financial Institutions act 2063.This act is trying to categorize the banking institutions in two ways based on their transactions one as bank and other as financial institutions. According to this act, Bank is the institution which performs its transactions under the section 47 of this act.This act has laid emphasis on the functions of commercial bank while defining it. Commercial banks provide short-term debts necessary for trade and commerce. They take deposits from the public and grant loans in different forms. They purchase and discount bills of exchange, promissory notes and exchange foreign currency. They discharge various functions of the behalf of their customers, provided that they are paid for their services. The act has categorized bank and financial institutions into 4 classes of the requirement of paid up capital required for obtaining license to operate financial transactions. At present 4 classes and their paid up capital requirements is illustrated in the table below (Shrestha, 2008).

Table: 1.1

Classes of financial institutors and their capital requirement

Class	National level	Regional level*	4-10 District*	1-10 District*
A	200 Crores			
B	64 crores		30 Crores# 20 Crpres	30 crores# 10 Crores
C	30 Crores# 20 Crores			30 Crores# 10 Crores
D**	10 Crores	6 Crores***	2 Crores##	1 Crores

Notes:

* Outside Kathmandu Valley And such Institutions need their area of lending limited to the approved districts only.
#Applicable to those institutions involved in leasing transactions.
**Institutions having micro finance transition.
##Institutions limited to 5 districts of rural area.
***Operating within a development region.

Source: Directives of Nepal Rastra Bank

Development of Banking Sector in Nepal

The banking sector in Nepal has developed to its current state in a gradual process. Its evolution can be trace back to the established of "Kausitoshikhana" as banking agency during the time of Prithivi Narayan Shah and" TejarathAdda"to its current expansion of above 260 Financial Institutions. Banking sector of Nepal has come long way for the initial stage to its present stage in quite short span of time. Even pioneer bankers would also not have imagined that it would come to its present stage where internet banking, mobile banking can be performed from staying at home.

History of Banking in Nepal

History of Banking in Nepal can be summarized in 4 distinct phases:

First phase of Nepalese Banking

The first phase of the Banking in Nepal can be traced back the date when a merchant named shankhadhar had started "New year-Nepal Sambat" after freeing all the people of Kathmandu Valley from their debts. This shows that there was existence of money lender at that time and some form of banking did exist at that time as well. Further king JayasthitiMalla had given the responsibility to a caste of society called "Tankadhari"which was responsible for transactions of money in the society. However a distinct starting of the organized financial institution in Nepal started after the establishment of "TejarathAdda" in 1933 B.S. The purpose of TejarathAdda was to provide loans to Government officials and provide loan against the security of Gold and silver to general public. Still at that time it would not accept deposit from the general public.

Second Phase of Nepalese Banking

The replacement of "TejarathAdda" by Nepal Bank Limited of 30th kartik 1994 B.S. marked the second phase of Nepalese banking. Nepal Bank Limited was established with an authorized capital of Rs.10 million. SadarMulukikhana of the then His Majesty's Government brought into circulation of 5, 10 and 100 rupees notes. In the beginning Nepal Bank limited was given the role of central bank with modern banking facilities and with the pace of time it was felt that a separate Central Bank is necessary.

Nepal Rastra Bank was established in 14thBaisakh 2013 B.S NRB act 2012 which has been replaced now by NRB act 2058 to match the current need of the modern banking.The central bank of Nepal issued notes on 7thFalgun 2016 B.S for the first time. Prime objective of that time was to replace prevalent India currency in Nepal, stop dual monetary system and to apply monetarism in all part of Nepal. Further its objective at that time of establishment was to provide issuance of note, to bring Nepalese currency in use, to manage monetary system well, to encourage nation industry by mobilizing the capital for the development of nation and too develop banking system in Nepal. Its objectives have changed over time and at present in objective are regulating banks and financial institutions prevalent in Nepalese economy, maintenance of positive balance of payment and maintaining exchange rate through NRB act 2058 (Bhandari, D.R., 2003).

After the establishment of Nepal Bank Limited and Nepal RastraBank another bank was established in 2022 under BanijayaBank act 2021 called RastraBanijaya Bank. RastriaBanijaya Bank was established according to the recommendation of NRB. RastriyaBanijaya Bank went into along with Nepal Bank Limited due to high nonperforming assets. After they went into trouble NRB started restructuring program and they are now slowly recovering.

Yet another bank was established in initiation of government for promoting agriculture sector of the economy. Agriculture development bank was established on 7thmagh 2024 for financing in agriculture sector of the economy.

Third Phase of Nepalese Banking

After the establishment of agriculture development bank there was gap of around 2 decades for further opening of the banks in the Nepal. In 2040 a joint venture bank Nepal Arab Bank Arab Bank Limited(NABIL) was established under the commercial bank act 2031 and companies act 2021 which marked the starting the 3rd phase of banking in Nepal. After NABIL Bank, came Nepal Investment Bank Limited (the then Nepal Indosuez Bank) and Standard Chartered Bank (the GrindalaysBank Limited) in 2042 and 2043 respectively. Soon many other joint venture banks were established after that Himalayan bank limited (JV of Habib Bank of Pakistan),Nepal SBI Bank Limited (JV of SBI India), Nepal Bangladesh Bank Limited (JV of international finance investment and commerce Bangladesh),Everest Bank

Limited(JV of Punjab National Bank, India), Bank of Kathmandu (JV of Syan Bank of Thailand), Nepal credit and commerce(form Bank of Colon. JV of Syan Bank of Thailand), Nepal credit and commerce (former Bank of Ceylon.JV of Srilankan and Nepalese investors). So third phase of Nepalese banking saw the foraging investment in Nepal grow in banking sector. Along with it grew the other the local Banks like Lumbani Bank and Laxmi Bank Limited, Siddhartha Bank, Kumari Bank etc. in Kathmandu (Bhadari, D.R, 2003).

Fourth Phase

After the establishment of democracy in early 90s in Nepal and liberalization of banking sector, banks were able to determine the of interest on the basis of demand supply and further to started the concept of regional banking and development banking which marked encouraging progress and massive of various types of banks and thus marked the 4th phase of Nepalese banking. With the promulgation of NRB 2058(amendments 2063) and bank and financial institution act 2063 that categorized as per the capital requirement and forms of transactions possible to be by them, many financial institution sprouted, at national as well regional level. The range of financial inclusiveness has widened, environment for capital mobilization eased, and opportunities in the banking sector extended with the expansion of the financial sector (Bhandari, D.R. 2003).

Current Scenario

At present there are 31 commercial banks, 88 development banks and 70 finance companies at the end of fiscal year 2068/69along with banks and financial institution. There are 24 of microfinance development banks. NRB licensed cooperative and 36 NRB licensed NGOs which are given limited right for banking transactions. There has been decline in number of finance companies due to the merge of finance companies with commercial banks or development banks and one increment of commercial bank is due the upgrading of Sanima development bank to commercial bank. Table below show the growth in the number of banks and financial institution over the year (Bhandari, D..R. 2003).

Table: 1.2

Banks and financial institution in Nepal

Bank and Financial Institutions	Mid - July					
	2007	2008	2009	2010	2011	2012
Commercial Banks	20	25	25	27	31	32
Development Banks	3	58	61	78	87	88
Finance Companies	74	78	78	79	79	70
Microfinance Development Banks	12	12	13	18	21	24
NRB Licensed Cooperatives (Under taking Limited banking transactions)	17	16	16	16	16	16
NRB Licensed NGOs (Under taking micro finance transactions)	47	46	45	45	38	36
Insurance Companies	21	25	25	25	25	25

Source: Nepal Rastra Bank (Banking and Financial Statistics). Mid-July 2012.

As the banking business works and operates in a dynamic environment where there is involvement of most liquid asset named cash. With the widening of cash transactions and network of banking there will be involvement of higher degree of risk and scope of monitoring needs to widen else the failure of banks and financial institution will be evident which has been shown as a result of failure of few development banks and finance companies like Nepal Share Market and Finance Company, Capital Merchant and finance Company and Gorkha Development Bank in recent time.

With the bubble growth of real estate and the lending of banks and financial institutions in the that sector had made the time hard for banks and financial institutions as the central banks put the caps through circulate in real estate sector and the same time the slowdown of global economy and decline in remittance. Further the central bank fixed the CD ration and increased cash reserve of financial institutions. However, with time the banking sector is recovering but at the same time there is rise in NPL of the banks and financial institutions which is the result of rampant lending in real estate during the bubble growth of real estate (Nepal Rastra Bank Act, 2058).

Banking in Pokhara

31 commercial banks have 52 branches operating in Pokhara. There are more than 24 Branches of 14 Finance companies among which 5 are with their head office in Pokhara Valley. There are 6 microfinance institutions working in Pokhara Valley. Another class of financial institution, Development Banks has more than 50 branches of 22 Development Bank among which 8 have their head office in Pokhara. When we combine all these financial institutions together there are more than 85 financial institutions branches alone and more than 125 out less serving the population of Pokhara Valley (Kunwar, Maju 2009).

1.1.2 AboutMachhapuchhre Development Bank Ltd.

Machhapuchhre Bank Limited is a class licensed commercial bank institution authorized by Nepal Rastra Bank. It is Pokhara based and have its head office in Nayabazar, Pokhara. It came into operations from 4thFalgun 2054 and has been operating in profit since then. It was started by individuals from various sectors with the goal to provide banking services to general public with the cutting edge technology and hence it has slogan of service with personal touch. It was established as 15th commercial bank of the nation; however, it has come into forefront in many indicators like Deposit mobilization. No of customers, lending and in respect of number of other measuring indicators.

Network

With the merger of its own kind, in fact the first biggest merger of two independent groups of the existing MachhapuchhreBank Ltd.and the Standard finance company with a paid up capital of above one billion rupees promoted by among other prominent local businessman, the highly renowned nonresident Nepalese, has given a big impetus to the bank.

After this merger with a paid up capital of over 2.47 billion rupees, 54 branch offices and 60 ATMs spread all across the country, it is one of the biggest full-fledged national level commercial bank operating in Nepal. It takes pride in have its own building for its corporate office in Lazimpat, Head office in Naya Bazar, Pokhara and Branch office in Jomsom, Balgung and Damauli. It also has a new structure fit for office of the corporate level coming up in Kathmandu (Maharjan, Reena, 2009).

1.1.3 Services and Products of Machhapuchhre Bank Ltd.

Deposit Products

Machhapuchhre Bank Limited offers a wide range of deposit schemes to its customers that the customer can choose. Customers can open deposit accounts in both local as well as foreign currency. Interest paid on Deposits is subject to tax deduction at sources (TDS) as per rules of Government of Nepal. The banks offer following deposit schemes:

- Call Deposit
- Fixed Deposit
- Saving Deposit
- Royale Saving Accounts
- Share Holder's Account
- FewaBachatKhata
- YuvaBachatKhata
- Salary Management Scheme
- UchchashikshaNickchhapYojana
- Mach 7 Saving Deposit Account
- SammanBachatKhata (Machbank @ mbl. com,np.)

Other Services

Along with the deposit and loans and advances productthe bank has offered other services like.

- Machhapuchhre VISA Debit Card
- MBL Mobile Money(M3)
- SMS Banking
- Internet Banking
- Any Branch Banking
- Trade Finances.
- Money 2 Nepal
- Remittance
- Correspondent Banking

Loan and Advances Products

Machhapuchhre Bank Limited provides various types of loan and advances designed so suit the varied requirements of industrialist business houses, professionals, Enterprise news and individuals.

Various loan products offered by the bank are:

- Term Loan
- Working Capital
- Trust Receipt
- Packing Credit
- Pre-shipment Loan
- Post shipment Loan
- Home Loan
- Hire Purchase Loan
- Loan against Securities
- Privilege Loan (Machbank@mbl.com,np)

1.2 Statement of Problem

With the growth in the number of financial institutions and their branches there has been increase in competition. As we know when the market becomes saturates then the banks and financial institutions have to compete with each other for the customer's For that they either have to cut down the rate of internet on lending or they have to provide greater volume of services at the same rate of interest. In either context the bank has to pay higher cost or loss the income generation capacity. To compete in the tough environment banks have to have greater better human resources and better system to operate. As the fact is that the interest income covers large part of the income and more than 80% of total income of the banks, hence it is very important to have better credit management of the bank. In the event that the banks don't have better credit they will have to suffer from credit risk and if there is no proper management than it will lead to the failure of the bank.

Bank's financial statements are very transparent as they are constantly monitored by NRB and on top of it; its financial highlights have to be published on quarterly basis upon the end of quarter. As they are published and its stakeholder can view financial statement, the bank has to perform better and show a better result so that they can remain in the competitive market. Hence for better result it is necessary to have better credit which enables them to earn good profit. As has been stated earlier, banks earn profit from the spread between the rate of interest they charge to the borrower and rate of interest they provide to the depositors. If the borrower is not able to pay the interest than the bank would suffer from loss as they would have to pay the interest to the depositors at any cost. In this scenario credit management and mitigation of credit risk is very important. Credit management would deal in assessing credit. Assessing of feasibility of project, security to be mortgaged, maintaining relation with the customers, follow up in case of default and eventually recovery of credit when the credit goes bad.

Since the different commercial banks have been established gradually because of the Liberal and market oriented economic policy (Report) of Nepal Governments. They have been facing though competition from other banks and of course with each other. Although various banks operating in Nepal after Government adopted the open liberal and market oriented economic policy (Report) the financial sectors have not enough resources the meet the growing need of the economy as expected before. Why is so and what is the problem? To answer this questions and analysis of their present credit management is necessary. Therefore, focus of the present study is on the credit management of commercial banks in Nepal with special reference to MBL. The study will attempt to evaluate following questions.

- What are the liquidity position and its effect in lending practice?
- What is the portfolio of Lending sector of the bank?
- Is MBL maintaining lending efficiency?
- What is the procedure of MBL for granting Loan?
- How is MBL managing its assets and profitability?

1.3 Objective of the Study

The main objectives of the study are to evaluate the trend of credit management of MBL. Undoubtfully the role of commercial bank in mobilizing coffered resources of nation is praise worthy one. This aims to examine its effectiveness, systematization and sincerity in disbursing and recovery loans well within the direction of Nepal Rastra Bank, Financial Institution Act and its own policy.

The objective of the study is to see the relationship between the figure and flow of deposit collection, loan distribution and loan recovery of MBL. So the study has evaluate the data of MBL from the fiscal year 2064/2065 to 2068/2069 the study has set the following specific objectives.

- To assess the liquidity position and its effect in lending practices.
- To analysis the portfolio of lending sector of bank.
- To analysis the lending efficiency of MBL.
- To evaluate the procedure of MBL for granting loan.

- To assess the assets and profitability of MBL.

1.4 Significance of the Study

The significance of credit management is very high in banking sector and it is widely accepted principal that for the success of the bank it is very essential to have proper credit management system outlined in its Credit Policy Guidelines. The concept of proper credit management is important for several reasons like credit administration. Credit documentation process,project appraisal, risk assessment, credit portfolio management and smooth recovery process in the event of default of the loan. The most important one is making lending decision to the event of default of the loan. The most important one is making industry being a service industry the product of this industry is the services made available to its customers and we will be studying lending products of its with reference to the risk associated to it and it and how it is mitigated for higher return on the investment of the bank.

We can find a whole a lot of work done in the field of credit management in overall and credit Fisk management id specific terms. Mostly studies on this topic has been done in Europe and America where there is highly developed financial system and banks play great roles in the functioning of the economy. As our economy is still in primitive stage in comparison to be developed financial system of Europe and America and there is very little research work done in this field in our banking industry. Since our banking sector is rapidly growing and in recent years number of commercial banks, development banks and finance companies have come into operations ignoring co-operatives that out numbers commercial banks, development banks and finance companies all together. These banks and finance had opened so many branches that out banking sector is crowded with banks and finance that other sector of the economy. With the growth of banks and finance companies our banking sector will soon face the same problem of the bank failure as the banks and finance face in Europe, America and other developed Asian nations. There are cases that were more than 500 banks failures in a single year in Russia. In Malaysia the number of banks increased to 57 and later decreased to 21. So the case that happened in these was mainly due to the rapid increase in banks and poor management of credit facilities they offered to the borrowers.

Few of the instances of bank failure also can be seen in case of Nepalese banking history. High NPL of two major Govt. Banks Nepal Bank Limited and RastriyaBanajya Bank Ltd, this bank's management was taken by Nepal Rastra Bank and foreign management was provided for the effective management of the bank. Further management of NCC Bank and

Nepal Bangladesh Bank was also taken by Nepal Rastra Bank, not only that Nepal Development Bank was liquidated and Nepal share Markets and Finance Limited and Gorkha Development Bank has been declared as problematic financial institutions. These banks and finance face problem due to its bad credit and the reason was not following proper corporate governance while making lending decision to the customers.Nepal Rastra Bank was felt that the number of financial has grown to large scale and it has to be slash down, hence it has adopted a policy of merging banks and financial institutions. With the step of NRB number of banks and finance has merged and there are other banks and finance which are in the process of merging.

The reason behind choosing this subject is quite evident from the above arguments and on top of it, there has been vast amount of literature in Credit Management and Credit Risk management of Developed economics like America, Europe and Developed nations of Asia but little research has been done in case of our nation. More over credit management is important in banking as it determines the fate of the bank: hence it is very crucial to have better credit management in the banking industry for the survival of banking industry which is still infant stage in our economy.

Machhapuchhre Bank is a prominent organization in the western region and it is one of the fastest growing commercial banks with largest branch network amount the regional level commercial bank of western region. With the growth of the branch, network and credit portfolio, it is highly necessary to have better policy to monitor the loans and advances issued by the branches else the bank would be really in trouble, hence this study would be greatly beneficial to bank and hence the bank has been chosen for the study purpose.

1.5 Limitations of the Study

Flawless study is never possible as always there are assumptions and limitation made while making the study of the topic and making the study possible. Following limitations are observed in this study.

- Since real exposure to the credit files was not possible and it is difficult to make actual analysis of the risk.
- Due to limited time a comprehensive study of all the factors was not possible.
- Since the credit appraisal was very confidential, the real process and its nature were not exactly disclosed by the banks management.
- Due to slight difference between different products it was hard to know exactly portfolio and the system to manage the portfolio.

- Since the process of credit administration and other data of the credit like name of borrower, rate and limit sanctioned to borrower, collateral offered by the borrower are highly confidential, these data disclosed by the management of the has been strictly kept confidential and the name of the borrower has been disguised to hide the actual name of the borrower.
- In case of group of borrower they have been called group A. Group B, Group C, Group D and Group E to hide the real name of group of borrower in the group and the company under study have been named ABC Company to hide the real name of the company to which the bank had provided lending.
- The quality of study depended upon the data provided by the bank and its management.
- This study will concentrate or covers only five year's data from fiscal year 2064 / 2065 to 2068/069 B.S.

1.6 Organization of the Study

This research has been organized in three chapters as below:

Chapter-I: The first chapter deals with introduction. This includes background. Statement of problem.Objectives of the study, significance of the study, limitation of the study and organization of the study.

Chapter-II: This chapter consists of conceptual review and review of related studies.

Chapter-III: This chapter includes research design, population and sample, sources and types of data, data gathering procedure and analytical tools such as financial and statistical and method of analysis.

Chapter-IV: This chapter deals with data collected from different sources. Based on the data collected analysis of such data has been made using statistical non-statistical tools. This chapter also includes major findings.

Chapter-V: This chapter includes summary, conclusion and recommendation for improvement.

CHAPTER-II

REVIEW OF LITERATURE

2.1 Conceptual Framework

The review of literature is a crucial aspect because it denotes planning of the study. The main purpose of literature review is to find out what works have been done in the area of the research problem under study and what has not been done in the field of the research study being undertaken. For review study, the researcher uses different books, reports, journals and research studies published by various institutions, unpublished dissertations submitted by master level students and resources availed in the internet by various websites. Of lately resources in the internet has been major source for literature as it has made available not only the research work of national and local researchers but also of researchers worldwide.

2.1.1 Credit Management

Management of credit can be defined with the help of defining management and credit separately and combining these definitions together. Management can be defined as organization and coordination of activities of enterprises in accordance with certain policies and in achievement of defined objectives. Credit can be defined at the contract or agreement between bank and the borrower where the bank lends deposit collected from the individuals in the form of loans and advances by obtaining real collateral or just on the basis on personal guarantee and the borrower pays interest on the loans and advances in agreed interval of time and eventually returns the principle sum borrowed as well. Now when we combine both of the definition credit management can be defined as organizing and coordinating the credit administration procedure starting form collection of documents to processing, appraising the project's feasibility, obtaining collateral and mortgaging it in favors of bank, follow up of for recovery of interest and principle and finally recovering the loan and advances when it goes default. Hence it will deal with the overall process of credit from beginning to the end. All these process are outlined and defined in the credit policy guidelines, generally called CPG (Van Horn, J.C. 1998).

2.1.2 Credit Policy Guidelines

Credit Policy Guidelines (CPG), is the main source of credit management of the each individual bank and financial institutions, the credit policy guidelines can be called bible of bank and financial institution regarding management of credit and advances of the bank. Each and individual banks and financial institution has its own CPG and on the basis of it. They would make lending decision, obtain collateral. Make administration of credit and finally make recovery of loans and advances. Though each individual bank has its own CPG, the basic norms will be same for all the banks. Some banks will have quite rigid policy and some will have a bit soft policy for the lending, but the basic theme will be same for all the banks and financial institution.

Now for the better performance of the banks and financial institutions they need to have good credit policy and good implementation of such policy for the good management of credit. The credit policy cannot be sound unless it is based on clear knowledge of the cost of credit, return on credit and the risk associated with it. The cost is determined by the quantity of credit, the average should be used which takes only incremental cost into account, the full opportunity cost has to be considered. The overall cost of credit will also is affected by the expected rate of inflation. For accurate assessment of the cost of capital, a discounting approach should be used. A credit package can be differentiated in various ways: by duration, by interest charge, and by the interaction with the rest of the pricing mix (Indian institute of banking and France, 2005).

2.1.3 Credit Risk

Financial activities are necessary for the economic development of the country and banking in this context is the heart of financial system. Optimal investment decision plays a vital role in each and every organization. But especially for the banks and other financial institutions, sound knowledge of investment is the most, because this is more concern with mobilization of funds in different sectors in view of return. As the banks and financial institutions, they must mobilize (i.e., investment in different sectors) their collections (deposits) and other funds towards the profitable, secured and marketable sectors so that they will be in profit. As we know without risk there is no return hence credit of the banks and financial institutions has risk associated with it and the risk will be of different categorized. As the risk can't be totally eliminated, hence and effort is made to mitigate it. For this purpose these banks and financial institutions should gather the sufficient information about the prospective borrowing firm (Client). The information collected include a financial background, nature of business as well as its ability to pay the loan back or basically check the five C of credit i.e. and the probable risk associated with it. Following are the risk associated with credit.

- Credit history or character of the client.
- Cash Flow or Capacity to pay back the loan along with interest.
- Collateral of security in case the loan goes default.
- Capitalization or what portion has been invested by the client in the business.
- Conditions or the different factors in the environment effecting the lending decision.

These all information should be gathered from the viewpoint of security and overall success of the business of the client. The income and profit of the bank depend upon the lending procedure applied by the bank and, lending policy and investment in different securities also affect the income and profit. In the investment procedures and policies it is always taken in mind that "the greater the credit created by the bank, the higher will be the profitability." A sound lending and investment policy is not only prerequisite for bank's profitability but also crucially significant for the promotion of savings of a developing country like Nepal. The sound policies help banks maximize quality and quantity of investment and there be achieve the own objective of profit maximization and social welfare. Formulation of sound investment policies, coordinated and planned efforts pushes forward the force of economic growth. Banks and financial institutions perform a number of internal functions among them, providing credit is considered as most important one as more than 80% of income is generated from the interest income from lending of the bank and financial institutions.(Indian institute of banking and finance, 2005).

2.1.4 Financial Analysis

Ratio analysis is the process of determining and interpreting numerical relationship based on financial statements. A ration is a statistical yardstick that provides a measure of the relationships between two variables or figures. There are more than 100 rations in practices though all these ratios are not equally important and ratios important for our study shall be discussed later in the chapter. These rations help us to check the financial health of the firm or company, when they are compared with the standard of the industry along with the past performance. When the ratios are above the average standard of the industry the financial health of the firm or company is supposed to be good while if the ratios are below the average of the industry than it is not a good sign and a firm or company may be in financial trouble. However when making comparison of the ratios a set of the ratios has to be taken into consideration as single ratio will not tell us the actual financial position of the firm or company in study.

Webster's ne collegiate dictionary defines a ratio as the indicated quotient of two mathematical expressions and as the relationship between or more things. In financial analysis a ratio is used as benchmark for evaluating the financial position and performance of a firm (New collegiate Dictionary" 8^{th} Edition).

Standard of Comparison

The ration analysis involves comparison for a useful interpretation of financial statement. A single ration in itself doesn't indicate favorable or unfavorable condition. It should be compared with some standard. Standard of comparison may consist of:

- Past ratios: Ratio calculated from the past financial statement of the same firm.
- Projected Ratio: Ratio developed using the projected or financial statement of the same firm.
- Competitor's Ratio: Ratio of some selected firms, especially the most progressive and successful competitor, at the same point in time.
- Industry Ratio: Ratios of the industry to which the firm belongs.

Types of Ratios

Several ratios calculated from the accounting data cab are grouped into various classes according to financial activity or function to be evaluated. Long term creditors or the other are more interested in the long-term solvency and profitability of the firm and short term lender will see the current assets and the cash flow if the firm can meet their obligation when the loan will mature in the near future. Similarly owners concentrate more on the firm's profitability and financial condition. Management is interested in evaluating every aspect of firm's performance. They have to protect the interests of all parties and see that the firm generate enough profit and maximize wealth of the firm and have adequate cash flow so that it will be able to meet the dues when they fall dues. In view of the requirement of various ratios they may classify into following groups.

Credit Practices Ratio

i. **Total loan to total deposit ratio:** The main source of bank's lending depends on its deposit and as per the directives issued by Nepal Rastra bank commercial banks can take deposit of unlimited amount but the development bank can take deposit only up to 20 times its paid up capital . This ratio is calculated to find out how successfully the banks are utilizing their deposits on loan and advances for profit generating activates greater ratio indicates the better utilization of total deposits.

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

iii. **Loan and advances to current assets:** Loan and advances is the major component in total assets. Which indicates the ability of banks channelize its deposits i the form of loan and advances to earn high return. If sufficient loan and advances cannot be granted as compared to the deposited than it's earning will be low as it will have to pay interest on those unutilized deposit funds as well and cost of fund will be high. So banks provide loan and advances in appropriate level to match with current assets.

iv. **Interest income to loan and advances:** Interest income to loan and advances is one of the major indicator of how well the bank and financial institution is operating its loan and advances. It indicates the return on the lending provided by the bank hence the higher ratio is indicator of good performance of bank. In other word it is average yield on loans and advances of the bank or percentage of return on the loans and advances of the bank.

v. **Loan loss provision to total loan and advances ratio:** It describes the quality of assets that a bank is holding. NRB has directed the banks to classified its loan to classify its loan and advance into five the category viz. pass, resurrected, standard, doubtful, and bad. As per the directive issued by the central bank. The banks and financial institution has to provide a provision of 1%, 12%, 25%, 50% and 100% respectively in the mentioned categories of loan and advances. NRB has classified the pass and restructured loan as performing loans and other three substandard, doubtful and bad types of loans non-performing loans. The provision made against the pass and restructured loan is called the general loan loss provision and provision made against the standard, doubtful and loan is called specific loan provision. The provision for loan loss reflects the increasing probability of non-performing loan. Increase in the loan loss provision decrease in the profit result to decrease in dividends. The low ratio indicates the quantity of assets in the total volume of loans and advances. High ratio risky assets in total volume of loans and advances.

vi. **Non-performing loan to total loan and advance ratio:** Non-performing loans and advance do not pay the interest and installment on time and hence the bank's profit will be hit hard by these of loans if the portion of non-performing loan is high in total loan and advance. This ratio shows the percentage of non-recovery loans and advance. High ratio indicates that the credit provided by that bank is not good and low ratio shows that the lending of such is good. In the context of Nepalese banking industry a NPL than 2% is not good, however central bank has made certain restriction on the bank and financial institutions only when the NPL goes above 5%.

Credit Efficiency Ratio

i. **Interest expense to total deposit ratio:**This ratio measure the percentage of total interest paid against total deposit. A high ratio indicates higher interest expenses on total deposit. Banks are depended upon its ability to generate to cheaper fund. The cheaper fund has more probability of generating loans and advance and vice versa.

ii. **Total loan to Liabilities Ratio:** Banks create credit through loans and advance 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 total liability ratio is favorable as it increases overall capacity of organization.

iii. **Interest expense to total expenses ratio:** This ratio measures the percentage of interest paid against total expenses. The high ratio indicates the low operational expenses and vice versa.This ratio shows the deposit mobilization cost and when the cost is low the rate on the credit can be low hence a lending probability will be higher.

iv. **Interest income to total income ratio:** Income is one of the most important factors of each and every organization.Interest income occupies a greater portion of the total income in the banking business.This ratio measures the volume of interest income in total income in banking business.This ratio measures the volume of interest income in total income. It helps to measures the bank's performance on other fee based activities too. The high ratio indicates the high contribution made by lending and investment whereas low ratio indicates low contribution made by lending and investment and high contribution by other fee based activities in total income.

v. **Interest from loan and advances to total interest income ratio:** This ratio measures the contribution made by interest from loan, advances and overdraft.Loan and advances generate the major portion of interest income.Hence this ratio measures how efficiently the banks have employed their fund loan,advances and overdraft.Interest income will be of two types one generated from loan and advances of bank and other is the interest income on deposited of the banks in other is the interest income on deposit of the banks in the order and financial institutions.when there was high liquidity crisis in the mid fy 66-67 and 67-68 and till the beginning of FY 68-69, the interest income from the deposit in the bank and finance also cover, NRB tried not to provided interest on the deposit made by one financial institution in another bank and financial institutions but due to the pressure from the financial institutions but due to the pressure from the bank and financial intuitions it has allowed the development bank and finance to receive interest on the deposit they make in other bank and finance .commercial bank will not get interest on the deposit they in another bank.

vi. **Interest suspense to total interest income from loan and advances ratio:** Interest suspense means the due but not collected. as per NRB directives when booking interest income from loan and advance the banks and financial institutions needs to follow basic i.e. interest that is receivable but not received can't be account as income rather an interest suspense account of equivalent amount has to be created. The increase in the interest suspense decreases the profit of the company. This ratio, interest suspense to the total interest income from loan & advances, measure the composition of due uncollected interest in the total interest income from loans and advance. The high degree of this ratio indicates high interest the low interest turnover and low degree of this ratio indicate high interest turnover. This ratio also helps to analyze the capacity of the bank in collecting the repayments of the loan and advance.

however, when measuring this ratio one has to take into account of overdue interest,as certain portion of the interest that has accrue suspense but the interest suspense on overdue interest means the recovery of interest is not good of that and financial institutions.

2.1.5 Factors Affecting Credit Policy

Number of affects the credit policy of the banks and financial institutions and generally factors following are be considered for effective credit management. It is also called the factors of credit policy.It helps to effectively manage credit and make lending to credit worthy client and borrowers where lending does not go in default or even if the credit goes default it be easy to recover the loan from the mortgaged assets.

Industry Environment

Viability of project the project is determined by the prospect of growth in which the project falls, for example during the of insurgency lending to the hotel and resort would not be decision as the hostels and resorts were not running on profit rather they were in loss. Hence study of the industry is very crucial further even if the industry is growing and overall business is good yet the position of the form would be very important as whether the firm can sustain the competition of its decision hence it will be incorporated in the credit policy the bank.

Financial Condition

It determine the aspect that affects the decision of management while making decision of lending is repayment capacity of the loan's interest and principal at the time of maturity. Management is study borrower's capacity to repay through cash flow is the "First way-out", though management will also check for strength of "second way-out " i.e. through collateral liquidation. Further the cash flow of sister concerns is also taken care of for making analysis of repayment capacity of borrower.

Management Quality

It determines the integrity, competence and nature of alliances of borrower's management them. Management of the firm and company will determine if operations of feasible project will be successful or not and not only that if the management is competent then they will not only make the feasible project successful. Further replacement of current management has to be studied as current management may change anytime.

Technical Strength

It determines the strength and quality of the technical support required for sustainable operations of the company in terms of human resources and technology used. Appropriate technical competencies of the human resources, the viability of the technology uses. Availability of after sales service, cost of maintenance and replacement need to be evaluated Moreover technology is changing rapidly and of the firm or company lacks the strength to meet the change in technology than it will be obsolete and firm and company will be in loss and loses the capacity to survive in the industry.

Security Realization

It determines the control over various securities obtained by bank to secure the loan provided. A security should be neither to big nor too small, very large collateral will be hard to sell when the credit goes default and too small will not cover the loan amount extended to the borrower. when the case become too big to fail like the loan extended to Hotel fulbari resort by RastriyaBanijay bank then when the loan become non performing than it will not only effect the profitability of the bank but will some time make the bank to collapse. Present value of the properties mortgaged with the bank need to be assessed and its future value when the credit matures need to be taken account of in the credit policy. Weakness in security threats the bank's second way out and when the security provided by the borrower is weak and does not cover the loan amount than the borrower will be reluctant to repay the loan and credit will go default.

Credit History and Past Performance

Past performance of the borrower will determine if the borrower is repaying on time or not and it will also tell how serious is the party in repayment of loan and it dues on time. The person who is repaying on time in one institution or in the same institution will repay the loan on time. If person's loan is in default in one bank then there is high probability that the credit availed to that party will go default in this bank as will further as per the directive of the NRB the banks and financial institution has to categorized the party in the same categorized by the bank from which the lone is swapped. Not only is that it mandatory to ask for the credit information from Karja Suchana Kendra prior to lending of loan amount greater than 1 million as per the directive of Nepal Rastra Bank hence this part should not be missed out by the bank in the credit police .

2.2 Review of Related Studies

Present section deals about concept or findings of earlier scholars on the concerned field of the study. It helps to develop the study as link in a chain of research that is developing and emerging the knowledge about the related field. The effort has been made in this section to examine and review some related articles published in different economic journals, bulletins, magazines and newspapers and website of Nepal Rastra Bank and other related websites.

Nepal Rastra Bank has issued directives to banks and financial institutions ensuring transparency during loan disbursement and report of such to be submitted in a monthly and quarterly basis. Further Banks and Financial Institutions have to report of loan greater than

2.5 million to credit Information Bureau (CIB) within 15 days from the time of lending. Not only that after the ending of each quarter banks and financial Institutions have to send report to CBI as well about the performance of each party. NRB directives have also barred the banks and financial institutions from lending to the blacklisted defaulter and his family members. Not only that if a lending is made to the black listed party then the central Bank would be able to fine the concern banks and financial equivalent to the amount of lending made to the black listed party .the credit information bureau (CIB) will blacklist the form, company and individual defaults the loan and does not asset the bank in recovery of the loan that loan that was sanctioned to them. Not only that the central bank will fine banks and financial institutions if they do not black list the defaulter who needs to be black listed.Further it is mandatory to obtain credit information regarding the customer prior to lending from CIB when banks have to make lending of more than 1 million. Not only has that prior to lending credit information had to be obtained from such banks and financial institutions (2012).

In the post report titled "NRB tells bank to assess risk" published in the Kathmandu post, the reporter is trying to show one of the control measure applied by the central Bank.NRB has asked commercial banks to prepare their Internal Capital Adequacy Assessment Process(ICAAP) policy and submit it the regulator by the end of second quarter of fiscal year2069-70.ICAAP is the bank's internal assessment of capita that is consider adequate to cover all material risks to which it is exposed to Commercial banks of Nepal have to comply with BASEL II accord which considers the credit risk, market risk and operation risk and operation risk and asks banks to maintain a minimum capital adequacy ratio of 10% to cushion the risks(the Kathmandu post,2012).Credit management and management of it risk have come a long way and modern portfolio management is lot more different than the traditional one. The volume of business has grown into tremendous volume and complex problems has arisen overtime and hence with the new problems and meet the challenges new set of tools and different strategies has been adopted for the management of credit portfolio.

In essence, a bank's credit culture was a series of written and unwritten rules about which types of customers, industries and credit profiles were acceptable. This culture ultimately dictated the structure and composition of the bank's total portfolio. The credit culture will vary upon the bank being commercial, development or it is a finance company. Not only that it will be depending on the depending on the location as well, as different part of the country have different specialty. However, real credit culture of bank is followed by only very few of the banks of Nepal.Still large number of banks and financial intuitions of Nepal will make lending on the basic of the collateral and does not follow a struck credit culture like a home loan to be provided to the individual where the lone himself/herself would be residing in the house mortgaged for the loan, but such practice is not followed (Baral, DilBahadur, 2012).

Patrick F. Reidy (1995) provided an overview of the credit portfolio management function, structure alternative, the skill necessary for its effective implementation, and a final word on training and compensation. The focus is on corporate credit portfolios, as there often present the largest concentration challenge though they can be easily modified.

Modern portfolio management of the bank assets has fundamentally changed the requirement for individual using this technique: their backgrounds, their training, and their skills in using available recourse to diversity the portfolio and hedge the risk associate with credit. While traditional credit training remains necessary, today's portfolio manager argues with knowledge of early-warning system, alternative structure to better set risk/return parameters, and more.

Traditional training focused on the indivisible loan. Traditional credit training focused on the analysis a firm's management, operations and financial structure as the basic for determining a borrower's credit worthiness; now training programs incorporate not only these techniques,but also that elusive called a bank's credit culture.

Protection measure against portfolio losses focused on loan loss reserves based on the moving-average formulas. Customers risk was to be avoided.But there were always those special customers for whom exception losses in the portfolio would be covered by reserves but those formulas and expectations were not always so accommodative.As a result certain concentration would invariably lead to extraordinary, or unexpected, losses that were charged to income in the year of their incurrence.

portfolio management looks at the impact of loans individually ,collectively, and comparatively, modern portfolio management technique use have supplemented these unwritten rules with portfolio analysis and policies that establish limits on exposure by country, by obligor, by industry,and so on. These are derived from a specific on the technical aspects of asset class, a segmentation of the credit product and an angle of the effects of combining credits into portfolios. Credit profiles can be evaluated on the basis of fundamental as well as quantitative portfolio analyses.

Functionally, Credit is now segmented into Four Parts

- Origination and determination of the required level of customer commitment the sales/relationship function in credit portfolio management is often separate from the analysis/underwriting function. This allows for an efficient use of resources for client development as well as analytical discipline and consistency. The relationship manager demines the commitment level that will maximize relationship income.
- Fundamental analysis of the individual credit. The underwriting function in credit portfolio management is charged with the more traditional responsibility of individual credit analysis and monitoring. But this function is being driven more and more toward a specialization based on industry, so that the fully benefit of analyzing alternative borrowers within an industry can be achieved. The more specialized structure enables CPM to provide key value-added analysis to relationship and product managers in complex customer support for example, merger and acquisition analysis. It also provides for a centralized efficient use of analytical resources.
- Portfolio monitoring many more tools and information resources exit today than were available in the past for portfolio monitoring. For example;
    - ✓ Institutions now set various portfolio limits to shape the structure of the desired portfolio.
    - ✓ Early-warning processes the measure portfolio deterioration have become an integral part of credit risk management.
    - ✓ For large corporate portfolios,Merton-based models relate information inherent in the equity markets to a firm's debt levels.
    - ✓ Bond spreads and credit derivative premiums provide a forward looking credit view from the market that can be compared with a bank's own credit view.
- The role of credit approval authorities. The credit approval function determines the desired exposure level for the institution's books within the context of pre-established limits by obligor and industry. As a result, credit approval manages expected loss and allocates capital to desirable transactions. CPM, as separate from credit approval, optimizes the use of capital through alternations to the portfolio's profile.

Alternative Structure for Credit Portfolio Management (CPM)

The establishment of credit portfolio management is typically an evolutionary process for each bank in situation. At start-up, CPM usually takes a defensive role eliminating concentration risk and culling underperforming relationships from the risk/return point of view, As CPM develops, and optimization of the selected portfolio is added to its role, adjusting exposure to take into account the best risk/return structure. The adjustment often use the credit derivatives markets in order to disturb the primary relationship with the customer. In its advances form, CPM adds the bank's credit view to its role, with the intention of improving the portfolio's relative value performance among different asset classed.

The state of CPM along this development curse often dictates whether it is located inside the wall(subject to the possibility of receiving non-public information) or outside the wall (not subject to non-public information and freer to adjust positions). Functions of Credit Portfolio Management CPM achieve two principle goals:

- To match required hold levels with desires hold levels.
- To optimize the portfolio of assets ultimately held by the bank.

To do this effectively, CPM must perform all or some of the following key functions, depending on the state of the development curve discussed above:

- Serve as an analytical and advisory group to the line and to the approval authorities, plus serve as an integral part of critical deal items.
- Prepare the credit approval package and advocate the transaction to the credit approval authorities.
- Closely monitor obligor risks, returns and concentrations.
- Evaluate, establish and effectively use advanced modeling techniques to help determine the potential risk inherent in the portfolio and its assets correlations.
- Manage those same risks through the judicious use of loan sales and synthetic instrument such as credit default swaps and CDOs. (Ready, RMA Journal, (2005)"Corporate credit portfolio management: Changing skills requirements".

Raja Ram Khadka (1998)A study on the investment policy of Nepal Arab Bank Ltd. In comparison to other joint venture banks of Nepal" has compared investment policy of NABIL with NGBL and NIBL. Mr.Khadka has found out that the liquidity position of NABIL is comparatively worse than that of Nepal Grindlays Bank Ltd (NGBL) and Nepal Indosuez Bank Ltd (NIBL). It is also comparatively less successful in on-balance sheet utilization as well as off-balance sheet operation than that of NGBL and NIBL. In case of profitability ration he has concluded that of other joint venture banks (JVBs). NABIL is more successful in deposit utilization but fails to maintain high growth rate of profit in comparison with NGBL and NIBL.

He has recommended that NABIL bank should increase cash and bank balance to meet loan demand. NABIL's loan and advances to total deposits ratios are lower than that of other JVBs to overcome this situation, NABIL is strongly recommended to follow liberal lending policy and invest more and more percentage amount of total deposits in loans and advances. He has focused his study on the investment policy of NABIL bank and has taken NGBL and NIBL average ratios as banking average. MrKhadka has recommended to adopt liberal lending policy however has not explained regarding liberal lending and invest more and more percentage amount of total deposits in loans and advances. However, while adopting liberal policy on lending he has not explained the consequences like bad dept, default loan, which may arise due to very flexible and liberal lending policy.

Lila Prasad Ojha (2002) Lending Practices: A study on Nabil Bank Ltd. Standard Chartered Bank Nepal Ltd and Himalayan Bank Ltd." Has found out that the measurement of lending strength in relative term has revealed that the total liability to total assets of SCBNL has the highest ratio.

However, the performance of other two banks has not deviated far from the mean ration of SCBNL and the combined average. SCBNL tendency to investment in government securities have resulted with the lowest ration of loans and advances to total assets ratio. The steady and high volume of loans and advances throughout the years has resulted Nabil ration to be the highest.

The ratio of loans and advances and investment to deposits ratio has measured the proportion of total deposits that is used to increase the income of the banks irrespective of the portfolios of its application. Nabil has deployed the highest proportion of its total deposits in earning activities and this ratio is significantly above the ratio of other two banks. The combine ratio is highly deviated from the mean ratio of Nabil and SCBNL. This is the indicative of that is fund mobilizing activities Nabil is significantly better than SCBNL.

He has further concluded that the overall liquidity strength of SCBNL can be considered the best among the banks. However the liquidity risk arising from interest rate in SCBNL is the most likely. Since the market is highly sensitive toward the interest rate and SCBNL has generally been offering low interest rate as compare to other banks. The analysis of lending strength of HBL in loan and advances is the best. However loan and advances, investment to deposit ratio have upgraded the performance of Nabil. If HBL succeeded in collecting the less cheaper sources of fund in future, the lending strength of HBL would push the performance of Nabil and SCBNL far behind in the coming future. Also the contribution made by HBL in the productive sector of economy is highly appreciable and the best among these three commercial banks. The highest growth rate, proportionately high volume of loans and advances and the best contribution in agriculture and priority sector and the high level of deposits mobilization of HBL has put this bank in the top position in the lending function as demand by national priority, national development. However the better activity ratio of SCBNL has proved this bank is the best in managing the lending portfolio according to the demand of profit oriented business. The high volume of lending activities and high volume of productive sector loan of Nabil has put this bank in the top position in absolute term.On the basis of the findings and conclusions he has recommended for the banks as the liquidity position of all these three banks is found to be high.

He has recommended the banks to look upon new area of lending and investment. The rural economy has always been realizing the credit needs and the dominance of non-organized moneylender in this area has been prevailing. To compromise between the liquidity and credit need of rural economy these banks are highly recommended to expand their credit in this area. SCBNL’s contribution in loans and advances is the lowest and this has low degree of variation and low growth rate as compare to Nabil and HBL.

SCBNL is recommended to give extra priority sector loan. The increasing provision on loan and high volume of non-performing assets in Nabil and HBL certainly attracts the high attraction of any person interested with these banks. The high volume of HBL non-performing assets may have caused due to the failure of industrial and agricultural sector. Nabil’s increased non-performing assets may have caused due to the accumulated bad debts that is kept behind the curtain to show the efficiency of management.

He has used different tools like standard deviation, correlation, trend analysis and financial tools for the data analysis and presentation. In this study he has also taken sector wise loan priority, productive sector etc. The different sector wise loan classification are presented and analyzed. Only secondary data has been used for the study, the overview of the theoretical aspect of lending practices of the bank has not been analyzed. He has taken five years data from 1997 to 2001 for study of lending practices of Nabil, SCBNL and HBL.

Subi Joshi (2003) "Financial Analysis of NBL" has found out that the analysis of the banks shows that the deposit have been increasing gradually during the study period i.e. (2053/54-2057/58). However the rate of increase was comparatively low in the year 1997/98 than in the year 2001/01. Total loans and advances have been also increasing. The total investment of bank has been increasing slowly over the year which is mainly due to bank strategy of safe lending as a result there is increase in customer deposits to higher volume as there are limited opportunities for prudent lending.

The bank has been holding adequate provision for losses over the years and general loan loss provision was 4% in average of the total risk assets. In her study, she has recommended that the bank should focus more on non-risky lending opportunities such as mortgages, housing loans and personal loans. It should carefully examine safety of principle as well as sources of repayment, capital structure, requirement and credit worthiness of a borrower for providing credits. In other words, credit manager should evaluate credit risk by considering well-known 5C's of credit viz. Character Capacity, capital, collateral and conditions.

The financial analysis of NIBL has been analyzed and interpreted in this thesis. Analysis on loan and advances is simply presented with comparison with the previous year data only. On the loans and advances part a simple comparison been done. Important issues like loan classification and provisioning of loans, investment in priority and deprived sector, loan investment regulation of NRB's directives has been followed or not has not been explained.

Niva Shrestha (2004)A Study on non-performing loans and loan loss provisioning of commercial banks: Revealed that SCBNL had risk averse attitude of the management or they have policy of investing low in the risky assets i.e. loan and advances as compared to NBL and Nabil because the loan and advances to total asset ratio of NBL, Nabil and SCBNL during the study period was appeared to be 52.3%, 47%, and 29.34% respectively. The SCBNL has higher proportion of the investment in risk free or nominally risky asset like treasury bills, National saving bonds. Similarly, the loans and advances to total deposit ration of NBL, Nabil and SCBNL during the study period was found to be 57.63%, 56%.35% and 35.94% respectively. It indicates that SCBNL has the higher inconsistent and variability during the study period where as the NBL has the higher inconsistent and variability as comparison to other two banks. Nabil has the moderate level of consistent and variability.

In the same way, the proportion of non-performing loan with regard to total loans of NBL, Nabil and SCBNL was found to be 48.37%, 10.67%, and 4.38% respectively. That means 51.63%, 89.33% and 95.62% of total loan of NBL, Nabil and SCBNL was found to be performing loan. Not only the public sector bank, even private sector bank like Nabil has higher proportion of non-performing loan. However, in recent year Nabil has shown significant decrement in non-performing asset, which are the result of effective credit management and its efforts of recovering bad debts through the recovery of establishment of recovery cell.

In the same way, proportion of loan provision of NBL was found to be significantly higher (i.e. 40.17%) as compared to other two commercial banks. The proportion of Nabil and SCBNL was found to be 5.69% and 4.49% respectively. The average ratio of provision held to non-performing loan of NBL, Nabil and SCBNL was found to be 80.03% 57.85% and 122.32% respectively shows that the SCBNL has maintained adequate level of provision against non-performing loan whereas Nabil was found to be comparatively lower. The NBL was found to be an average position.

Reetu Shrestha(2007) Non-performing Asset Management of Nepal Bank Ltd. Study is concerned to examine the effect of NPL in profit of the bank and how adversely its effects the banks performance. As the study show the adverse effects the banks performance. As the study show the adverse effect of NPA in profit of the bank, it is focusing on how NPA are dealt and how credit management system is developed in order to avoid NPA in the future.

ManjuKunwar (2009) Credit Management a comparative Study of Himalayan Bank Ltd and NABIL Bank Ltd. Study is concerned to examine and study the practice of credit management in Himalayan Bank Ltd and NABIL Bank Ltd. This study is trying to compare credit management bank and especially between Himalayan Bank Ltd and NABIL Bank Ltd.

Bandana Paudel (2010)An Analysis of Loan Disbursement and Repayment Patterns of agriculture Development Bank Limited in Nepal" study focused on disbursement pattern of different sector loans and advances and their repayment pattern as well. The research shows strong relation between disbursement of loan and repayment of loan when a targeted disbursement is made there will be positive targeted repayment as well. The research was also checking the regional level of disbursement of loan and in that case Central Development Region and the largest share of 50.03% and Far Western Region has the smallest share over total loans and advances of the bank and it is just 5.19% only and likewise Central Development is the largest one in loan repayment with 50.68% and Far western Development is the largest one in loan repayment of 6.03%. There is lower loan repayment of Eastern, Western and Mid-Western Development Region after commercialization of the bank than its pre-commercialization period.

The study recommends that the actual loan disbursement is less than targeted loan disbursement hence a new standard needs to be for meeting target and also decrease the variance over loan disbursement and repayment of loans and advanced. There is shortage of skill in the human resource of the bank bench a targeted training needs to be provided to the staff of the bank to meet the match between actual loan disbursement and repayment. The researcher also points that if the bank has compete and come forward it needs to diversify its loans and make disbursement of loan in other sectors like transportation and other sectors. It is good news that the loan repayment is increasing but it should be increased with the pattern of loan disbursement and the bank needs to be caution that the loan repayment not exceed loan disbursement of the bank. One of the ironical point noted by the researcher is the though the bank was targeting for development of agriculture and people in the rural area where large number of people are depending on agriculture there is no presence of the bank and it has been able to provide service to the agricultural people living in the rural area, hence it is recommended to extend the service in the rural area.

DilBahadurBaral (2012)Loan Management of Commercial Bank, Acase study of Kumar Bank Limited" study is concern with how credits of commercial banks are managed. It makes the study of loan management of Kumari Bank Limited with the help of structured questions, statically and financial tools like trend analysis, correlation coefficient, profitability ratio, liquidity ratio and capital adequacy. The study can be summarized in the following way, it says that still Nepalese banks lacks proper and consistent credit policy. It states that most of the commercial banks are inn profit but few are in loss as well. This is due to instability in loan management of Banks.

The researcher has recommended that prior to making lending decision the bank needs to make proper analysis of customer's position and their repayment strength. Further the researcher suggest that the documentation needs to be done properly and inspection of the collateral needs to properly done. The focus from the traditional lending has to be shifted to retail banking like auto loan, housing loan, education loan etc. and the sector choose should be viable and profitable.

The review of above relevant literature has contributed to enhance fundamental understanding and knowledge, which is required to make this study meaningful and purposive. There has been lots of article published related to investment policy, loan and advances of commercial banks, credit practices of commercial banks, impact and implementation of NRB guidelines in commercial banks but there are a few research conducted strictly focusing on the credit administration and management of credit. Further very little literature has been written on development banks and Finance Companies of Nepal. Therefore, the researcher attempts to study in this area with a study of credit management of selected development bank i.e. Machhapuchhre Bank will be one of its kind in study area of development banks of Nepal.

2.3 Research Gap

The purpose of this research is to development some expertise in one's area, to see what new contribution can be made and to receive some ideas knowledge and suggestions in the relation to credit management of MachhapuchhreBanks Ltd. previous studied cannot be ignored because they provided the foundation to the present study and guide the research to the new level without repetition of work .In other words,there has to be continuity in research and one research should help the other so that what has already need not be repeated. This continuity in is ensured by linking the present study with the past research studies. After the study of past research work and NRB directives it is found that number of work has been done in regards to the study of nonperforming assets of credit of development bank, their compliance to the directive issued by NRB, risk management of credit of development bank with the study of two or more development banks' comparative study. Lots of work has been done in study of credit risk management of development banks' and to that with the specific banks taken into consideration. A very little work was found on credit management of banks and financial institution. Further a very little work has been done in the field of commercial banks and Finance and credit management of commercial banks has not been done hence, to fulfill this gap, this research is selected. To complete this work, many books, journals, articles, various unpublished dissertation, website of NRB, website of Nepal research and search engine like Google are followed as guideline to make the research easier and smooth. In this regard, here the researchers going to analyze the different procedure of credit management of MachhapuchhreBank Ltd. Our main reach problem is to study and analyze what sort of credit policy the bank follow ,how a project is appraised prior to lending and how does the central bank controls the credit risk of the bank. To achieve this main objective, various financial and statistical tools are used. Similarly, trend analysis of investment, NPL and profit are reviewed to make this research a complete one. Therefore, this study is useful to the concern banks as well as different persons, such as shareholders, investors, policy makers, stockbrokers, state of government etc.

CHAPTER-III

RESEARCH METHODOLOGY

3.1 Research Design

This chapter deals with the research methodology employed in the entire aspect of the study. Research methodology is the process of arriving at solution of the problem through planned and systematic dealing with the collection, analysis and interpretation of facts and figures. The research has been done on topic "Credit Management of Machhapuchhre Bank Ltd." In order to reach and accomplish the objectives of the study, different activities were carried out. In order words, research methodology refers to the various methods of practices applied by the research in the entire aspect of the study. This chapter includes the research design, population and sample, nature and sources of data and analysis of data.

To achieve the objectives of this study, descriptive and analytical research design has been used. Some statistical and financial tools have also been applied to examine facts and descriptive techniques have been adapted. The study is based on secondary data and the descriptive and analytical research designs have been used.

3.2 Sources of Date

There are mainly two types of sources of collect data primary and secondary. Data observed or collected directly from first and experience is called primary data. Published data and the data collected in the past or other parties are called secondary data.

To collect the primary data I have made verbal discussion with the manage and staffs of oblation and credit department of MBL. Different questions and asked, secondary data prols and official accords of MBL, articles, magazines and website of the MBL.

3.3 Data Collection Procedures

Data sequined for analysis are directly obtained from the bankers published annual sport (for the five year pevods from 2064/65 to 2068/069) articles, website http://machhare.com etc. Formal and informal talks with the conducted with authority to collect reliable data.

3.3.1 Population andSampling

The number of commercial banks ha crease till now there are 31 commercial bank in Nepal. Among them Machha nited is selected as sample.

A population can be defined as including all people or items with the characteristic one wish to understand. Because there is very rarely enough time or money to gather information from everyone or everything in a population, the good becomes finding a representative sample that population. Sampling is concerned with the selection of a subset of individuals from within a statistical population to estimate characteristic of the whole population. The three main advantage of sampling are that the cost is lower, data collection is faster, and since the data is smaller it is possible to ensure homogeneity and to improve the accuracy and quality of the data. The total number of commercial bank are considered the population of data and the bank under study construed the sample for.

3.4 Tools and Techniques used for Data Analysis

The analysis of data consist of organizing, tabulating, and performing statistical analysis(Wolf and Pant; Yen:127). In this study basically financial tools has been used and where a statistical tools further make the study more fruitful has been used. In some cases where the descriptive explanation would simplify the research report for better understanding descriptive technique has been used.

3.4.1 Descriptive Techniques

These techniques were used to simplify the research for better understanding as well as analysis and interpretation of the collected data in theoretical form.

3.4.2 Financial Tools

For the study of the financial institutions one of the best options would be the study of its financial statement and for the interpretation of the information provided in the financial statement ratio analysis would be the best. Hence ratio analysis has been used for the study, however, to some extent absolute value like total deposit and lending has been used in comparative.

3.4.3 Ratio Analysis

Ratio analysis is the most powerful financial tools used widely for the analysis of strength of any firms and companies. Ratio simply defined is quotient of tow mathematical expressions or simply a relationship between two or more things. In financial analysis a ratio is used as an index or yardstick for evaluating the financial position and performance of a firm. In short a ratio analysis would help in summarize large financial data into qualitative financial information allowing the stakeholder to make qualitative judgment about the firm's financial performance.

i. **Nonperforming Loan(NPL) to Total Loans and Advances:**Nonperforming loans and advances to total loans and advances give us an idea about what percentage of total loan is not performing well or is in default. This ration is good indicating of how well the portfolio has been maintained by the bank.

NPL/Total Loans and Advances = $\frac{\text{Non Perfoming Loans and Advances}}{\text{Total Loans and Advances}} \times 100\%$

ii. **Provision to Non-performingloan(NPL):**This ratio shows if the non- performing loans and advances are adequately provisioned or not. This ratio is greater than 100% is considered good and that the NPL is adequately provisioned but if it goes below 100% than it is not adequately provision hence the bank may be at risk.

Provision/NPL= $\frac{\text{Provision for possible Loans Loss}}{\text{Non Performing Loan}} \times 100\%$

iii. **Capital Adequacy:**This is ratio between core capital and risk weighted assets. This will check if the capital is adequate for the loans and advances sanctioned as around 90% of the assets of the bank covered by loans and advances sanctioned, NRB has set a minimum requirement of capital adequacy of 11% for development banks of Nepal.

Core Capital Adequacy = $\frac{\text{Primary Capital}}{\text{Sum of Risk Weighted Assets}} \times 100\%$

Total Capital Adequacy = $\frac{\text{Primary Capital+Supplemantary Capital}}{\text{Sum of Risk Weighted Assets}} \times 100\%$

iv. **CD Ratio:**CD ratio of credit to deposit ratio is the ratio which shows how efficiently fund collected by the bank has been utilized by the bank. Hence if the ratio is higher than the fund utilization is good and vice versa, however, if the ratio is very high that the bank may face the problem of lower liquidity. This shows that the ratio needs to be maintained to the standard scale and should not be too low so that it will affect the earning of the bank nor should it be higher that the bank face problem of liquidity. NRB has set the standard of 80% and banks and financial institutions should not have this ratio greater than 80% while calculating this ratio capital and reserves of the bank is added to the deposit.

CD ratio=$\frac{Total\ deposit+Capital+Reserve}{Loans\ and\ Advances} \times 100\%$

v. **Average Yield on Loans and Advances:** Average yield on loans and advances is an indicator of return on the loans and advances and it also show the price made on loan and advance by the bank. Avg. Yield on Loans and Advances=$\frac{Interest\ i\ Income}{Average\ Loans\ and\ Advances} \times 100\%$

vi. **Fixed Assets Turnover Radio:** Fixed asset turnover radio show how well fixed asset has been utilized and when the radio has falling trend, it show that the capacity of the fixed asset is decreasing and it is one of the serious indicator to be checked. If there is fall in fixed asset radio than it is not wise to make leading. Fixed Asset Turnover Radio is calculated as below.

Fixed Asset Turnover Radio=$\frac{Net\ Sales}{Operating\ Fixed\ Asset}$

Net Sales=Sales revenue less cost of goods sold
Operating Fixed Asset=Fixed Asset

vii. **Return on Investment (ROI):** This radio measures how well the investment is generating profit hence it is very important to check this radio and this should not be less than the leading rate of interest. This radio is calculated as below.

Return on Investment Ratio=$\frac{Operating\ Profit}{Operating\ Assets}$

Operating assets includes both fixed and current assetsROI must be greater than interest rate.

viii.**Gross Profit Ratio:** Another operating radio that is good measure of the viability of project is gross profit which is calculated

Gross Profit Ratio=$\frac{Gross\ Profit}{Net\ Sales}$

ix. **Equity-Total Debt Ratio:** Equity-Total Debt Radio measure the long term financial risk of the business. It also attempts to measure the efficiency of the company in striking a balance between risk and profitability in its capital structure because these two are often investment related to each other. The standard norm is that in the total investment of the project, the equity financing should beat least 30% and debt financing should be 70%. Sometime this radio's standard is considered as 0.33 which implies that 25% should be equity financed and 75% to be debt finance.

Equity-Total Debt Ratio=$\frac{Total\ Outside\ Liabilities}{Net\ Worth}$

x. **Equity- term Debt Ratio:** This radio is also called credit strength radio and it indicates the degree of financial prudence of an enterprise which cuts across both small and large companies. The company will try to maximize creditors' financing because it comes free of cost and there is change of overtrading which needs to be checked hence to exercise control this radio is used. The standard of this radio is around 1and can go down 0.6 because if its goes less than 0.6 than it shows the company radio, it is showing financial prudence. However, if it is less than the standard radio, it is show less use of the cost free financing

Equity Short Term Debt Ratio=$\frac{Current\ Liabilities}{Net\ Worth}$

xi. **Current Ratio:** This is the most common and widely used financial ratio the study of firms and companies over the world.This ratio is calculated as current assets divided by current liabilities.The standard for is 2 which shows that current liabilities be just half of its current assets.

Current Ratio=$\frac{\text{Current Assets}}{\text{Current Liabilites}}$

xii. **Inventory turnover Ratio:** This ratio shows the ratio how well the inventory has been turnover during year. Higher inventory turnover ratio shows higher efficiency and vice versa.This ratio when studied in modified form as number of days of stock holding would be more meaning full. Both of the ratio is calculated as following.

Inventory turnover ratio =$\frac{Cost\ of\ goods\ sold}{Inventery}$

No .of days of stock holding =$\frac{Inventery*365}{Costs\ of\ goods\ sold}$

xii. **Interest coverage Ratio or Debt Service Coverage Ratio:** This ratio is the one of the most important ratio for the bank ratio will determine if the obligations of the bank is met by the profit generated by the company. However,this ratio will not check if the profit earned will realized into cash or not and it only cash that met the obligation of the bank. This ratio is calculated as under.

Interest coverage ratio =$\frac{Profit\ before\ tax\ and\ interst+deprection}{Interest+other\ obligation\ to\ the\ bank}$

xiv. **Receivable Turnover Ratio:** Another financial ratio that needs to the studied is receivable turn able turnover ratio. This shows how well the receivable of the company is realized and this very important because if the credit sales of the company are not recovered on the time then the profit earned will go in the interest payment to the bank and eventually the business will be in the loss. Hence, the receivable needs to be collected on the time.

xv. **Payable Turnover Ratio:** What is the payment trend of the company is shown by this ratio and when the number of the days of days is less it is consider good, however, to make use of cost free fund every firm will try to hold payment to the creditor as much as possible withy without hampering their image.

3.4.4 Statistical Tools

For presenting and supporting study, statistical like mean or average, trend analysis,bar chat and pie chat has been used.

i. **Mean or average:** Mean or average represent a single value for the whole data of the observations. it is calculated as,

Mean or average $=\frac{Sum\ of\ obervations}{no.of\ observations} \times 100\%$

3.5 Limitation of Methodology

Various descriptive tools, financial tools like ratio analysis and statistical tools has been used for their study of the credit management of Machhapuchhre bank and these tools have certain limitations. For the study of credit management of the bank, five years data of bank, credit and recovery policy of the bank , different journals , web site of Nepal Rastra bank , unified directives of Nepal Rastra bank and other source of information has been adopted hence there are certain limitation regarding the information and method adopted for collection of data. Further the time and money.Spent has a constraint for the study and the conclusion draw for the study. Though there were certain limitations of the research work, it does not mean that have weaken the basic finding of the study is reliable.

CHAPTER-IV

DATA PRESENTATION AND ANALYSIS

4.1 Data Presentation and Analysis

Most of the important aspect has been discussed in the previous chapters and management of credit along with the different financial rations has been dealt in previous chapters. From the beginning of this research work, it has been discussed that how important is credit and its management for the success of the bank. As the fact we have seen in the past five years, the expansion of the banking sector has been rampant, which is evident from the fact of growing number of banks and finances. With the growth of the financial institutions the competition has grown together and to survive in this tough competition, it is very essential for the bank to remain competitive it is very essential to manage credit of the bank which will determine the quality of assets and success of the bank will largely depend on the quality of assets it holds.

4.1.1 Different Aspect Covered by CPG of Machhapuchchhre Bank Limited

Credit policy guidelines generally CPG is guideline which guides the bank's Management in managing credit of the bank or in other word it can be called Bible for the bank's management for managing portfolio of the bank. it will set out different process and procedure of lending like, who is eligible for lending, in What sector to obtain as collateral security, who holds the right over the decision of lending, what percent of interest to charge and what other sort of charges to be obtained from the borrower. It will further have process of recovery of loan in case of default and how to write of the loan when it is not recoverable, how to categorized the loan and provisioning of the loans and advances. One point to note is that the CPG will give a very board outline and on the basis of it a credit manual is prepared which is elaborates it and set standard for loans and advances sanctioning. Credit manual sets risk mitigating standard and procedure not only that it will have minimum procedure for mitigating minimum risk related to credit. Further on the basis of CPG and credit manual, a credit approval memorandum is brought into practice which will check if the credit risk are addressed and mitigated. Hence a CPG needs to be studied in line with credit manual and credit approval memorandum of the bank. Let us study the aspects covered by CPG of the bank.

- Background study of borrower –character of the borrower.
- Investment of borrower /proposal –capital of borrower.
- Repayment or cash flow of borrower –capacity of the borrower.
- Security for loan-collateral.
- Industry or environment analysis –condition.
- Charges for services – interest rate.
- Recovery of default loan-way outs.

When these aspects covered by CPG are studied from the view of risk mitigation and address for such risk by the Central Bank of Nepal or Nepal Rastra Bank (NRB) than it will be more fruitful.

Background Study of Borrower

Generally CPG will be specific regarding the person or sector that are not fit for lending, however, it leaves some space to management where management can use their discretionary power for determining the person or sector that are illegible for lending. CPG of Machhapuchchhre Bank has specifically restricted the following sector for lending.

- Those people who has been blacklisted by Credit information Bureau of Nepal.
- To political parties and for political reasons.
- To promoters and shareholders as per the norms of Nepal Rastra Bank.
- To industries that supply arms and ammunitions to other Government than Government of Nepal.
- To those sector or industries that are declared illegal by the Government of Nepal like Gambling and Prostitution.
- To those persons and individuals/companies/firms/industries to whom Nepal Rastra Bank has restricted for lending.
- Minor/person of unsound mind and person who is insolvent.

Further CPG has restricted in lending to those individual who has no capacity to repay the loan, who have violated the terms and conditions of credit facility with the bank, where the collateral is not sufficient to cover the credit facility.

CPG also has provision of minimizing the risk of loan being sanctioned to non-credit worthy individuals and firm/company. CPG has made provision of collection of number of document from the customer but has given the discretion power to the management for determination of format of application from and information to be obtained through it but has made it mandatory to obtain following documents from the borrower at the time of application of credit facility or credit facilities.

- Completely fill up application from as prescribed by the bank.
- Copy of citizenship of borrower and Guarantors.
- Photograph of borrower and guarantors.
- Details of collateral offered to the bank.
- Copy of lalpurja if the collateral offered is land and building.
- Four boundary certificates if the collateral offered is land and building.
- Tiro Rashid of land and building.
- Cadastral map or blue print of the collateral offered.
- Banking transaction detail if any-both deposit and lending.
- Purpose of loan and amount required.
- Income source justifying documents like salary, rental agreement etc. or audit report in case of business.
- Approved map of building if the collateral offered includes building.
- Building Completion Certificate if the collateral offered is building.
- Copy of blue book if the collateral is vehicle.
- If the collateral offered is other than land and building and Vehicle the document showing the ownership over the assets.

  Additional Documents required in case of firm.
- Copy f registration certificate.
- Copy of PAN.
- Tax clearance and tax paid receipt.
- Audit Report and Projected Reports.

  Additional Documents required in case of Company.
- Copy of MOA and AOA.
- Board Resolution for.
  - ✓ Obtaining loan.
  - ✓ Amount and tenure of loan.
  - ✓ Authorization of person to carry such activities.

- ✓ Collateral security offered to the bank.
- ✓ Lien over the stock of company to the amount of loan.

As CPG has outlined these things, CAM will check number of things prior to making lending decision after obtaining those mandatory documents from the customers. A background study of the individual and the business firm or a company will be made. It will check if the person is eligible to obtain loan, like if the person is the promoter, employee or family member of employee of the bank or if they have been blacklisted by any banks or financial institutions than they will not be able to obtain the loan. Hence the background study will confirm if the person is eligible for lending. Further it will check if the background of the borrower is inconsistent with the directives of NRB.

NRB directives has made a provision that the promoters, employee, family member of employee are not allowed to obtain loan from the bank and further lending to black listed parties has been restricted.

As per the provision of NRB, if the prospective borrower has any banking transactions regarding loans and advances than credit information needs to be obtained from such banks and financial institutions. If the requested amount of prospective borrower is greater than 1 million than it is mandatory to obtain credit information from capital information Bureau. If the report from credit Information Bureau shows that the repayment is not regular than the bank will not consider such prospective borrower a good one and reject the loan. Not only if the customer declares that he or she has loans from other banks and financial institutions than the bank need to obtain credit information from such banks and financial institutions as well prior to making lending.

Along with these information social standing and organization that the person is associated is studied. For example if the person is working in India as Indian Army then the lending to that person is preferred to the person who works in Arabian countries even if the person in Arabian Countries is earning more than the Indian Army.

Study of the Proposal-Investment of Borrower

Banks and financial institutions generally have not specific set of sector of lending and will lend in different sector which are feasible and will provide them good return. In some case few of the development banks have chosen particular area or sector for lending like Tourism Development Bank Ltd which focus Ltd which focus on lending particularly in tourism industry and Clean Energy Development Bank Ltd which focus on lending in power and energy sector and assist in development of power and energy sector.

In case of Machhapuchhre Bank, it has no specific sector of lending nor there is any direct restriction made by CGP for not making lending in particular sector not in particular kind of project. CPG has let it sanction credit in different sectors and provide them with funded and non-funded credit facilities. In case of funded facilities the bank can lending sectors like

- Construction–Banking and Infrastructure.
- Small scale hydro power.
- Agriculture.
- Manufacturing Industry.
- Transport and transport equipments.
- Whole sale and retail business.
- Real Estate.
- Service Sectors.
- Consumption Loan.

In case of non-funded credit facilities, following credit facilities may be sanctioned.

- Bid Bond.
- Performance Bond.
- Advance Payment Guarantee.

Limit of the credit facilities sanctioned to the borrower is limited by the collateral offered and the amount demanded by the borrowers. The limit of the credit facility may be diminishing upon the payment of the installment or interest and principle or the limit may be of revolving nature which only expires on the maturity of the credit facility. Generally the first type of the loan is installment loan or term loans, which are repaid in installment. CPG guides that the term loans to be sanctioned for the consumption type of loan or where the credit facilities will be used in investment of fixed assets. Second type of loan is generally called overdraft loan where the borrower will be able to repay the loans and again use it when the borrower needs it. CPG has guided the management that such credit facilities to be sanctioned to the corporate borrowers.

The CAMs make the study of the proposal is depth prior to making lending decision. The risk associated with project like failure of the project to generate enough cash flow is studied. Not only that the CAM will also see if the project goes in failure are there any alternative source of cash flow through which the party will be able to meet the installment obligation towards the bank. One of the major things that are checked in the CAM is what portion of project has to be funded by the bank. Generally the bank has the practices of funding not more than 70% of the total cost of the project. This could be best studied if it is divided into six topics.

i. **Loan Provided to Purchase Vehicle – Hire Purchase Loan:**Study of Lending portion of the bank is very easy to study in case of the files where the security is vehicle and the loan was sanctioned to purchase vehicle. Project cost is determined by the quotation from authorized showroom in case of new vehicle and valuation report from the technical person in case of old vehicle. Loan limit sanctioned determines the investment portion of the bank in the project.

ii. **LoanProvided to Purchase or Land and Building – Housing Loan:**CAM will check the portion of the bank in the total project through the assistance of technical persons. These technical persons are called the valuators of the bank and they are qualified civil engineers, the bank has made an agreement with them for obtaining professional service and the cost of professional service are charged directly to the customers. They will assess the fair market value of the property to be mortgaged in the favor of bank. Apart from it the CAM has made compulsory to obtain "BainaPatta", an agreement between buyer and the seller of the property. Here the buyer is the customer of the bank. This bainapatta determines the cost of the project, however the bainapatta is not that reliable and CAM and CPG has made it mandatory to have the property valuated prior to make the lending decision. Portion of the bank in the project is determined by ascertainment of market value of the property.

Land Only

Fair Market Value of the land is determined by taking weight age of market rate and government rate. For determining market rate of the land, the valuator makes inquiry of the market rate through the local resident and latest transaction rate of land in such location. Then a weight age of 50%-70% of it is taken of market and remaining weight age is taken of government. For example a property is located in BirautaPokhara. The land is ideal with front face 20 hatt and pichhad of 40 hatt (area of land is around 5 anna) and the access road is 20 feet, then the valuator makes inquires with local resident for current rate at which the land is purchased and sold. If the rate of per hatt is around 150,000 then the valuator will take around 140000 per halt for valuation of the property. The valuator will obtain Government rate from the book published by Malpotoffice Kaski for determining the Government rate of the concern property. If as per the Government rate the cost of ropani is 2, 000,000 then the Fair Market Value is calculated as the table under.

Table: 4.1

Calculation of Fair Market Value of Land

Market Rate per Hatt	Rs 150,000/-
Market Rate adopted for Valuation	Rs 140,000/-
Government Rate per Ropani	Rs 2,00,000/-
Area of Land	0-5-0-0
Hatt	20
Govt. Rate for 0-5-0-0	625,000.00
Govt. Rate per Hatt	31,250.000
70% of Market Rate	98,000.00
30% of Market Rate	9,375.00
Fair Market Rate per Hatt	107,375.00
Fair Market Value of the Property (Weighted Rate per Hatt x 20 hatt)	2,147,500.00

Source: CPG of MBL

The decision of lending on the project is directly affected by the value of the proposed collateral hence in no way it will be more than the calculated fair market value of the property.

Land and Building

After the calculation of FMV of land, value of the building is determined by the structure of the building and generally a building with RCC frame structure is valuated. The value of building is affected by number of different factors like.

- Whether there is marble or not.
- If there is facility of hot and cold water system.

- Solar system.
- Number and size of iron rod used in the pillars and beam.
- Size of the building.
- Age of the building.
- If the building tallies with the approved map of the building.
- If the building has been built leaving the write off zone as per the rules and regulation of the Municipality.
- If the building has been built as per the approved area and floor for the approving authority.
- At present the estimate cost of the building is determined by using the built up cost per unit square foot multiplied by the built up area. Present rate per square foot of building valuation range from 1000 to 2000 square foot. Hence fail market value of the building is determined by multiplying the buildup area of building with the market rate of the building. For example if it is assumed that the building was constructed in the land discussed above then the fair market value of the land and building is as follows.

Table: 4.2

Calculation of Fair market Value of Building

Particulars	Area	Rate	Total
1st Floor	908 sq ft.	Rs. 1800/sq.ft	1,634,400.00
2nd Floor	908 sq ft.	Rs 1600/sa.ft	1,452,800.00
3rd	680 sq.ft	Rs. 1600/sq ft.	1,088,000.00
Total			4,175,200.00
Depreciation (5 years @ 1.5% / Year)			313,140.00
Fair market Value of Building			3,862,060.00
Fair Market Value of Land			2,147,500.00
Fair Market Value of Land and Building			6,009,560.00

Source: CPG of MBL

iii. **Business Loan:**Proposal of the business loan will be studied from present stock level, sale, and debtors (receivable) and projected cash flow. The debt obtained by the party and capital invested by the party is checked by the ratio debt equity ratio. From the balance sheet of the prospective party, a liability side is studied and equity investment and debt is determined, then a ratio is calculated. If the ratio is within the range of 30 to 70 then it is favorable of lending. Further the purpose of loan of business people is also studied. The purpose of needing cash by business world may be for the following reasons.

- Working capital need.
- Meeting the cash short.
- Purchase of land and building.
- Purchase of plant and machinery.
- Purchase of Vehicle.

As the lending is not totally based on the financial statement of the business and it backed up by the collateral and lending is made on the basis of cash flow of the firm of company and value of the collateral. Generally if the cash flow is good then the lending will be made up to 80% of distress value the collateral. Distress value of the collateral is calculated as 80% of the Fair Market Value of the collateral.

iv. **Gold Loan:**Gold Loan is very secure loan and even NRB has allowed it to categorize as performing loan even if the repayment of such loan is not regular. Calculation of value of gold is made as under.

Table: 4.3

Calculation of Fair Market Value of Gold

Rate of Gold of per gram (Current Market as published in newspaper)	Rs.400/gram
Rate of Gold adopted for valuation	Rs.3,000/gram
Weight of Gold	50 gm
Deduction of Kediyam	5gm
Net weight adopted for Valuation	45gm
Value of Gold	135,000.00
Margin Deduction	30%
Value of Margin Deduction	40,500.00
Net Value of Gold	94,500.00

Source: Gold Loan Working Manual of MBL

For the calculation of gold value the rate adopted will make the lending on gold less than 60% of market rate per tola of gold. Generally in market the lending on gold is almost only 50% of gold price in tola.

v. **Loan against Fixed Deposit Receipt (FDR):**Lending against FDR is safest for the bank and while making lending against FDR, a calculation will be made if the requested amount's interest at the time of maturity and requested amou8nt is less than the amount deposited by the client. However, this calculation is done for the upper limit of loan against FDR. Generally lending is made with in the limit of 80%.

vi. **Share Loan:**A weighted rate of last 180 days is taken for the calculation of value of share and less than 50% of the value of share is provided as loan. For the determination of weighted average rate data is obtain from the website of SEBON.

vii. **Other Loans:**Other loans like consumer loans are fully based on the value of the collateral and the lending does not exceed 60% of the fair Market Value of the propose collateral.

Previously NRB had left the banks and financial institutions free to lend as per their discretion on the value of the collateral however, after the booming of real estate and Failure of it, NRB sensed that the lending in real estate would bring the economy almost near to halt and it introduce directives to stop the further lending in real estate sector by the bank. It introduced directive that the lending should not exceed more than 60% of lending. Hence NRB has restricted banks for lending not more than 60% of the fair market value of the collateral obtained as security for the loan sanctioned. However, NRB has left the ceiling of lending within 60% to two third of the collateral's fair market value in case of residential real estate i.e. in case of home loan and purchase of land and building for residential purpose. However, lending percentage on hire purchase loan and auto loan has been left on the part of the bank. Machhapuchhre bank has strictly followed the direction of NRB in case of

Lending within the value of collateral. A study of 87 files of different categories was done and the result of such study is shown in the table as under.

Table: 4.4

Percentage of loan sanctioned against the value of collateral-product wise

S.N	Types of loan	No. of files studied	Loan to FMV ratio
1	Business loan	26	50.24%
2	Housing loan	13	54.57%
3	Personal	22	46.69%
4	Hire purchases loan	13	74.30%
5	Auto loan	13	58.74%

Source: Field Survey, 2013

The above table shows that the bank has invested less than 60% in the project of Borrower except hire purchase loans and advance where the average portion of Lending is 74.30%. There is least investment in personal loan's project which is 46.69%. Since the lending of bank is less than the standard norms of 30/70 i.e. at least 30% of borrower and 70% of the bank, the bank has followed the direction of NRB and has mitigated the risk of over exposure in the project of the borrower.

Industry or Environment Analysis–Condition

CPG of the bank has specified the sector and what kind of credit facility to be Sanctioned in those particular sectors. Once the sector is determined than the CAM Will make in-depth analysis of that sector. For example if the lending has to be made In hotel industry, then CAM will check how the hotel industry is growing over time, What risk dose the hotel industry faces, what is the current situation of tourism Industry, what is the projected future of the industry, what is the flow of tourist in the Region and at what project is it growing. The CAM makes the analysis of both Strength of the industry, weakness of the industry and projected growth of the industry In the future. The recent case of non-lending to real estate sector by the banks and Financial institution can been taken as good example of bank and financial institutions Taking real estate sector as risky sector and unfeasible for lending. Another good Example would be tourism industry which suffered a loss during insurgency and the Bank which made huge lending in tourism face the problem of high NPL. Sector wise lending or concentration risk in particular sector is checked by NRB through making it mandatory to obtain approval from board in case the lending In particular sector exceeds 100 percent of its core capital. The concentration in a sector is checked through a report 9.3, which needs to be submitted within 15 days

from the end of month of each month by all the banks and financial institutions. Machhapuchhre Bank has submitted all the reports within the stipulated time. Table Below show the sector wise lending of Machhapuchhre bank and it has adhered to the norms of Nepal Rastra Bank and tried to diversify the loans and advances, however in some sector the lending is in excess of 100% of core capital and it has obtained approval from board where the sectoral lending is excess than its core capital.

Table: 4.5

Sector-Wise Loans and Advances of Machhapuchhre Bank Ltd.

Sectral year	2064-65		2065-66		2066-67		2067-68		2068-69	
	Principal	% of corer capital	Principal	% of corer capital	Principal	% of corer capital	Principal	% of corer capital	Principal	% of corer capital
Corer Capital		552,869		637739		750353		1750425		2624971
Agricultural and Forest Related	-	-	-	-	288	0.02%	13725	0.78%	260839	9.94%
Fishery Related	-	-	-	-	-	-	-	-	-	0.00%
Mining Related	-	-	-	-	-		--	-	-	0.00%
Manufacturing (Producing Related)	115999	20.98%	261418	40.9%	532035	30.39%	801202	45.77%	978490	37.27%
Construction	167579	30.31%	594720	93.25%	1111520	63.50%	1210771	69.17%	163825	62.40%
Electricity Gas and Water	-	-	-	-	-	-	-	-	25686	0.98%
Metal Product machine & Electronic	6000	1.08%	10545	1.65%	-	-	122693	7%	160974	6.13%
Transport communicate & Public	862615	156.62%	1451040	179.55%	2235590	127.72%	1594930	91.12%	2243192	85.45%
& Retailer	368733	66.69%	439432	68.90%	2267045	129.52%	20211375	115.48%	2441740	93.04%
Finance Insurance & Real Estate	147707	26.72%	859500	134.77%	1881799	107.51%	1302956	74.43%	963577	36.94%
Hotel or Restaurant							302057	17.25%	760531	28.97%
Other services	319675	57.82%	334051	52.38%	727056	41.54%	579011	33.07%	2015260	76.77%
Consuming & Loan	10883	1.97%	120622	18.91%	213314	12.18%	952610	54.42%	1290801	49.17%
Local Government	-	-	-	-	-	-	-	-	-	0.00%
Others	1068005	193.18%	2052115	321.78%	4399337	251.34%	4501748	257.18%	6939315	264.36%
Total	3067196	-	6123443	-	13067984	-	13703078	-	19724430	-

Source : Monthly Report of MBL

From the table it is very clear that the lending in transport, communication and Public utilities and other loans exceeded 100% than its core capital in the year FY 2064-65, likewise in the year FY 2065-66 the bank's loans and advances in three Sector exceeded its core capital viz. transport, communication & public utilities, Finance, insurance & real estate and other loans. In the year FY 2066-67 four Sectors exceeded the lending then its core capital; however in the later years FY 2067-68 and FY 2068-69 only one sector, other loan exceeded its core capital. This may be due increase in the core capital of the bank in the later year due to injection of new capital from outside as there is more than 100% increase in core capital of the bank. Not only have that in the later years the loans were diversified. The sector like agriculture and manufacturing had no loans or very little loan and in the initial years and in later years the loan were disbursed in those sector as well, the table shows that there is lending of 9.94% of core capital in agriculture in FY 2068-69 and 37.27% of core capital in manufacturing sector in FY 2068-69. Hence this good sign that the sectoral risk or concentration risk has been mitigated to some extent in the later years. As the approval from the board has been obtained for the excess lending Machhapuchhre has complied with the directives issued by the central bank.

This way the concentration risk of loans and advances being sanctioned in single sector is minimized. In other word the portfolio is diversified.CPG and NRB have minimized concentration risk by diversifying the loans and advances in different sectors.

Concentration in Single Borrower or Single Group

CPG has defined single group and single borrower and has restricted single group of Borrower or single borrower from obtaining loans more than 25% of the bank's core Capital. The CPG has defined single group of borrower as such single group of Borrower means credit facilities sanctioned to borrower parents, spouse, sons and Unmarried daughters, joint family uncle and aunt, company or partnership firm Operated by joint family, who holds more than 25% of shares of a company or if the Company owned by the borrower or borrower's group hold more than 25% shares of another company or if the borrower's group holds key position like director, CEO of the firm then even if the company own shares less than 25% than such group shall be consider as single group of borrower.

CPG has defined the single borrower as the borrower who does not fall under the category of single group of borrower CPG has specifically guided the management That even though the loans and advances granted to different individuals of single group seems to be different loans with different limit; it should be taken as single loan with different title and the limits to be summed up and it needs to be approved by concern authority whose credit sanctioning authority will have approving authority of summed limit. However, CPG has allowed the single group of borrower to use the facilities sanctioned to one person to be used by another with the mutual consent and by transferring such credit facilities to the required individuals. However, the bank's management will have full right over not allowing such transfer and any credit facilities sanctioned to the group may be revoked with specific notice.

CPG has restricted the bank's management for lending in excess than 25% of its core capital to single group of borrower or not to exceed the limit prescribed by NRB from time to time through issuance of directives. Not only that the bank's management needs to make proper study of the loan diversification of loans and advances so that concentration of loans and advance will not be in single sector.

Table: 4.6

Percentage of top 5 Borrower (Single or Group) toCore Capital of the Bank

2066-67			2067-68			2068-69		
Top FiveSingle Groups	**Limit**	**% of corer capital**	**Top five Single groups**	**Limit**	**% of corer capital**	**Top five Single groups**	**Limit**	**% of corer capital**
Group A	217482	12.43%	Group A	161830	9.25%	Group A	390839	14.89%
Group B	210347	12.02%	Group B	160530	9.17%	Group B	301500	11.48%
Group C	147080	8.40%	Group C	154230	8.81%	Group C	284100	10.82%
Group D	123165	7.04%	Group D	130698	7.46%	Group D	206680	7.87%
Group E	121519	6.94%	Group E	97894	5.59%	Group E	184070	7.01%
Core Capital	1750353	-	Core Capital	1750425	-	Core Capital	2624971	-

Source: Single Obligor Group Report of MBL to NRB.

Concentration of loans and advances of single group of borrower or single borrower is least in FY 2067-68, i.e. maximum of 9.25% of core capital, and highest concentration of 14.89% in FY 2069-69 .When absolute value is compared the large borrower or group of borrower of the bank has increased by 2.75 times from FY 2066-67 to FY 2068-69. Even though the loans and advances to single borrower or single group of borrower has increased in absolute value from FY 2066-67 to FY 2067-68, there is decrease in comparison to the core capital of the bank. This is due to 2.47 times increase in core capital of the bank from FY 2066-67 to FY 2067-68. The table presents that so far the bank have made the lending to single borrower single group of borrower within the limit prescribed by CPG and NRB.

Now when risk is analyzed in single group of borrower of single borrower in comparison to net profit of the bank, than the bank seems to be lending a bit more to single borrower or single group of borrower. The analysis of this also has to be done because if top one or two borrowers goes in default or becomes non performing, than the profit and loss account of the bank will be hit hard due to provisioning of such loans and advances. This may result in negative balance sheet of the bank.

Table: 4.7

Percentage of Loans of Single Borrower or Single Group of borrower in Comparison to Net Profit

F.Y.2066-67			F.Y.2067-68			F.Y.2068-69		
Top Five Single Group	**Limit**	**% of corer capital**	**Top five Single groups**	**Limit**	**% of corer capital**	**Top five Single groups**	**Limit**	**% of corer capital**
Group A	217482	176.45%	Group A	161830	107.31%	Group A	196000	112.35%
Group B	210347	170.66%	Group B	160530	106.44%	Group B	164150	94.09%
Group C	147080	119.33%	Group C	134230	89.05%	Group C	154100	88.33%
Group D	123165	99.93%	Group D	110698	73.40%	Group D	116680	66.88%
Group E	121519	98.59%	Group E	97894	64.91%	Group E	92407	52.96%
Net Profit	123251	-	Net Profit	1750425		Net Profit		

Source: Single Obligor Report to NRB

Though there is low amount in absolute figure of 217482 thousand of top borrower in FY 2066-67, when compared to net profit of the bank it is 176.45%. This shows that had the top borrower of the bank gone in default than the profit and loss account of the bank would have gone negative. Likewise in FY 2067-68 and FY 2068-69, the top borrower still exceed the net profit of the bank, hence if top borrower of the bank goes in default, than the profit and loss account of the bank would go in negative.

Above results show that even though the bank have followed the norms lending up to 25% of its core capital, but needs to decrease the concentration of loans and advance of top single borrower of single group of borrower to mitigate the risk of balance sheet of bank going in default if the top borrowers goes in default.

Collateral – Security for Loans and Advances

CPG of Machhapuchhre Bank has restricted the management of the bank from lending without any collateral. Collateral may be any one of the following items,

- Land which is suitable for construction of residential or business purpose building.
- Land and Building which is suitable for resident or business.
- Gold and Silver.
- Shares or debentures or reputed and listed public companies.
- Government bond and securities.
- NRB bonds and securities.

Further CPG has made it clear that following types of the collateral must not be obtained as security for credit facility that shall be sanctioned.

Land and Building

- Ownership is legally not clear.
- Ownership is legally clear but it is against the interest of public or community or has been used for the interest or public or community.
- Dispute over ownership or where the legal case in court is pending.
- Collateral where access road is not clear or the BOUNDARY is not clear.
- Building where is ruined or which has been made with mud or has been constructed with weak materials.
- Land or land and building which is owned by minor or person with unsound mental health.
- Land or land and building which is located in area where the Government of Nepal is planning to use for public purpose.
- Land where the Govt. of Nepal or Local Govt. Bodies of Nepal has restricted for construction of building or residential or business purpose.
- Land, land and building,vehicle or any collateral which can't be auctioned.
- Land which is very near from river, hill where there is danger of landslide, near gorge, where there is high tension wire or where there is risk of any other natural calamities.
- Other collateral which does not cover the credit facilities or which is not fit deemed as by the management of the bank.

Vehicle and Machinery

- Vehicle which is old and which can't be resold in the market.
- Vehicle which has been caught in accident and can't be used for commercial or private use.
- Vehicle which has been auctioned once.
- Vehicle which can't be insured or not accepted by the insurance company of Nepal.
- Vehicle or machinery which can't be auctioned.
- Vehicle or machinery which ownership is not clear.
- Vehicle or machinery which will not cover the credit facilities which has been sanctioned.
- Vehicle or machinery which is deemed unfit by the management of the bank.

Other Materials

In case of other materials like gold and silver there is no clear demarcation but it has restricted from obtaining assets whose value can't be exactly determined or where the auction can't be made of the collateral. Not only that the ownership should be clear and the materials should be resalable in the market if the borrower does not repay the loan.

One thing that is clear is that no credit facility should be sanctioned against the securities of the collateral that is not resalable, which can't be auction or which is not sufficient to cover the sanctioned credit facility. In short is says that a collateral should cover the loan if the borrower defaults in repayment of the loan.CPG has clearly outlined that the collateral has to have following properties so that is can be taken as collateral security.

Land and Building

- The access road has to be very clear and should be motor able, in case the access road is not clear in blue print then it should be certified from the municipality or VDC and enforceable.
- Free from any litigation and free from mohi and guthi.
- The land should be suitable for construction of building and should be useful for the resident or business purpose.
- The ownership should be single or joint but it should not be disputable and easy transferrable.
- The property should not affect the interest of public.
- The property should not be of minor nor should it be of person of unsound mind.
- The property should not be near of steep hills, near river, near gorges and under high tension wire.
- The property should not be in the area which may be taken by Government for their use.
- Houses should have been constructed in RCC frame work and it should have been made by cement and rods.

Vehicles and Machinery

- It should not have been more than 5 years old at the time of loan disbursal.
- The resale value of the vehicle is good and should come in commercial use when necessary.
- Manufacturing company is still in operations and still manufactures that product.
- Ownership should be transferable when necessary.
- Should have been brought in the country legally and paid all the applicable taxes.

Though CPG of the bank has totally restricted the bank from lending without collateral, Nepal Rastra Bank has no fix set of rules for the banks and financial institution regarding collateral or security to be obtained. The banks and financial institutions may even make lending based on personal guarantee or corporate guarantee but such should be clearly outlined in the banks and financial institutions from lending without collateral in personal guarantee but if such lending is make an extra provision of 20% has to be made, hence in other way round NRB is discouraging the banks and financial institutions from lending just in personal guarantee or corporate guarantee.

This way collateral risk has been addressed by CPG of the bank and has tried to make the loans and advance of the bank secure. Further the CPG has set standard norms for valuation of major items that the bank will take as collateral security and left the valuation of collateral in the hand of technical person and these technical persons are called valuator of the bank. CPG has set that at least the following norms to taken into consideration valuating the proposed collateral security.

i. **Land and Building:** While calculating the value of land a weight age of 30% or more of Govt. Rate and 70% or less (Total of 100%) of Market Value has to be taken for determine the value of the land. Generally set rule is that for valuation of the land a weight age of 30% of Govt. and 70% of Market rate has to be adopted and the value obtained is called Fair Market Value (FMV) and 80% of FMV is called Distress Value (DV). In case of building which has been constructed as per the approved map of the municipality, the approved area is multiplied with the estimated cost per square feet and depreciation is deducted from such value for determining FMV of the building.

ii. **Vehicle and Other Collateral:** In case of Vehicle the valuation is totally left in the hand of technical person. In case of other assets like gold a value is determined by multiplying the mass by its current market rate and deducting the margin of a least 20%. For other collateral securities the calculation of value has been left in the hand of management of the bank and as per the directive of NRB.

Table: 4.8

Security wise Loans and Advance of Machhapuchhre Bank

Collaterals(Securities)	2064-65		2065-66		2066-67		2067-68		2068-69	
	No	Amount	No	Amount	No	Amount	No	Amount	No	Amount
Gold and Silver	-	-	-	-	17	3,071	116	8,349	231	15,890
GovernmentSecurities	-	-	-	-	-	-	-	-	-	-
Non-Governmentalsecurities	-	-	-	-	1	2,800	1	1.983	1	1,105
Fixed Deposit Receipts	4	1,088	25	12,062	43	18,261	100	22,181	144	31,173
Collateral of Properties	372	305,626	667	685,280	1,063	1,280,667	1,433	1,519,074	1837	1,993,723
Real Estate (land and	220	216,698	442	520,260	677	1,020,029	906	1,184,237	1230	1,651,126

Building)										
Machinery andEquipment	-	-	-	-	2	222	2	4,872	2	6,053
Vehicles	152	88,928	225	138,020	384	260,417	525	329,966	605	336,545
Against Security of Bill	-	-	-	-	-	-	-	-	-	-
Against Guarantee	-	-	-	-	-	-	834	38,723	2700	80,555
Credit Card	-	-	-	-	-	-	-	-	-	-
Others	-	-	-	-	-	-	-	-	-	
Total	376	306,714	692	670,342	1124	1,304,799	2484	1,590,310	4913	2,122,446

Source : NRB Reporting of MBL

From the above table it is very clear that a very large portion of the bank's loans and advances have been sanctioned obtaining land and building as collateral security. In the FY 2068-69 there is 77.79% loan in term of amount sanctioned against land and building and loan sanctioned against vehicle covers 15.86%. These two securities based lending alone covers 93.65% of the total lending. There is 80,555 thousand loan sanctioned against guarantee in the FY 2068-69 which is around 4%, this lending is total based on group guarantee and that loan is sanctioned through micro finance division of the bank. This is done in order to provide loan to deprived sector and follow the mandatory requirement of the central bank to each and every banks and financial.

From the table loan and advances based on security, it is very evident that the bank has complied with the CPG of the bank and lending is secured by the collateral in the event the cash flow or the repayment capacity of the borrower depletes hence loans and advances of the bank are highly secure in terms of collateral. Further what has been discussed in the section investment of borrower in the project is also relevant here.

The table no. 4.4 Percentage of loans sanctioned against the value of collateral product wise, also shows that high margin has been deducted while making sanctioning loans and advance to the borrower. As only 50.24% of collateral's FMV has been sanctioned in Business Loan and Maximum of 74.30% has been sanctioned in Hire Purchase Loan, hence minimum of 25% margin has been deducted in the value of the collateral hence the collateral risk has been mitigated by the bank.

Guarantors

Since the lending is fully based on the collateral security and the lineage of the owner will have the right over the property and more importantly it is very important when the collateral is of father or mother and the lending is done to me of the son or daughter among two or more brother and sisters than the guarantee is must because, the right over the property is of all the sons and unmarried daughter of the owner, hence it is very important that the guarantee of all the aged sons and unmarried daughter has to be obtained prior to make lending. Obtaining guarantee has two meaning to the bank.

i. **Mitigating Collateral Risk:** If the guarantee is not obtained from the family members and those individuals who holds right over the collateral security than the risk of being the collateral subprime will be high. For example if the borrower does not repay the loans and advances and the bank have to auction the property than if guarantee has not be obtained from even one member of the family or who holds right over the property than that person can claim his right over the property and stop the auction process. Even the court will allow the auction only when the right of the person who has claimed is settled than only the portion of the bank can be settled. Hence it is very clear that without the guarantee of the right holder of the property the loan and advances will be subprime.A survey was done among 12 Branch Managers and 6 credit staff of the bank among the importance of personal guarantee and the result has been illustrated in the table below.

Table: 4.9

Necessity of Obtaining Personal Guarantee

	Must	If Possible	Few would Be enough	Not Necessary	Total
Guarantee of Family Members	15	3	0	0	18
Guarantee of Brother and Sisters who have separated	8	5	3	2	18
Guarantee of Neighbour	0	18	0	0	18
Guarantee of Friends	4	14	0	0	18

Source: Filed Survey, 2013

It is very clear that the personal guarantee is a must in case of family member and in other cases it would better if the bank is able to obtain personal guarantee against the loans and advances sanctioned to the borrower even if the bank has obtained collateral security for the loan as the collateral may become prime if one of the right holder of the property does not provide the consent over the loans and advances sanctioned to the borrower.

i. **Providing Additional Security of Loans and Advances:** It would be very good for the bank if its loans and advances are fully secured, as there is no chance of loans and advances being 100% secure but trying on mitigating all the possible risk would be good. For securing the loan one of the ways is obtaining guarantee form neighbor and friends of the borrower, this way when the borrower is not able to repay the loans, the personal guarantor will assist in repayment of loans. The table Necessity of obtaining Personal Guarantee shows the importance of Personal Guarantee as all the staff says that if possible it is better to obtain personal guarantee from external person other than family member or the borrower. It is much safer to the bank if the guarantee is obtained from the renowned person of the society then even if the person goes in default than the recovery of the loan is easier as the well-known person of the society will not risk his name and will pay the loan.

NRB has no specific rules for obtaining guarantee but it has made it mandatory to obtain family detail of the borrower hence it is one of the way the central bank want all the family member to provide guarantee for the loan sanction. In case of Machhapuchhre Bank it has made it mandatory to obtain bio data and family declaration from the borrower which can been seen when the study of file and it is clearly stated in their checklist as well hence the bank has followed the instruction of the central bank.

There is no specific rule for person who is eligible to be guarantee but following person can't be the guarantor for the loan sanctioned.

- Blacklisted Person.
- Promoters of the bank.
- Minor person as the contract made by minor is not valid.
- Staff of the bank.
- Insolvent person.
- Any person who have no capacity to repay the loan obtained by the borrower.

The bank has obtained personal guarantee of all the family members of the borrower and if possible obtained personal guarantee to relatives, neighbor and friend where possible, hence the risk of the bank has been additionally mitigated and collateral security of the bank is provided with additional security by obtaining personal guarantee from the right holder of the assets mortgaged.

Repayment or Cash Flow of Borrower-Capacity of the Borrower

Even though the proposed sector of lending of lending is good and vibrant, the collateral offered by the prospective borrower is secured on good one still the bank would not entertain such party unless the repayment capacity of the borrower is good enough to repay the installment of loan or at least interest of such loan. Basic thing is that the project of the borrow should generate enough cash to meet the obligation of the borrower including bank's installment and in case of fixed income earner, cash inflow should be enough to cover the obligation of the borrower including that of bank's installment. The study would be easier if the borrower is dividing as individuals with fixed income earner, firm or company with definite project and vehicle for commercial use.

i. **Individuals :**Basic thing checked here is the cash inflow of the customers and regularity of such cash flow is checked. Regular includes salary, rental income from house/land and vehicles. Once the regular income of the individual is determined then the expenditure of the individual is studied, which is outflow of cash. Expenditure includes, rent payment, expenses on food, education, transportation, medicine and other contingency expenses. Cash outflow is deducted from cash inflow to determine disposable saving of the prospective borrower. This disposable saving determines the loan capacity of the customer. The table below shows the decision making process.

Table: 4.10

Study of Cash Flow for Decision Making of Loans and Advances

Particulars	Case I	Case II	Case III
Cash Inflow- Income	25,000.00	60,000.00	150,000.00
Cash Outflow-Expenditure	10,000.00	40,000.00	90,000.00
Disposable income-Saving	15,000.00	20,000.00	60,000.00
Installment of Bank	10,000.00	25,000.00	50,000.00
% of Bank Installment to Saving	67%	125%	83%
Decision	YES	NO	In Between- Further analysis is needed
Reason	Installment to saving is less than 80%	Installment to saving is more than 100%	Installment to saving is more than 80% and less than 100%

Source: Credit Manual of MBL

Even though the income of case II is greater than case I, the file is rejected as the saving of the customer is not enough to cover the installment payment to the bank. Again in case III, the saving is enough to cover the installment but, the installment to saving ratio is close to hundred percentage, hence if some emergency events occurs and the clients have to make such payments than the installment payment to the bank will be in default hence further study needs to be done.

Hence a total income of the individual is checked with the evidence like salary certificate certified from the office of borrower or salary statement of bank or salary sheet of borrower's organization, rental agreement in case of rental income and such should be verified with the concern property like if the agreement is of land or building than the borrower need to submit the land ownership certificate of such land or land and building. There are other source of income as well like remittance income such should tally with remittance received paper or deposit in the statement of the bank, income like pension is verified by pension receiving certificate or pension receiving bank statement.

Risk or repayment is mitigated by obtaining and verifying the source and authenticity of document presented by the prospective borrower.

Table: 4.11

Source of Income and Supporting Documents Verifying Process

Source of Income	Supporting Documents and Verifying Process
Salary	• Letter from the organization where the client is working. • Statement of bank where client's office make deposit of salary. • Salary sheet of the organization where the client is working. • Statement of Bank where client deposits his salary income. • Any one of the document will be enough but the bank statement will be consideredas most reliable one.
Rental Income	
Land	• Rental agreement specifying the plot no, area, location and owner of land. • Land ownership certificate. • Photograph of the land. All three documents are necessary to justify the rental income.
Building	• Rental Agreement Specifying the plot no, area, location and owner of land. • Building completion certificate from municipality. • Photograph of Building.
Vehicle	• Blue Book of Vehicle- Three should be no loan on vehicle. • Route permit of Vehicle. These two documents must be presented.
Remittance Income	• Remittance received slip. • Statement of remittance received in regular interval. • Copy of passport with valid visa.
Pension Income	• Pension receiving certificate. • Statement of receiving pension in bank.
Other	• Fee received for professional service rendered. • Any documents to support the income stated by the customer.

Source: Credit Manual MBL

Further a detailed expense of the customer is obtained to check saving of customer so that what the customer earns would be enough to meet his day to day expense and meet installment obligation of the bank. A study was made among18 staff of the bank (12 Branch manager and 6credit staff of head office), asking what percentage of installment to saving or disposable income would they consider safe for lending or what standard ratio have they maintained for their branch and following result was obtained.

Table: 4.12

Maximum Ratio between Installment Amounts to Saving for Obtaining Loan

Maximum % of Installment to Saving	Less than 50%	50-60%	60-70%	70-80%	80-90%	Above 90%
No. of Respondent	5	3	8	2	0	0
Percentage of Respondent	27.78%	16.67%	44.44%	11.11%	0%	0%

Source: Field Survey, 2013

The survey shows that the bank would not make lending to the individual if installment to saving ratio is higher than 80% and larger concentration of the respondent falls under the category of installment to saving ratio of 70% or 80% of the respondent would not provide loan if the percentage of installment to disposable income goes above 70%, hence the loan of the bank is secured in terms of repayment of loan.

This way the risk of repayment is mitigated by verifying the income source of the borrower and having margin of safety between disposal income and installment so that even if some of the unexpected incident occurs and the customer has to make other payment still the borrower would be able to serve the installment so that even if some of the expected incident occurs and the customer has to make other payment still the borrower would be able to serve the installment obligation of the bank.

ii. **Commercial Vehicle:** Commercial Vehicle is one of the major lending of banks and financial institutions. Repayment of the commercial vehicle is very to study and estimate as well. Generally the concern samiti under which the commercial vehicle runs will provide certification of the estimated income of the vehicle. When the income generated by the vehicle is enough to cover installment of the bank and the day to day expanse of the borrower the leading seems feasible. However, what has been discussed like ratio of installment to disposable income and percentage of lending on the value of vehicle will play crucial rule over lending decision making.

ii. **Firm/Company:**Analysis of the firm and company is quite complicated than analysis of the individuals. Here the financial statement is studied in comparison with its own past data and compared with the industry average where possible. Major thing that has to be studied in cash flow of firm and check if it is generating enough profit to pay at least the interest of the bank loan. The major item studied in the financial statement are the financial ratios like current ratio, quick ratio, solvency ratio, interest coverage ratio, gross profit and gross profitability, net profit, net profitability, return on investment, fixed asset turnover ratio and along with these ratio the physical stock verification and growth in sale, debtors/ receivable and inventory turnover are also studied.

Viability of a firm rests on the strength of its operating structure and financial structure. When both are strong, credit manager does not have much to worry about, and when both are weak he might as well forget his receivables. In between, there are several of a firm who suffer from weakness in either of the structures. If the operating structure of a firm is good but its financial structure is poor, there is chance that the firm would be able to make a turnaround by suitable modification of its financial structure. But if it other way round i.e the financial structure is strong but operating structure is weak then the chance of revival is bleak. Hence the focus should be more on the strength of its operating structure rather than on financial structure.

Majorly the credit managers are more focused on financial ration of the firm and companies however, in cash of Machhapuchhre they are equally focus on financial and operating ratio. Further they do not sanction credit just on the basis on financial statement submitted by the customer rather hey visited the business of customer and study day book, ledger maintained by them, bank statement of customer, stock and turnover of stock, volume of sales, margin of such business in overall industry.

To study repayment or cash flow of the business firm it would be better if we take sample financial statement of the firm or company. The credit manager provided with one of business credit files for study of how the project is studies prior to making leading by the bank. The bank has practice of making study of following operations and financial ratio of the firm or company prior to making leading decision and credit manual of the bank has set stander for the ratios.

Ratio Analysis

i. **Fixed Assets Turnover Ratio:** Fixed asset turnover ratio shows how well fixed assets have been utilized and when the ratio has falling trend, it shows that the capacity of the fixed asset is decreasing and it is one of the serious indicator to be checked. If there is fall in fixed asset ratio than it is not wise to make lending. Sometime, financial ratios will be good but if the fixed asset ratio is decreasing than it is not safe for lending and sometime financial ratio is not be good but the fixed asset ratio will be increasing trend, this may be due to growth in business of the firm or company, as the growing firm will need money and their financial ratio will not be that good.

Table: 4.13

Fixed Assets Turnover Ratio of MBL

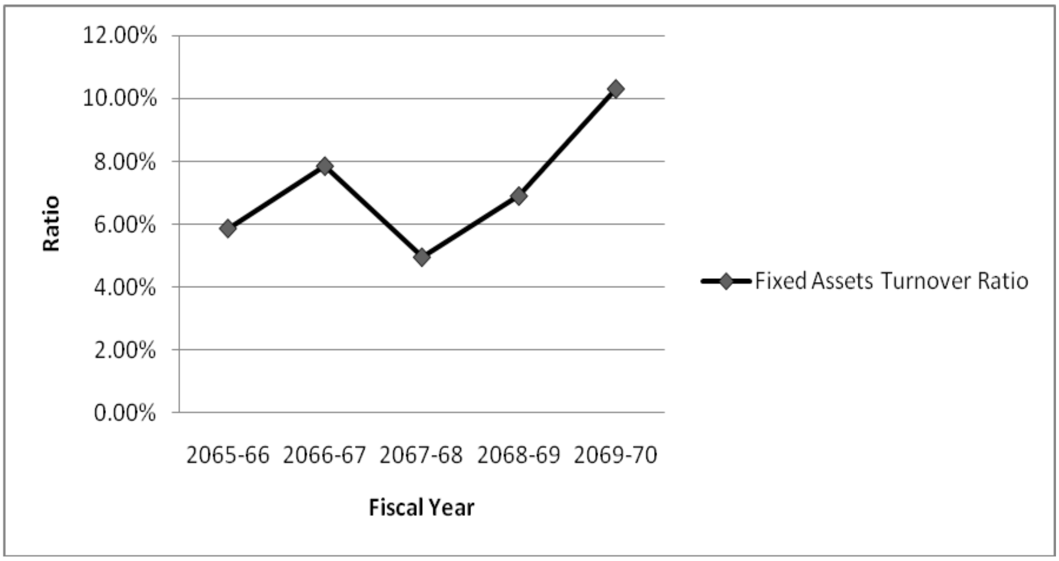
Fiscal Year	2065-66	2066-67	2067-68	2068-69	2069-70
Fixed Assets Turnover Ratio	5.88	7.86	4.97	6.91	10.31

Source: Financial Statement of MBL

Fixed asset turnover ratio is calculated as net sales divided operating fixed asset. When we study the fixed asset ratio of the MBL it is showing rise from 5.88 to 7.86 and fall to 4.97 and again rise to 6.91 and to 10.31, respectively in the FY 2065-66, Fy 2066-67, FY 2067-68, FY 2068-69 and FY 2069-70. The figure of the FY 2068-69 and Fy 2069-70 are projected figure of the company. Though there is fall in fixed asset turnover ratio in year Fy 2067-68, but there is consistent increase in the fixed asset turnover ratio, hence the ratio is showing good increasing trend. Further there is increase in fixed assets as well, hence there is additional of new assets which is increasing the operation of the firm. Hence according to the study of this ratio the lending to the firm is viable.

Fig 4.1

Fixed Assets Turnover Ratio



iv. **Return on Investment (ROI):** Operating ratio is calculated as operating profit divided by operating assets. Here operating assets includes both operating fixed assets and current assets. Table no. shows the return on investment of the MBL

Table: 4.14

Return of Investment of MBL

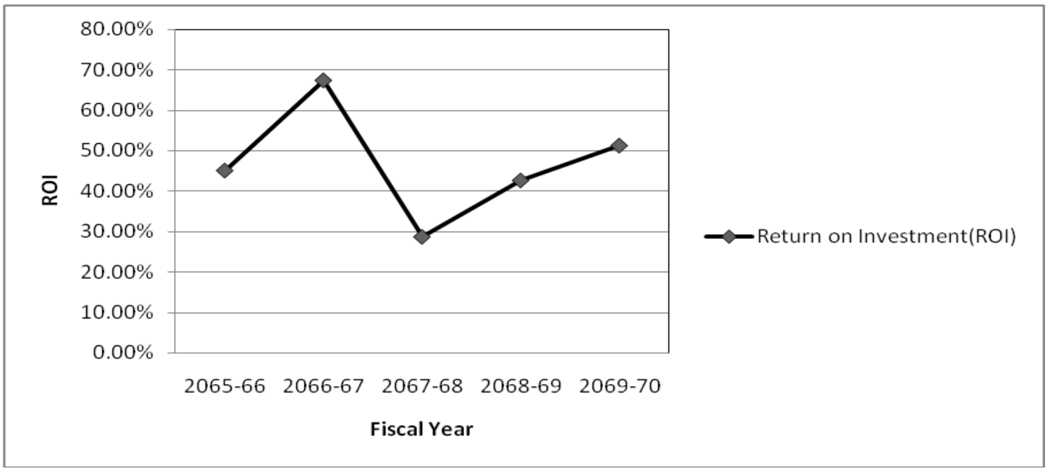
Fiscal Year	2065-66	2066-67	2067-68	2068-69	2069-70
Return on Investment (ROI)	45.41%	67.44%	28.71%	42.71%	51.29%

Source: Financial Statement of MBL

When a trend analysis of the return on investment of the MBL is made, there is rise from 45.41% to 67.44% and after that there is fall to 28.71%. After that there is rise of 42.67% and to 51.29% in FY 2065-66, FY 2067-67, FY 2067-68, FY 2068-69 and FY 2069-70 respectively. Though there is fall in the return on investment it is still above than the normal return of 12% to 15% or maximum rate of interest charged by the bank i.e. 18% hence it is quite feasible to lend as per return on investment ratio. If the trend was only decreasing then it would be quite a serious thing to consider but there is again rise in return on investment.

Fig: 4.2

Return on Investment of MBL



iii. Gross Profit Ratio: Another operating ratio that is good measure of the viability of project is gross profit which is calculated as gross profit divided by net sales. The table no. shows gross profit ratio of MBL.

Table: 4.15

Gross Profit Ratio of MBL

Fiscal Year	2065-66	2066-67	2067-68	2068-69	2069-70
Gross Profit Ratio	50.00%	50.00%	50.00%	50.00%	50.00%

Source: Annual Report of MBL

The MBL has been operating at consistent peace and has gross profit of 50% in all FYs. Since this ratio is the single most important ratio to evaluate the strength of the MBL operating function which is fundamental to a MBL business? As this ratio is well above the interest rate payable to the bank it is viable for the bank to make lending.

As per the analysis of the operating ratio the MBL is feasible for lending.

iv. Equity- Total Debt Ratio: Equity- Total Debt Ratio measures the long term financial risk of the business. It also attempts to measure the efficiency of the MBL in striking a balance between risk and profitability it its capital structure because these two are often inversely related to each other. The standard norm is that in the total investment of the project, the equity financing should be at least 30% and debt financing should be at least 30% and debt financing should be 70%. Sometimes this ratio's standard is considered as 0.33 which implies that 25% should be equity financed and 75% to be debt finance.

Table: 4.16

Equity- Total Debt Ratio

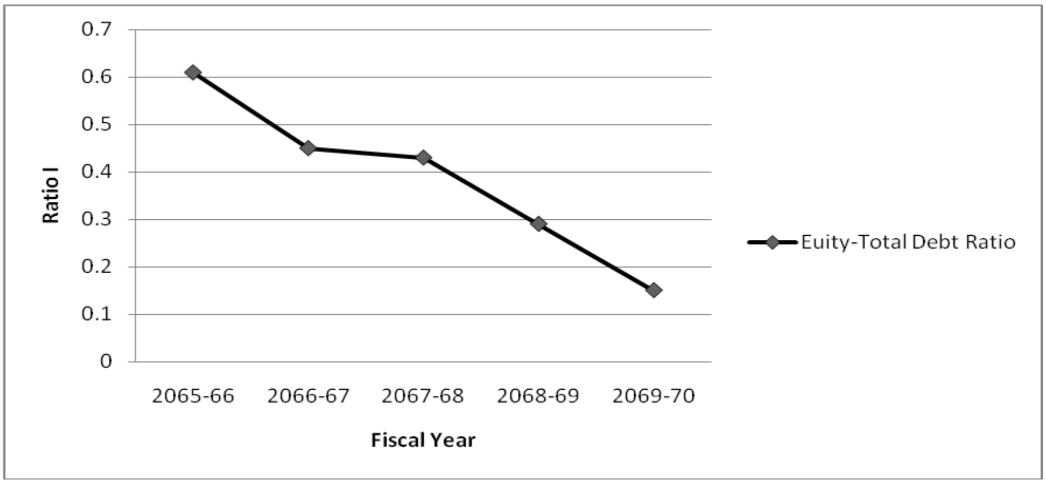
Fiscal Year	2065-66	2066-67	2067-68	2068-69	2069-70
Equity-Total Debt Ratio	0.61	0.45	0.43	0.29	0.15

Source: Financial Statement of MBL

There is steady fall in the ratio and in the projected year 2069-70, it is less than the standard of the ratio .This fall is good for the lender or the bank as the portion of loan of bank is decreasing over time but that may not be good for the company as it would eating up the tax benefit that the company would be able to rip, hence the fall in the ratio is good point for the bank but the fall to 0.15 is not good sign for the company. Since when the portion of capital investment of bank is highest it was still 38% of the project hence it safe for the bank to make the lending. Hence as per this ratio it is safe for lending.

Fig. 4.3

Equity – Total Debt Ratio



v. **Equity–Short Term Debt Ratio:** This ratio is also called credit strength ratio and it indicates the degree of financial prudence of an enterprise which cuts across both small and large companies. The company will try to maximize creditors' financing because it comes free of cost and there is chance of overtrading which needs to be checked hence to exercise control this ratio is used. The standard of this ratio is around 1 and go down 0.6 because if its goes less than 0.6 than it show the company is not showing financial prudence. However, if it is less than the standard ratio, it is shows less use of the cost free financing.

Table: 4.17

Equity – Short Term Debt Ratio

Fiscal Year	2065-66	2066-67	2067-68	2068-69	2069-70
Equity Short Term Debt Ratio	0.11	0.11	0.08	0.08	0.09

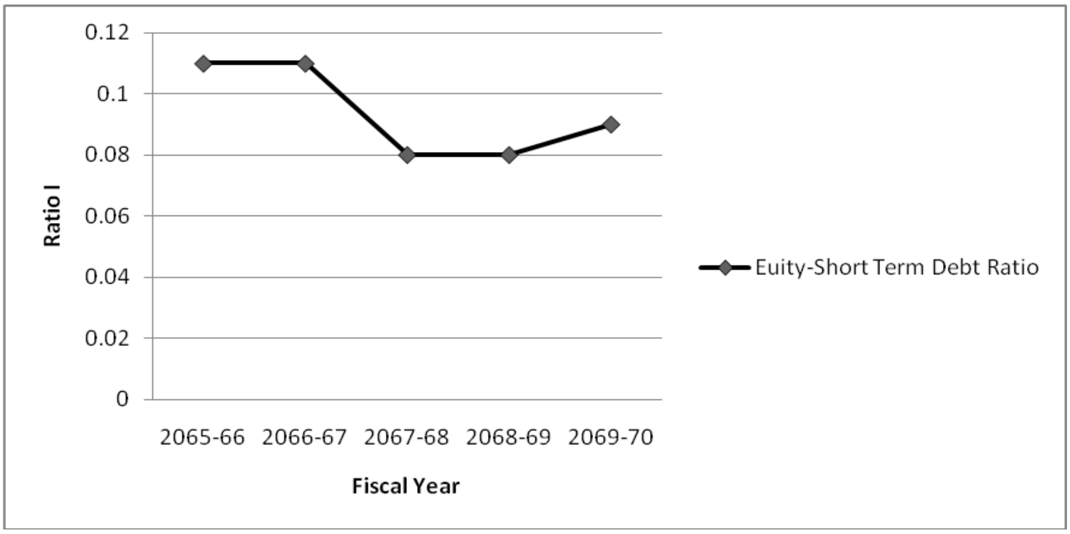
Source: Financial Statement of MBL

However, off lately the trend of credit sales is decreasing in Nepalese market and further for the credit sales the creditor will charge higher rate as well this may be the reason the company is reluctant to use the cost free financing.

The lower ratio of the company is also good for the bank as the MBL does not have much of the external debts and secure for the bank as the company will meet the cash flow to the bank only and does not have to pay for the external debtors.

Fig. 4.4

Equity-Short Term Debt Ratio



vi. **Current Ratio:** This is the most common and most widely used financial ratio for the study of firms and companies over the world. This ratio is calculated as current assets divided by current liabilities. The standard for this ratio is 2 which shows that current liabilities be just half of its current assets. But in case of your company it is hovering around 10 i.e. current assets is around 10 times of current liabilities. This shows a bit mismatch in current asset and current liabilities but what has been discussed that the Nepalese market does not prefer credit sales and higher cost on credit sale are the reason for company not preferring higher amount of current liabilities.

Table: 4.18

Current Ratio of MBL

	2065-66	2066-67	2067-68	2068-69	2069-70
Current Ratio	9.25	9.23	10.88	10.52	10.00

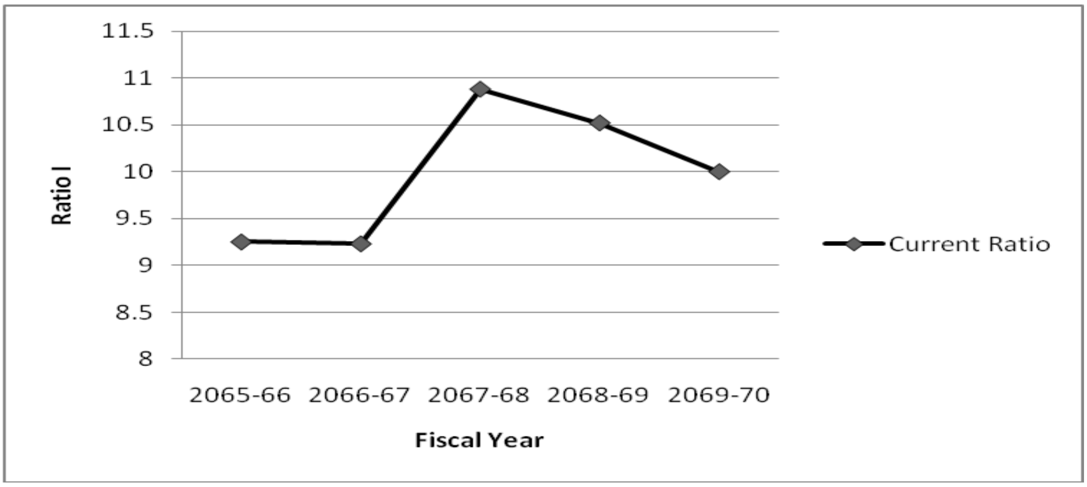
Source: Financial Statement of MBL

Current ratio is hovering around 10 which is not as per the standard norms but it is Safe for the bank as there is less external debts and total debts will be just of bank and The cash flow of the company will met the obligation of the bank.

It needs to be suggested to the company that they decrease their current ratio so they would earn more profit.

Fig. 4.5

Current Ratio of MBL



vii. **Inventory Turnover Ratio:** This ratio shows the ratio how well the inventory has been turnover during a year. Higher inventory turnover ratio shows higher efficiency and vice versa. This ratio when studied in modified form as number of days of stock holding would be more meaning full. Both of the ratios is calculated as following.

Table: 4.19

Inventory Turnover Ratio and No. of Days Holding of Inventory

	2065-66	2066-67	2067-68	2068-69	2069-70
Interest Turnover Ratio	18.00	19.80	13.50	14.85	16.34
No. of Days holding ofInventory	20.28	18.43	27.04	24.58	22.34

Source: Financial Statement of MBL.

The table above illustrate that the MBL is turning the inventory quite well and it is 18, 19.8, 13.5, 14.85 and 16.34 time to the FY 2065-66, FY2066-67, FY 2067-68, FY 2068-69 and FY 2069-70 respectively. Though the ratio is falling down in FY2067-68 at the least of 13.5 but gaining the pace and projected to increase to 16.34 Times this is good ratio as the holding of inventory is less than a month time which is Good ratio for most of the company and for the industry of ABC Company it is around 25 days hence it is good the company is turning the inventory more efficiently than the other company in the industry.

viii. Interest Coverage Ratio or Debt Service Coverage Ratio: This ratio is the one of the most important ratio for the bank as this ratio will determine if the obligations of the bank is met by the profit generated by the company. However, this ratio will not check if the profit earned will be realized into cash or not and it only cash that met the obligation of the bank. This ratio is calculated as under.

Table: 4.20

Interest Coverage Ratio of MBL

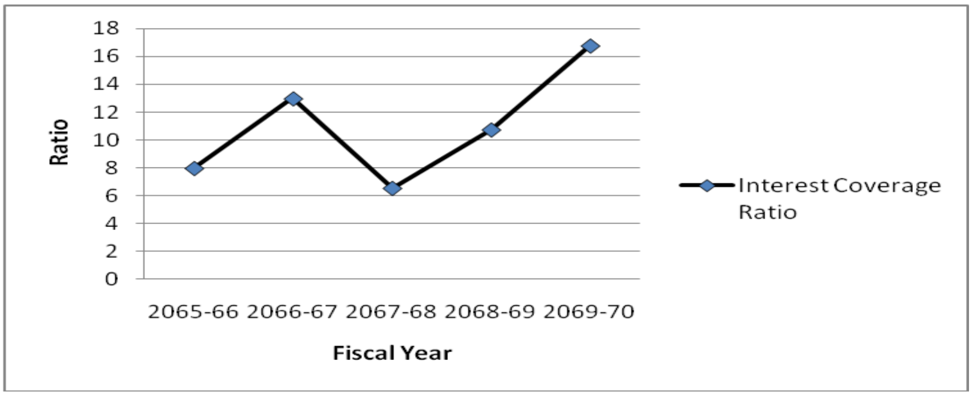
	2065-66	2066-67	2067-68	2068-69	2069-70
Interest Coverage Ratio	7.96	12.97	6.53	10.73	16.77

Source: Financial Statement of MBL

The table and line graph shows that there was least interest coverage ratio of 6.53 **t**imes in the FY 2067-68 but still the profit is enough to cover the interest obligation of the bank by 6.5 time. Hence interest coverage ratio of the company is good as all over audited period and projected period it is well above 6 and in the projected year 2069-70 it more than 16 times hence this ratio tell the bank that it can make the Decision of lending to the company.

Fig. 4.6

Interest Coverage Ratio of MBL



ix. **Receivable Turnover Ratio:** Another financial ratio that needs to be studied is receivable turnover ratio. This shows how well the receivable of the MBL is realized and this very important because if the credit sales of the company are not recovered on time then the profit earned will go in the interest payment to the bank and eventually the business will be in loss. Hence, the receivable needs to be collected on time.

Table: 4.21

Debtors Turnover Ratio and No. of Days of Holding of Debtors

	2065-66	2066-67	2067-68	2068-69	2069-70
Receivable Turnover Ratio	100	100	100	100	100
No. of Day of Holding of Creditors	3.65	3.65	3.65	3.65	3.65

Source: Financial Statement of MBL.

Number of days of holding of debtors is very short hence the collection of receivable Is good.

x. **Payable Turnover Ratio:** what is the payment trend of the company is shown by this ratio and when the number of days is less it is consider good, however, to make use of cost free fund every firm will try to hold payment to the creditor as much as possible without hampering their image. The holding period of MBL is presented in the table below.

Table: 4.22

Payable Turnover Ratio and No. of Day of Holding of Creditors

	2065-66	2066-67	2067-68	2068-69	2069-70
Payable Turnover Ratio	20	20	20	20	20
No. of Day of Holding of Creditors	18.25	18.25	18.25	18.25	18.25

Source: Financial Statement of MBL.

Holding of payable is 18.25 days, which is less than a month. This shows that the Repayment of the MBL is good. Since the interest payment or installment of the Bank will be on monthly basis the payment of the company will be good. As the financial ratios and operating ratios of the firm is good it is safe for lending And now how much to lend is determined by what kind of loan is requested by the Firm. If the firm is requesting for long term loans for purchase of plant & machinery, Purchase of land or building or construction of building than installments or Obligation meeting capacity of the firm is tested which determines the amount of loan i.e. interest coverage or debt servicing ratio should be more than 1. Further if the request is for short term cash need like working capital or overdraft loan cash conversion cycle is studied along with the working capital of the firm.

Interest Rate and Charge

CPG of the bank has left the management for determining the interest rate and charges Applicable for the credit facilities provided by the bank. Though the CPG has given the discretionary power to determine the rate of interest and other applicable charges, It is mandatory to approve such rate of interest and charges from the board of Directors of the bank. Prior to changing the rate of interest and charges and applying new rates, the management needs to obtain approval from the board. The management Of the, bank will obtain approval of rate of interest within a rage so that they will be Able to charge the interest depending on the risk factor associated with the credit Facility.

Nepal Rastra Bank has started to control over of interest and charges on credit Facilities sanctioned by the bank to the borrower. The prepayment charge taken for Early payment of principle amount has been checked by the central bank but, the directive is not very clear, it says that the prepayment charge can't be taken for early payment by the borrower when there is change in rate of interest or other terms than at the time of obtaining loan if the borrower wise to pay from his own source. Hence the bank will assume that they will be able to charge prepayment charge if there is no charge in rate of interest than at the time of obtaining loan.

Further the directive says from the own source of borrower, then the bank will assume that they will be able to charge prepayment charge if the borrower wish to change the bank.

As CPG of the bank have given discretionary power to the bank's management, Management of the bank will determine the rate of interest on the basis of number of Risk associated with the credit facilities. The rate of interest is based on the principle of high risk high return, hence when the bank's management feels there is higher risk on the lending then they will charge higher rate of interest on it and vice versa.

Table: 4.23

Sector Wise Weighted Interest Rate

Types of Loan	**No. of Files Studied**	**Interest Rate**
Business Loan	26	15.47%
Housing Loan	13	16.17%
Personal Loan	22	17.13%
Hire Purchase Loan	13	16.83%
Auto Loan	13	16.77%

Source: Credit Files of MBL

A Study of 87 credit files was made and they were separated in five sectors, viz.

- Business Loan
- Housing Loan
- Personal Loan
- Hire Purchase Loan
- Auto Loan

Weighted interest of the sector was calculated for each sector and the calculated Interest is illustrated in the table no., sector wise weighted interest rate. The rate of Interest rate charged on different sector loan is different and the reason is due to the Risk associated with that sector as whole, rate of interest on business loan is least i.e. 15.47% and maximum is in personal loan I.e. 17.13% the reason of charging higher rate on personal loan is due to the uncertainty of the use of fund obtained from the bank and during the time of real estate boom, large number of people were involved in real a state and the fund was diverted in real estate hence the rate of interest is higher. Further NRB, will categorized personal loans and advances with limit greater than 5 million as real estate hence this is also another reason for charging. Higher rate of interest on the loans and advances. The reason for lower rate of interest on business loan is not only less risk associated with it but also the greater limit of loan in that sector. When the limit of loan is higher the rate will fall and when the limit is lower than interest rate will be higher. This can be best studies with the composition of loans and advances in total loan. Pie chart no. composition of loans and advances of FY 2068-69, shows composition of loans and advances. The chart shows that business loans covers 63.39% hire purchase and auto loan covers 16.27% other loans cover 7.8% home loan covers 6.65% and real estate loan covers 5.85%. hence the loan in business is highest so the rate is lower in business loan. Detail of composition of loans and advances has been done in ratio analysis section.

Decision Making and Mitigating Risk Associate

After the study of the project and its feasibility, if the project is feasible and it is good for lending then pricing of the credit facility will be made and offer will be made to the customer outlining following topics.

- Limit and type of credit facility.
- Tenure of loan and mode of repayment.
- Interest rate per annum and other charges.
- Disbursement criteria.
- What the borrower has to offer as collateral security.
- Who needs to provide personal guarantee.
- Charges on default of loan and authority of the bank when the credit goes in default.
- Binding clauses what the borrower has to do and should not do.
- Borrower will be accepting change in terms and condition imposed by the bank and NRB.
- Will be bind by prevailing laws of the nation.
- Other special terms agreed between borrower and bank.
- Any other terms and conditions that the bank feels necessary to put in the contract.

Along with offer letter following extra documents are prepared the borrower will bind by that too.

- Internal loan deed.
- Letter of continuity.
- Promissory note.
- Debit Authority.
- Consent deed for blacklisting in CIB if the credit goes in default.
- Consent deed over the use of collateral property.
- Declaration of family member.
- Declaration of all the information submitted is true to the best of his knowledge.
- Lien of the stock of the business in default.

Once the borrower signs the contract then it is the time now the personal guarantee signs the documents.

- Personal guarantee.
- Consent deed for blacklisting in CIB if the credit goes in default.
- Consent deed for use of property.

After the contract is signed and applicable charges are deposited by the borrower then, mortgaged of the property will be made in concern malpot or ownership is transferred in the same of the bank in case of Vehicle. After the completion of all these documents, legal risk of the credit facilities is mitigated.

Disbursal of Loan

After the decision of lending is made and collateral security is mortgaged in favour of bank or ownership of the vehicle is transferred in the name of bank or other collateral security is secured in favour of bank and all the documents are signed by the borrower then it is time the loan is disbursed by making entries in the system.

Repayment of Loan

Disbursal and Sanctioning of Loan will not be enough but repayment of loan is equally essential. Repayment of loans and advance are made in two bases.

Installment- Interest on outstanding principle and part of principle every month or quarter:Repayment of the loan is made on installment basis, and the installment payment of each month will be equal till the full loan is repaid. This equal monthly payment is generally called EMI of Equal Monthly Installment. Installment will contain both interest and principle of loan. In the initial installment there will be more interest and less principle but in the later installment there will be more principle and less interest. This is due to decreasing there will be more principle and less interest. This is due to decreasing trend of principle with the payment of installment. Though the installment will be equal the portion of principle and interest will varies over different installment payment. These types of loans and advance are called installment loan or term loan.

Interest only on monthly or quarterly and principle at maturity: When only interest is paid on monthly or quarterly basis and principle at the time of maturity than such type of loan is generally called, overdraft loan or OD is short. The interest is calculated on daily used balance of loan. Generally these type of loans will be renewed after expiry of its tenure which is generally one year if the transaction and repayment of loan is good and as per the standard set by the bank.

The repayment of loan is checked by the NPL of the bank; if the NPL of the bank is low the repayment of the loan is good but if NPL is high repayment of loan and advances is not good. This is because the provision and categorization of loan is done on the basis of ageing of due of the outstanding of the loans and advances. The table below shows the categorization of loan on the basis of ageing.

Table: 4.24

Categorization of Loans and Advances on the basis of Ageing of the Outstanding Dues

Names of Loan and Advances	Provision Required
Standard Loans and Advances	No Dues or Dues outstanding till 3 months
Sub- Standard Loans and Advances	Due outstanding more than 3 months and less than 6 months
Doubtful Loans and Advances	Due outstanding more than 6 months and less than 1 year
Bad or Loss Loans and Advances	Dues outstanding more than 1 year

Source:- NRB(Unified Directives for Banks and Financial Institutions)

As NPL is good indicator of repayment of loans and advances, when the NPL is high than the repayment of loan is not good and the recovery of the loan is not good. As the NPL of the bank is less than 1% of the total loans and advances, it shows the repayment of loans and advances is good. The detail analysis of NPL has been done in ration analysis section.

Recovery of Loan

How secured lending has been made from every angle, few of the credit facilities will go in default and the bank has to recover the loan by applying various techniques. CPG has set rule for the recovery of loan when it goes in default.

When the credit goes default of expiry of loan is coming near than a reminder letter has to be issued to the customer reminding that the credit facility has gone into default for such duration or the credit facility has expired. Once the reminder day expiries but still the loan is not recovered than at least a notice for clearing the credit facility within 35 days needs to be send to the customer. If the credit facility is cleared than the recovery will be complete but if still the loan is not recovered than the loan may be recovered by following methods like.

- Extending the time of credit facility, however; the extended time duration should be no more than 6 months from the time of expiry of loan.
- By making agreement with the customer and changing the term and condition that is feasible to the customer.

- Transferring collateral security in the name of the bank.
- Initiating legal action.
- Auctioning of collateral security or securities of the borrower.
- Any other method that is suitable for recovery of loan to the borrower and management.

When extending time duration of signing new agreement with borrower, concern borrower needs to at least deposit 25% of the sum of interest and principle of the term loan and 50% interest amount in case of renewable loans.

CPG has left the management with one facility of recovering credit facility partially as well. When the loan can't be recover totally at one time than a defaulted credit facility may be recovered partially and such may be deducted in proportion of interest and principle of defaulted credit facility.

i. **Auction of the Collateral Security:** Few loans are not easy to recover just by negotiation and agreement with the borrower and the bank is left with no other choice than to recover the loan by auctioning the collateral security of the borrower with the bank.

CPG of the bank has set definite rule for the management and assisted the management in recovery of defaulted credit facility. As the procedure of auctioning of the property is clear the management has no doubt of how to start the process and what action to take in what state of recovery of loan. CPG of Machhapuchhre Bank has detailed the flow chart of auctioning of the property of the defaulted borrower as under.

Table: 4.25

Action taken by Bank according to Outstanding Dues on the Basic of Ageing

Duration of Default	**Action to be taken by Management**
Stage 1	
Default is less than 3 months (Remainder of dues and installment)	Inform the customer about the dues and installment dues through telephone
Default is more than 3 months but less than 4 months – (Meeting with customer)	Meet the customer and learn about the difficulties and problem faced by the customer. If the customer has some kind of serious problem that is beyond his control than ask for

	his/her application for time extension for repayment of dues. If the borrower has no serious problem than ask him/her to repay the dues to the bank.
Stage 2	
Default more than 2 months and less than 5 Months – (35 Days letter to clear the dues)	If the customer does not pay the dues even when the bank official meets him or her than the bank will issue letter reminding him or her about his or her due to the bank. The letter shall be issued with strict instruction that the dues needs to be cleared within 35 days from the date of letter.
Default more than 6 months and less than 7 months – (15 days letter to clear the dues)	When the borrower is issued a letter instructing him or her abut clearing dues within 35 days and still the borrower does not clear the due or does not initiate any procedure for payment of due than the bank shall issue a letter instructing the borrower that he or she has to clear the due by 15 days from the day of letter else the bank will publish public notice in the newspaper for repayment of entire loan.
Stage 3	
Default is more than 8 months and less than 10 months –(35 days Public Notice for clearing entire loan and due)	When the borrower is issued two letters of 35 days and 15 days to clear the dues or else the public notice in the newspaper and still the borrower is reluctant to repays the dues than the management of the bank will publish public notice in newspaper for clearing entire loan amount due to the bank within 35 days from the date of public notice.
Default is more than 10 month and less than 12 months – (15 days public notice for clearing entire loan and due to the bank)	When a 35 days of public notice in newspaper is published to clear entire loans and outstanding to the bank and still the loan is not recovered than the public bank will publish final notice in newspaper asking borrower to clear all the loan and due to the bank within 15 days from the date of publish of such notice in newspaper or else initiate legal process and auction the property to recover the loan.
Stage 4	
Default is more than 1 year -(35 Days Public Notice of Auctioning of Collateral Property)	Two letters to clear the due and two public notice in newspaper to clear all the loan and due to the bank and still the borrower does not clear the loan and due to the bank shall publish a public notice in the newspaper stating that the borrower repay entire loans and dues to the bank or else at the end of 35 days the bank shall initiate legal process of auction and auction the property.

7 days of collection of Seal bid from the interest buyer of the collateral security.	No initiation from the side of default borrower to repay the loan outstanding with the bank than the bank will start the auction process and collect the seal bidding from interested buyer of the collateral property in the prescribed format of the bank. 5% of cash margin has to be deposited in the bank by the interested buyer of the price he is ready to offer for the collateral security.
Stage 5	
Auction of Property	The seal bid submitted by the interest borrower shall be opened in the stated day in the public notice in presence of the following representative for different organization. • Representative from the office of Government of Nepal • Representative from the Office of Nepal Police • Representative from the Office of Nepal Police • Representative from the Office of Nepal Police. • Representative from Municipality or village Development Committee. • Staff From the bank. Seal Bid shall be opened in presence of all these representatives and the bidder who has bided highest amount shall win the bid. The highest bidder shall deposit the remaining amount to the bank deducing 5% cash deposit that he/she has deposited in the account of the bank within 15 days from the date of auction and the bank shall transfer the ownership title to such bidder. However, if the bidder is not able to deposit remaining amount within the stipulated time than bank will forfeit such deposit and transfer the ownership to the second highest bidder in the auction.
Stoppage of Auction Procedure	In the following event the bank will stop the auction procedure. • If the borrower repays the entire loan amount to the bank. • If the court of law send a stoppage notice to the bank for stopping the auction process. • If the borrower repays entire interest dues to the bank and apply written application for time extension than the bank will stop the auction and provide time duration of at the most 6 months.

Source: Credit Manual of MBL

The CPG of the bank does not restrict the management of the bank to initiate the legal process of auctioning of defaulted loan in short notice as well in the following conditions.

- The borrower is black listed by other financial institutions.
- The borrower has turned into insolvent.
- Where the borrower has siphon the loan.
- The borrower is fraud and had misled the bank.

ii. **Transferring the Ownership of Collateral in the Name of theBank:** There are cases when the auction of the property will also not recover the loan amount sanctioned to the borrower and the bank will not have any other option than to transfer ownership of the collateral in the name of the bank. CPG of Machhapuchhre Bank is very clear how to obtain the ownership in the name of the bank and at what conditions shall the bank obtain the ownership in the name of the bank and at what conditions shall the bank obtain the ownership of the collateral in the name of the bank. CPG of Machhapuchhre Bank allows the bank to obtain the ownership of the collateral in the following conditions.

- If no one bids in the auction.
- If the bided amount will not cover the loan amount dues of the browser.
- If the collateral is suitable for the use of the bank.
- If the bank feels that selling of the property will easier if the ownership is transferred in the name of the bank first.

While transferring the ownership of the property the bank shall conduct it in the presence of following representatives.

- Representative from Malpot office.
- Representative from District office of Govt. of Nepal.
- Representative from ward office where the collateral property is located.
- Official of the bank.

However, if the borrower repays the entire loan and dues to the bank within 2 months from the date of transfer of ownership than the bank will return the property to the concern borrower by obtaining all the charges that the bank and borne for such transfer.

iii. **Use of the Non-Banking Assets, Provisioning of Loans, Write off of Default Loan and other:** The non-banking asset shall be used properly by the bank and the bank needs to sell the such property as soon as possible and as stipulated in the directive of Nepal Rastra Bank.

Provisioning of all the loans and advances both performing loans and non-performing loans shall be provision as per the directive of NRB. In the event if the default loan is not recovered and the collateral is also not sufficient to cover the loan than the insufficient loan amount shall be written off by the board.

NRB has strictly stated that when none banking assets is booked then right from that date, 100% or provisioning should be made. Not only that when not banking assets needs to be book for loan limit greater than 2.5 million then at time such defaulted borrower needs to be black listed in CIB first. If the bank feels that the non-banking asset will be useful for the bank and wish to use it than such should be approved from the board of director and inform the Central Bank.

CGP has instructed to the bank management to operate as per the norms and directives issued by the central bank of Nepal from time to time.

4.1.2 Financial Analysis of MBL

Loans and Advances of the Bank

When a study of last five years data is made, Machhapuchhre has made continuous growth in its loans and advances. In the initial stage of the bank the growth in loans and advances seems to be much higher than in the later years. From the Table Loans and Advances and its growth, it is clear that the growth of loans and advances in FY 2065/66 compared to FY 2064/65 is around 116.15% whereas the growth in FY 2068/69 compared to previous year is around 33.46% though the volume of loans and advance over the five year period has grown around 7 times.

Table: 4.26

Loans and Advances and Its Growth

	2064-65	2065-66	2066-67	2067-68	2068-69
Total Loans	306,715	662,956	1,304,799	1,590,310	2,122,446
Growth		116.15%	96.82%	21.88%	33.46%

Source: Loan and Advances of MBL

Growth of the loans and advance is crucial for the operation of the bank but equally important is how well the portfolio of loans and advances has been managed by the bank. If the lending of the bank is growing due to rampant lending than obviously it will look good from outside in first few years but, over the time the bank will suffer from higher NPL and the interest income it will bank will suffer from higher NPL and the interest income it will earn will be eaten up by higher follow up recovery. Not only that the interest accrued in such loans and advance can't be treated as income unless cash is received accrued in such loan and advance can't be treated as income unless cash is received and it will affect the Profit of the bank, further the provision of NonPerforming loans and advances will eat up the income generated by other performing loans, hence it is very important to manage the portfolio. Along with the growth of loans and advances study of composition is equally important.

Fig. 4.7

Growth of Loans and Advances

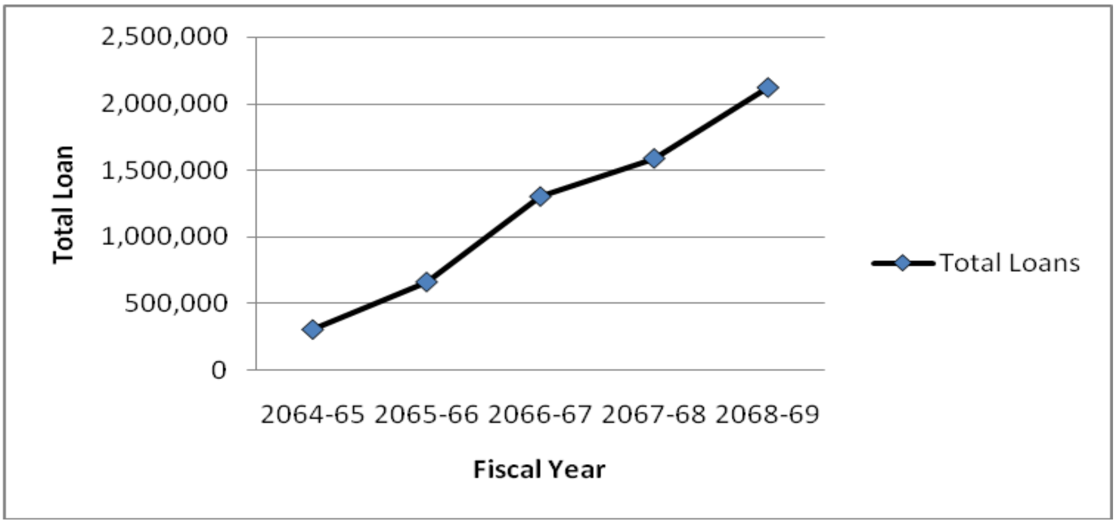


Table: 4.27

Composition of Loans and Advance of Machhapuchhre Bank Ltd.

Types of Loans and Advances/Year	2066-67		2067-68		2068-69	
	Amount	%	Amount	%	Amount	%
Real Estate Loan	205,666.42	15.76%	156,179.09	9.82%	124.075.47	5.85%
Margin Type Loan	2800.00	0.21%	1983.00	0.12%	1105.00	0.05%
Home Loan / Residential Real Estate	113,867.89	8.73%	106,015.00	6.67%	141,042.14	6.65%
Business Loan – Capital Investment (Term Loan)	103,607.14	7.94%	155,340.19	9.77%	296,147.87	13.95%
Business Loan-Overdraft Loan/Working Capital Loan	259,872.16	19.92%	336,588.93	21.16%	345231.93	16.27%
Hire Purchase / Auto Loan	259,872.16	19.92%	336,588.93	21.16%	345231.93	16.27%
Others Loans	62,020.84	4.75%	114,565.67	7.20%	165,568.35	7.80%
Total Loans & Advances	1,304,799.45	100.00%	1,590,310.80	100.00%	2,122,446.24	100.00%

Source: Unaudited Financial Reports of MBL

Let us make a study of composition of loans and advance of the bank. Prior to study of the composition of loans and advances it is better to know what sort of loans has been categorized in particular heading.

- Real estate loan has been categorized as such loans which has been sanctioned to real estate companies, the loans obtained for plotting of land and personal loans and advance with limit higher than 5 million which has been provided without disclosing purpose of the loan.
- Home loan or residential real estate includes loans and advances provided to the individuals who are purchasing the land or land and building for their personal use.
- Margin loan includes the loans and advances sanctioned against the security of Shares or Non- Government Bodies.
- Term Loan (Capital Investment of Business) includes the loans and advances sanctioned to the corporate house or business entity for investment in construction of their building or purchasing plant and machinery for their business use.
- Overdraft and Working Capital Loan includes the loans and advances sanctioned to corporate house and business entity for investment in their stock, meet their day to day working capital and maintain their cash flow smoothly.
- Hire Purchase and Auto loans are the loan sanctioned against the security of vehicle and provided to individual and corporate house for commercial use or private use.

- Other loans cover the remaining loans like Loan against Gold & Silver. Loan against FDR, Micro Finance Credit, lending deprived sector, education loan and all other consumption loans and advances.

Machhapuchhre has quite well maintained its portfolio and the bank seems to be focusing more on business loan than other loans. When we study the composition of loans and advances of the bank over last three Fiscal Years viz. 2066-67, 2067-68 and 2068-69, Business Loan covers 50.63%, 55.02% and 63.39% in FY 2066-67, 2067-68 and 2068-69 respectively. The fig.4.8 Compositions of Loans and Advances 2066-67, fig 4.9 Composition of Loan and Advances 2067-68 and fig. 4.10 Composition of Loans and Advances 2068-69 show the composition of loans and advances of the bank.

Fig. 4.8

Composition of Loans and Advances FY 2066-67

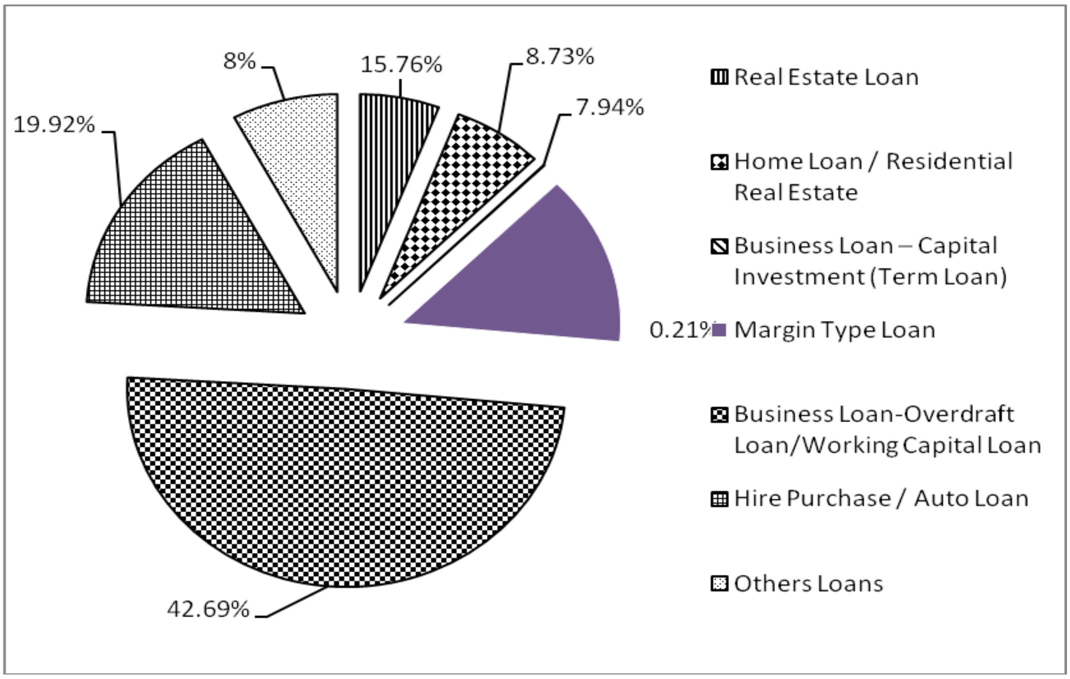


Fig. 4.9

Composition of Loans and Advances FY 2067-68

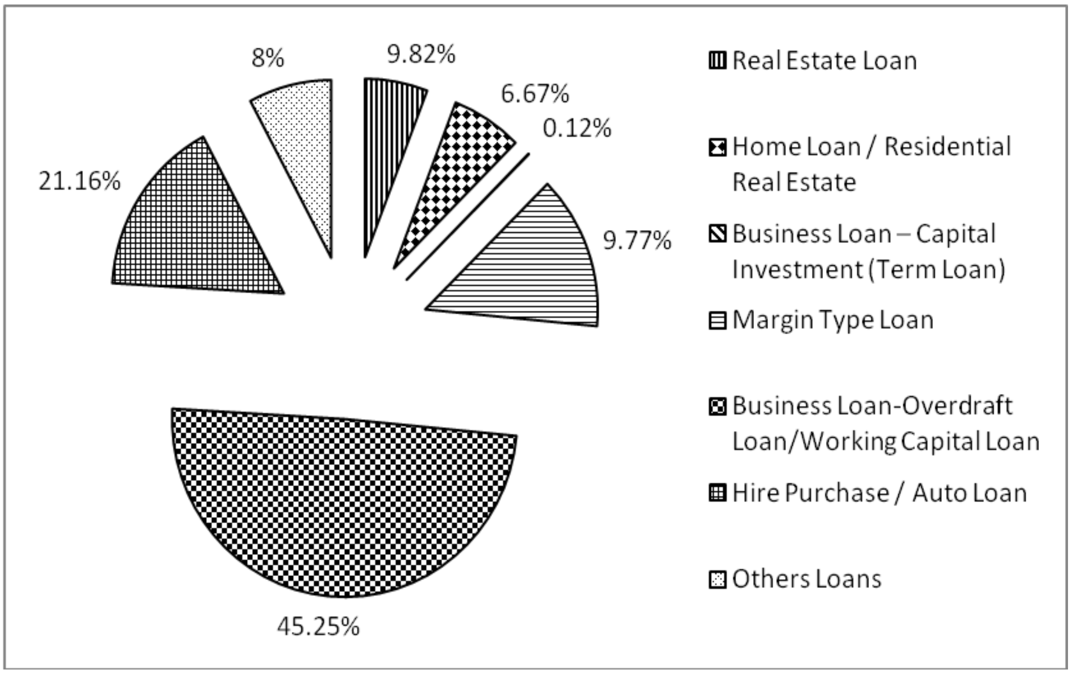
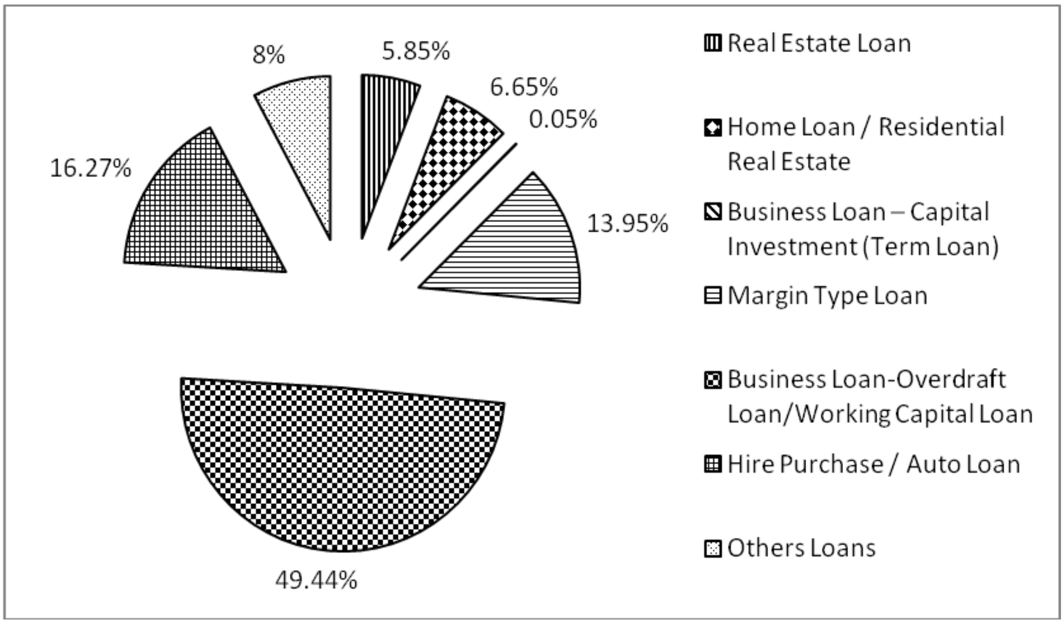


Fig. 4.10

Composition of Loans and Advances FY 2068-69



The figureshow that very large share of the loans and advances is covered by business loans. After business loan is hire purchase loans which covers 19.92%, 21.16% and 16.27% respectively in the FY 2066-67, 2067-68 and 2068-69. One point to note is that there is drastic fall in the real estate loan over the study period. We all know that real estate business boomed in the FY 2066-67 and there was fall in the real estate business. Even during that time the exposure in real estate loan was just 15.76% and its percentage over the total loan has fall sharply. Not only the percentage of loan has fall over the total loans and advances, but the absolute amount has also fall down. This shows that there is very little risky asset in the portfolio. This fact has been supported by low NPL and higher return on the loans and advances which shall be dealt in the passage below.

Interest Income and Average Yield on Loans and Advances

Interest income on loans and advances is another indicator which shows how well the portfolio has been maintained and how diversified is the loans and advances. Though interest income alone will not tell us about the soundness of the loans and advances and selling capacity on the products of the bank's management, hence it needs to be studied in comparison with average yield on loans and advances. The table below shows the interest income, growth of interest income and average yield on loans and advances.

Table: 4.28

Interest Income, Growth of Interest Income and Average Yield on Loans and Advances

(Amount in Thousands)

	2064-65	2065-66	2066-67	2067-68	2068-69
Interest Income	15,166	58,733	158,383	248,540	338,294
Growth		287.27%	169.67%	57.55%	35.57%
Average Loans	152,881	521,478	1,121,554	1,154,014	1,914,93 7
Average Yields on Loans	9.92%	11.26%	14.12%	17.16%	17.67%

Source: Financial Report of MBL

- Note- Average Yield on Loan = Interest Income divided by Average Loans

  Average Loan = Sum of Loans of 4 quarter divided by four quarter.

Fig.4.11

Interest Income of MBL

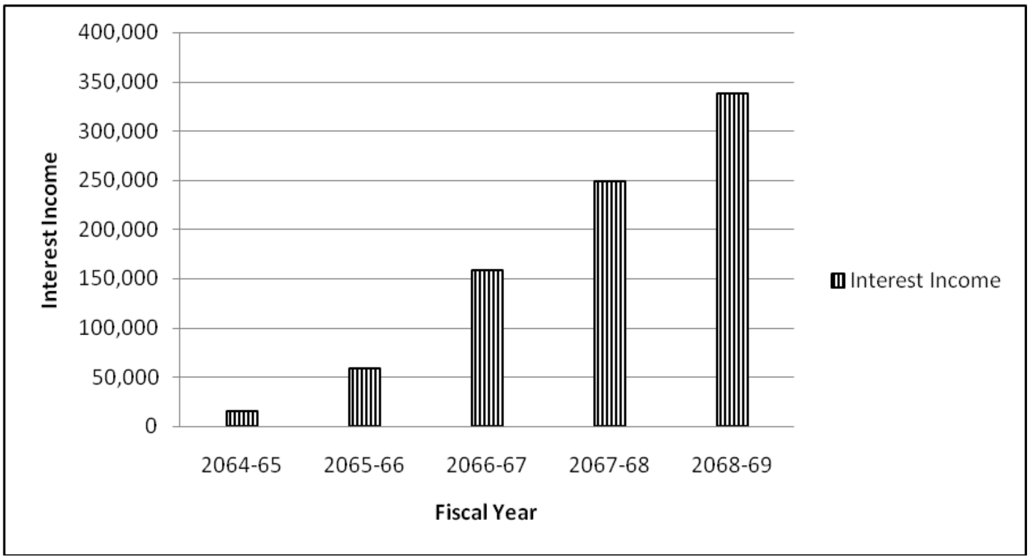
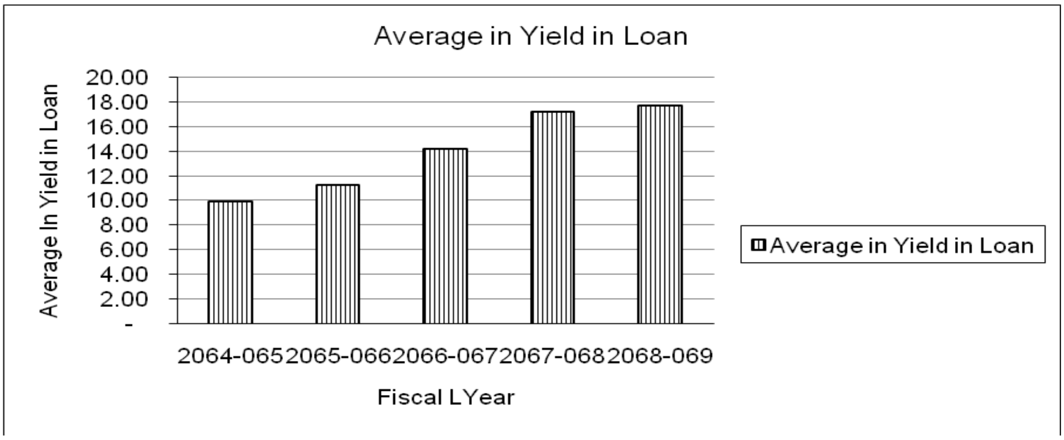


Fig. 4.12

Average Yield on Loans and Advances



We can see that interest income of the bank has increased sharply and when compared between FY 2064-65 and FY 2065-66, there is increase of as high as 287.27%. When the data for last five year is studied, there is over 22 times increase in interest income and not only is that even in FY 2068-69 there increase of 35.57% in interest income as compared to FY 2067-69. Further not only there is increase in interest income in terms of absolute terms but also there is high increase in yield on loans and advances. This quite high return on loans and advances as the average rate of over 17% in last two years is shows quite good product selling capacity of Bank's Management, However, when interest income or average yield on loans and advances is seen in comparison with the spread rate and net interest income then it will give us better view. Let us discuss spread rate and net interest income in next paragraph.

Net Interest Income and Spread Rate

Net Interest Income shows how efficiently the deposit collected has been mobilized in the form of loans and advances. When the net interest income is higher or the spread rate is higher than it can e said that loans and advances are secure or the asset quality of the bank is good. Now let us see the table below for net interest income and spread rate of the bank.

Table: 4.29

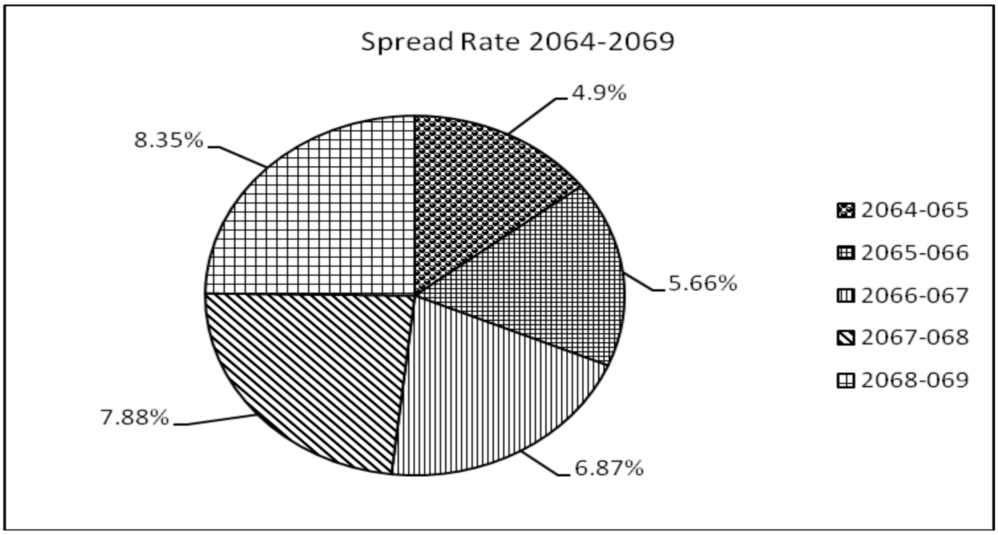
Net Interest Income and its Growth, Cost of Fund and Spread Rate

	2064-65	**2065-66**	**2066-67**	**2067-68**	**2068-69**
Net Interest Income	4,319	21,646	57,811	96,186	131,596
Growth of Net Interest Income		401.18 %	167.08 %	66.38%	36.81%
Cost of Fund	5.02%	5.60%	7.25%	9.29%	9.32%
Average Yields on Loans	9.92%	11.26%	14.12%	17.16%	17.67%
Spread Rate	4.90%	5.66%	6.87%	7.88%	8.35%

Source: Financial Reports of MBL

Fig. 4.13

Net Interest Income and its Growth, Cost of Fund and Spread Rate



There is seen that net interest income has grown 401.18%, 167.08%, 167.08%, 66.38% and 36.81% growth in FY 2065-66, FY 2066-67, FY 2067-68 and FY 2068-69 respectively. Though in the later year the growth rate of net interest income is lower compared to initial years but what we have to see is that there consistent growth and in the last FY 2068-69 the spread rate is greater than 8% which is considered good as per the industry norm of Nepalese bank industry. Consistent growth in net interest income and well maintained spread rate shows that the portfolio of the bank has been maintained quite well.

CD Ratio- Credit Deposit Ratio

CD Ratio shows what percentage of the deposit of sum of deposit, capital and reserve has been provide as loans and advance t the borrowers. Higher CD ratio show higher utilization of fund and lower one show under utilization of fund available with the bank. However, very high CD ratio may put the bank in liquidity crunch and very low CD ratio will not make the bank sustainable as the interest income received from the loans and advances will not be able to cover the interest expanse that the bank has to pay the depositors. Hence CD ratio need to be balanced and should not put the bank in risk. Since mid FY 2066-67 NRB introduce that the bank and financial institution needs to maintain their CD ratio within 80%. The table below shows the CD ratio of the bank for last five years.

Table: 4.30

D Ratio of Machhapuchhre Bank Ltd.

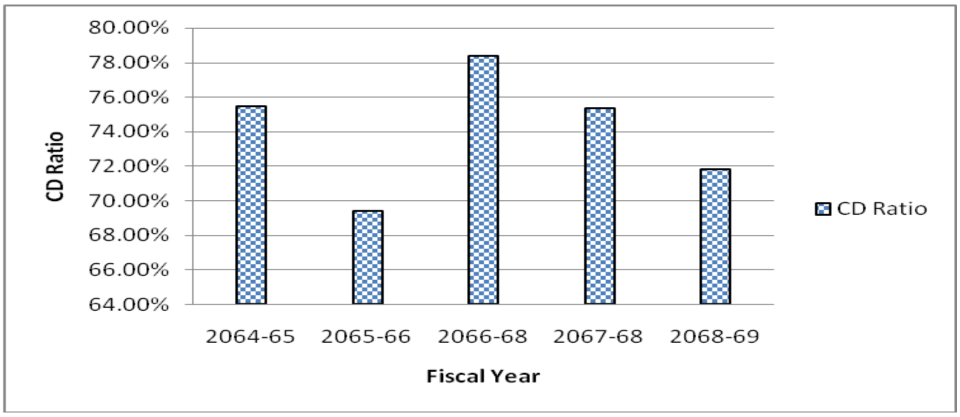
	2064-65	2065-66	2066-68	2067-68	2068-69
CD Ratio	75.47%	69.40%	78.39%	75.35%	71.79%

Source: Financial Report of MBL

Bank's CD ratio hovers around 57% to 80% a upper limit fixed by the central bank of Nepal, hence the CD ratio of the bank is good except in the FY 2056-66 and FY 2068-69 where CD Ratio is 6.40% and 71.7% respectively. But one point to note is that during the second half of FY2068-69 there was very growth of deposit in the economy and all the banks and financial institutions had higher growth in deposit than in their lending. Hence when compared to the industry average of 65% in FY 2068-69 the CD ratio of the bank is very good. Hence the utilization of deposit of the bank is good. Further the growth of deposit exceeded in only those financial institution which has good image in the market hence the image of the bank in general public is good which shows the standing of the bank is good and one of the bank is good and one of the major indicator of goodness is good credit as well.

Fig. 4.14

CD Ratio of the MBL



Non Performing Loan (NPL) of Sub Standard Loan

Non-Performing Loan is the major indicator of quality of loans and advances. Higher percentage of NPL is the sure way to tell that the asset quality or loans and advances of the bank are not of good quality and vice versa. The table no. shows the percentage of NPL in total loans and advances and in absolute figure.

Table: 4.31

Non-Performing Loans and Percentage of Not Performing Loan to Total Loans

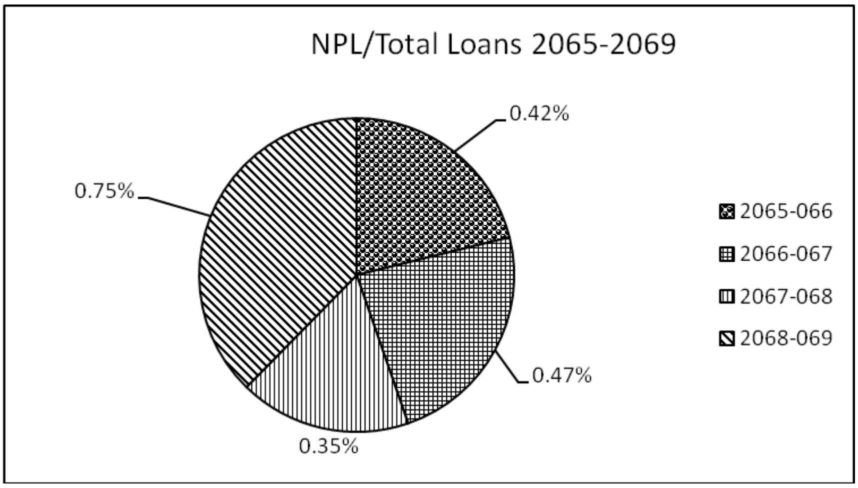
	2064-65	2065-66	2066-68	2067-68	2068-69
NPL	-	2,784	6,132	5,566	15,918
NPL/Total Loans	-	0.42%	0.47%	0.35%	0.75%

Source: Financial Report of MBL

In the case of Machhapuchhre Bank Ltd. percentage of NPL is its five year of operations is less than 1%. Maximum is 0.75% in the FY 2068-69 and least in the FY 2065-66 i.e. 0.42%. This NPL of less than 1% is much less than industry average of 4.25% NPL of Commercial Banks of Nepal as per the data of Nepal Rastra Bank (Banking and Financial Statistics, July 2011).

Fig. 4.15

Net Interest Income and its Growth, Cost of Fund and Spread Rate



Provision for Loan Loss

Provisioning is a way of securing against the possible loss and provision of loan loss is the way to separate certain portion of profit to secure against the probability of loan and advances going bad. It is not certain that the loans and advances granted to the people and business entity will always be good and secure, hence to protect against the bad loans, banks and financial institutions will make provision for the possible loss due to loans and advances turning bad. When a provision is adequately made then even when the loan and advances turning bad. When a provision is adequately made then even when the loan and advance turns bad, then the bank will be able to maintain quite well. The portion of bad loans covered by provision will not make any threat to the banks and financial institutions unless the profit of the banks and financial institution is hit hard. The table below, Table No. 4.34 shows provision made by the bank and percentage of NPL to Provision.

Table: 4.32

Provision for Possible Loan Loss and Percentage of NPL to Provision

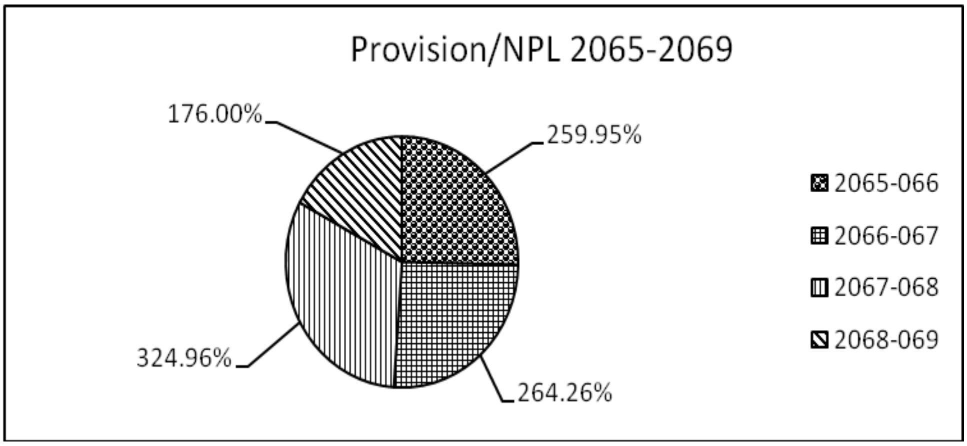
	2064-65	2065-66	2066-68	2067-68	2068-69
Provision	3,067	7,238	16,205	18,087	28,016
NPL	-	2,784	6,132	5,566	15,918
Provision / NPL	-	259.95%	264.26%	324.96%	176.00%
Total Loans	306,715	662,956	1,304,799	1,590,310	2,122,446

Source: Financial Statement of MBL

The table shows that so fat non - performing loans and advances are adequately provisioned. In the FY 2064-65 there is no non-performing loans but the bank has made provision of 3067.15 thousand, in FY 2065-66 there is NPL of 2784.42 thousands and bank has provision of Rs. 7238.09 which is 259.95% of the NPL. Likewise in the FY 2066-67 there is NPL of 6132.56 thousands and provision has been set of RS. 16205.90 which is 264.26% of NPL. Similarly in the FY 2067-68 there is 5566.09 thousand NPL and provision of 18087.56 thousands has been made which is 324.96%. In the same way in FY 2068-69 there is NPL of 1518.35 thousand and the Bank has made provision of Rs. 28016.45 thousand which covers 176.00%. Hence the non performing loans and advances goes bad as well it will not affect the bank. The data from above table shows that credit of the bank is managed properly. The risk of the loans and advances has been mitigated quite while by setting a provision for the possible loan loss.

Fig. 4.16

Provision for Possible Loan Loss and Percentage of NPL to Provision



Capital Adequacy

Capital Adequacy is the method to limit the banks and financial institutions form excess lending. What is the logic behind this capital adequacy is that when the a bank of financial institution is making a lending at least certain portion of the lending should be from the investment of the promoters of the bank or in other word there should be certain portion from the capital of the bank or in other word there should be certain portion from the capital of the bank not totally deposit of the customers. This is one of the ways a central Bank control the lending of the banks and financial institutions. Capital adequacy is calculated as;

Risk is assigned from 0% to 150% for different assets according to their inherit risk. As the table show the risk assigned to different assets and higher risk is assigned to asset which has inherit ant risk and incase of loans and advances 100% risk is assigned. Not only that if there is excess lending in real estate or residential real estate than prescribed by the central bank than 150% risk has to be assigned hence this will limit the lending of the banks and financial institutions. In the event the banks and financial institutions fail to maintain the required level of capital adequacy i.e. 11% in case of Machhapuchhre Banks than the NRB will take Prompt Corrective Action and restrict the banks from distribution of dividend or bonus shares.

In case of Machhapuchhre Bank it has been able to maintain required level of capital through the study period. Table no: Capital Adequate Machhapuchhre Bank Ltd.

Table: 4.33

Capital Adequacy and Core Capital of Machhapuchhre

	2064-65	2065-66	2066-68	2067-68	2068-69
Capital Adequacy	11.37%	11.55%	11.59%	22.70%	17.74%
Core Capital	552869	637739	1750353	1750425	2624971

Source: Financial of MBL

What is evident from the table is that in the first three FYs, FY 2064-65, FY 2065-66 and FY 2066-67, Capital Adequacy of the bank is hovering around the required level. From the table no above in the first three years the capital is Rs 552869 thousand, 63773 thousand and 1750353 thousand respectively which compared to later years is less than half. Capital adequacy of FY 2068-69 is lower than FY 2067-68 even though the core capital of later year is more than the former year because the growth of loans and advance is more compare to the FY 2067-68. Hence, when the loans and advance of the bank increases than the capital requirement of the bank will increase too and this how the loans and advances of the bank will be limited by its capita as well.

4.2 Major Findings

After the analysis of the data presented above following major findings have been obtained.

- CPG of the Machhapuchhre Bank Makes mandatory to make detail study of the Background of borrower prior to making lending decision by Bank's Management.
- NRB has made .it mandatory to obtain CIB Report of the borrower prior to sanctioning of loan with limit greater than one million.
- CPG of Machhapuchhre Bank has let the management of the bank to decide the percentage of lending in the project. While making study of the different project it was discovered that
  - ✓ The Business loan has loan to FMV ration of 50.24%
  - ✓ Housing Loan has loan to FMV ration of 54.57%

- ✓ Personal Loan has loan to FMV ration of 46.57%
- ✓ Hire Purchase loan has Loan to FMV ratio f 74.30%
- ✓ Auto Loan has loan has Loan to FMV ratio of 58/74%

- CPG of Machhapuchhre Bank has enlisted the sector for providing credit facility and those sectors are thoroughly studied through CAM prior to making credit sanctioning decision. Machhapuchhre Bank's has exceeded 100% in some of the sector in all the study period as follows.
    - ✓ Transport, Communication and Public Utilities with 156.02%, 179.55%, 127.72% in FY 2064/65, FY 2065/66 and FY 2066/67 respectively.
    - ✓ Other Sector with 193.18%, 321.78%, 251.34%, 257.18% and 264.36% in FY 2064/65, FY 2065/66, FY 2066/67, FY 2067/68 and FY 2068/69 respectively.
    - ✓ Finance, Insurance and Real Estate with 134.77% and 107.51% in FY 2065/66 and FY 2066/67.
    - ✓ Wholesaler and Retailer with 129.52% in FY 2066/67.
- Concentration risk of loans and advanced being sanctioned in particular sector or industry has been checked by NRB through 9.3 report and it has made it mandatory to obtained approval from Board prior to making lending in excess than 100% of Bank's Core Capital in single sector.
- Lending of the bank has been more diversified in the later years of study as loans and advances have been sanctioned in new sectors like Agriculture with 37.27% in FY 2068-69 and Hotel and Restaurant with 28.97% in FY 2068/69.
- Concentration of Loans and Advances of Single Group of Borrower or Single Borrower is least in FY 2067-68, i.e. minimum of 9.25 of core capital, and highest concentration of 14.89% in FY 2068-69.
- Since the percentage of loan and advances of Single Borrower or Single Group of Borrower is less than 25% of its core capital, the Bank has followed the directive issued by NRB of providing loans and advances to Single Borrower or Single Borrower within 25% of Bank's core capital.
- Percentage of Single Borrower or Single group of Borrower with respect to Net Profit of the Bank is quite high and it is as high as 176.45% of Net Profit in FY 2066-67 and top borrower in FY 2068-69 is 112.35%. This figure is high because

in case the borrower goes in default than the Balance Sheet of the Bank will be adversely affected with negative profit figure.

- CPG of the Bank has restricted bank the bank's management from providing credit facility without collateral and collateral may be land, land and building, gold and silver, shares or debentures, government bonds and securities, plants and machinery and FD Receipts.
- NRB has not restricted the banks and financial institutions from providing credit facility without collateral but an extra provision of 20% has to be made when lending is made without collateral.
- MBL has sanctioned very large portion of loans and advances on the basis of land and building as collateral. It is a high as 77.79% in the FY 2068-69. Second highest one is based on vehicle as collateral which is 15.86% in FY 2068-69.
- While making lending decision personal guarantee has been taken as integral part of mitigation of different risk like collateral risk, repayment risk and additional security to the loans and advances, 83.33% of the BM and Credit Staff of the bank said it is must to obtain personal guarantee of family members of the borrower.
- CPG of the banks makes detail study of repayment capacity of the borrower through CAM and it has been outlined in the credit manual of the bank as well. Credit Manual of the bank has instructed the management that installment or obligation to the saving must be less than 80%, 100% of the 18 staff interviewed of the bank working in credit, responded that installment or obligation to bank to saving ratio must be within 80%.
- While making lending decision of company or firm the bank makes study of operating ratios and financial ratios Viz. 1. Fixed Asset Turnover Ratio 2. Return on Investment 3. Gross Profit Ratio 4. Equity – Total Debt Ratio 5. Equity – Short Term Debt Ratio 6. Current Ratio. 7. Inventory Turnover Ratio 8. Interest Coverage Ratio. 9. Receivable Turnover Ratio.
- Interest rate on loans and advances are different for different types of loans and advances and it was lowest for Business loan 15.47% and highest for Personal loan 17.13%.

- CPG of the Bank has divided the stage of recovery into 5 different stages and it shall auction the property of the borrower if the borrower goes into default for more than 1 year continuously.
- During the study period the composition of the loans and advances of the bank is concentrated in Business Loan with highest percentage of 63.39% in FY 2068-69 and Lowest in Margin Loan with percentage of 0.05% only in FY 2068-69.
- There is consistent growth in the loans and advances of the bank during the study period with highest growth f 116.15% in FY 2065-66.
- There is growth in absolute value of interest income of the bank, however the growth of interest income is decreasing. The growth of interest income is highest in FY 2065-66 with growth of 287.27% and lowest growth of 35.57% in FY 2068-69.
- Average yield on loan of the bank is increasing consistently and it is highest in the FY 2068-69 with 17-67% and lowest in FY 2064-65 with 9.92%.
- Spread rate of the Bank is also increasing trend during the study period. It is highest in FY 2068-69 with 8.35% and lowest in FY 2064-65 with 4.90%.
- CD ratio of the Bank is hovering around 75% with average of 74.08% during study period. It is highest during FY 2066-67 with 78.39% and lowest during FY 2065-66 with 69.40% . CD ratio of the bank is within 80% ceiling put by NRB. Further the CD ratio of 71.79% during FY 2068-69 is quite high compared to industry average of 65% for the FY 2068-69.
- NPL of the Bank is highest during FY 2068-69 with 0.75% and it is quite low compare to industry average of 4.25%. During the study period NPL, of the Bank is less than industry average.
- The bank has adequately provisioned against not performing loan and it has provisioned maximum during FY 2067-68 with 324.6% and lowest provision is during FY 2068-69 176%.
- The Bank has maintained capital adequacy above the standard norm set by the central bank of Nepal i.e. 11% for development banks. During the study period capital adequacy is highest during FY 2067-68 which is 22.70% and lowest during FY 2064-65 with 11.37%.

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Credit management is very integral part of the bank and most probably the existence of the bank would be non-existence if there is no credit. Credit is the life blood of the bank and bank survives with the interest income from loans and advances that it provides to the business entity and individuals for different purposes. When a lending is make by the bank it would check and verify number of things about the business entity and individuals prior they make decision about lending, not only that it would also study about the overall economy and growth of the industry it is lending. Along with the study of individual files, it will also see its overall portfolio and if the lending in that particular sector will put the over portfolio, what are the inheritant risk of that sector, what is the pricing of that sector of the economy and particular file.

In short we could say that the credit is the reason that the bank exists and it is what is fueling the economy of the Nepalese economy and world around us .Hence the management of credit of the bank is as important as the existence of the banks.

The main objective of this study is to supplement the prior studies in credit Management of the Banks and Financial Institutions and provide some insight into how the credit policy of the bank determines its portfolio, how it assist in management of credit risk. Further how Nepal Rastra Bank controls credit risk of the banks and financial institutions. Generally in the previous studies a comparatives study of the two commercial banks were done and the study mostly focused on the financial analysis and portfolio of the loans and advances and no studies were done on how the banks and financial institutions mitigate the risk associated with credit and how central bank control credit risk in the banking industry.

The study was done by getting to the every details of the bank and tabulating necessary data wherever necessary thus facilitating the analysis. Two methods were used for presentation of data and analysis of it, viz. One descriptive method and another financial method. Different risks associated with credit were studied and control over it by Credit Policy Guidelines of the Bank and Directives of Nepal Rastra Bank was shown.

In the additional part of this study, a sample project study was done in different paragraph to illustrate different credit risk and how each risk is addressed by the bank's policy. Further in overall how the Central Bank of Nepal mitigates risk over total portfolio of the bank and the industry over all.

5.2 Conclusion

The research paper in overall has been able to reach considerable amount of deductions which are beneficial for the study as well as the organization and banking industry as a whole. On the basis of various observations, analysis and testing of data several insights has been found regarding credit management of Machhapuchhre Bank Ltd.

We can summarize the conclusions reached in the following points.

- Nepalese economy though not directly is affected by the turnouts in the world economy, which we could see in the economic slowdown of our economy too.
- Nepalese economy is largely driven by the remittance send by the migrant worker form aboard and if the remittance inflow decreased than Nepalese economy would be affected to substantial volume.
- Banking industry is the only one industry which survived all the ups and down faced by the Nation's Economy.
- Banking industry went into boom after the Nation adopted free economy policy after reinstate of democracy in 1990s and more rapidly after the end of Maoists insurgency.
- Credit Management of Banks and Financial Institutions is a rare piece of work and even if the study has been done it is mostly related to financial analysis and comparative study of commercial banks was done. Hence this study of credit policy guidelines and directives of NRB regarding mitigation of risk is an exception in this case.
- The credit policy Guidelines of the bank is good one and has tried to address different risk associated with credit. Management of the bank has developed a good credit Appraisal System call Credit Appraisal Memorandum (CAM) which makes detail

study of the different aspect prior to making lending decision after addressing different risk associated with credit.

- CAM makes study of different credit risk like.
  - ✓ Back Ground Study / Credit History / Character risk.
  - ✓ Repayment Risk / Cash Flow.
  - ✓ Collateral Risk/ Securities to be obtained and its adequateness.
  - ✓ Legal Risk / legally binding customers.
  - ✓ Capital Investment of the customer/ Project risk.
  - ✓ Condition Risk / Industry Risk.
- Bank's lending is adequately secured as the loan limit sanctioned to Fair Market Value (FMV) of collateral is less than 75% even of the sector where the Loan to FMV ratio is highest. I.e. in hire purchase sector. Likewise, the lowest one is Personal Loan which has loan to FMV ratio of 46.69%.
- Machhapuchhre Bank has made lending within 100% of its core capital in most of the sector and has obtained approval from board where the lending has exceeded more than 100% of its core capital. The sector which exceeded lending than its core capital is other sector in FY 2068-69 and FY 2067-68. However, in FY 2066-67 four sectors had excess lending viz 1. Transport, Communication and Public Utilities, 2. Wholesaler and Retailer 3. Finance, Insurance and Real Estate and 4. Other sector.
- Income source, Collateral and background study are major things that are studied prior to making lending to the individuals and while making lending decision in case of business in case of business loan, a detail study of project, financial structure both operating and financial ratios are studied, collateral securities offered and its adequateness, future prospect of industry and its present study is made, what portion does the lending cover in total project cost, what is the background and how is character of the individuals of the firm or company is done.

5.3 Recommendation

On the basic of the detailed study that has been performed many insights have been derived or reached and on the basic of such conclusions, following recommendation has been suggested to the management as well as other bankers.

- Lending without collateral has been restricted by CPG of the bank, however, it is not good to restrict the lending without collateral as professional like doctors, CAs and engineers are provided loans on the basis of their earning capacity and based on their qualification and bank may miss opportunity of earning good sum of interest and service charges from the elite group of society and further it will provide good brand image of the bank in the society.

- With the growth in volume of portfolio and branch network, monitoring of the loans and advances will be highly essential and setting standard is one of the very good methods for internal control. Further the bank needs to develop internal credit rating system so that the bank will be able to know that when the loan will go default, and they will be able to address the issue before it become chronic.

- During the study period, it is seen that the bank has not fully utilized its fund which it has collected as deposit. During FY 2065-66 it is as low as; 69.4% hence for higher profitability, the bank need to focus on higher fund utilization even though the central bank has put the ceiling of 80% of sum of its deposit and core capital.
- This can be done through proper matching of funds so that the funds are not remained idle. If the bank is can make a proper lending at the cost of fund plus spread rate to be maintained then only to obtained the deposit or focusing on the alternative investment opportunity and putting the excess fund in other investment instruments.

- Equal monthly installment or most commonly called EMI system has same amount of payment every months or quarter which consist of higher interest and low principal repayment in the initial year and vice versa in later years. This practice is putting the repayment risk and collateral risk higher in case of depreciating asserts like vehicles and plant and machinery. These depreciating assets will have lower value due to number of reasons like.

- Due to wear and tear the assets will lose its value.
- Due to change in technology, the assets will become obsolete.
- Repair and maintenance will be higher in later year and decrease the value of assets.
- Though the bank has followed the directive of NRB and CPG of the bank regarding loan limit for single borrower or single group of borrower and loan limit sanctioned is within the prescribed limit of 25% of core capital of the bank but when compared with the net profit of the bank the loan sanctioned to the top borrower or group of borrower seems to be high. Loan limit sanctioned to the top borrower is quite high compared to the net profit of the bank

- Though the bank have followed the system of obtaining CIB report prior to sanctioning of loan limit greater than I million but there is lack of system of internal black listing and checking if the prospective borrower's name has been published in the newspaper. Hence it is recommended to prepare the information system of internal blacklisting and preparing database of those person whose name has been published in the newspaper due to non-payment obligation to the bank.
- As the bank has exceeded 100% ceiling in few of the sector of lending it is recommended to identify new sector like hydro power, tourism and agriculture for new lending which shall further diversity the portfolio of the bank and risk of concentration of loan in few sector shall be mitigated.

- The bank has made the practice of making ratio analysis of operating and financial ratios prior to making lending decision which is a good practice, however it has left the part of making analysis of business cycle and working capital need assessment of the firm or company it shall sanction the loan, hence it is recommended to include such thing in the CAM of the bank to make the credit appraisal system more comprehensive to mitigate the risk of repayment of loan eventually.

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APPENDIX–I

Questionnaires Given to the Employees of
Machhapuchhre Bank Limited

Dear Respondents,

These questions are prepared for assisting my thesis work and your independent answer would be a great help and form an integral part of my thesis work. Hence you are humbly requested to reply the following questions and assist in my research work. The answer and your opinion shall be kept confidential and shall be used only for the research work and for no other purpose. Your kind help will be highly appreciated.

Thank You.

……………………….

(Researcher)

Name :- ………………………….

Position :- ………………………

Questionnaires for Survey

1. What is most important element you think would make the borrower eligible for loan ? Rank the following item in your preference order?

S.N.	Particular	Rank
1	Character	
2	Collateral	
3	Repayment Capacity	
4	Net Worth of Borrower	
5	Condition of the proposed Sector	

2. What up to what percentage of FMV would it be safe to make lending ? Please tick mark he one you feel is the minimum requirement.

   a) Less than 40%

   b) Between 40% to 50%

   c) Between 50% to 60%

   d) Between 60% to 70%

   e) Between 70% to 80%

   f) Between 80% to 90%

g) Greater than 90%.

3. Which sector loan in your opinion is less risky? Please rank the following sector of loan in the order of risk. Riskiest one to be ranked 1.

S.N	Sector of Loan	Rank
1	Business Loan	
2	Housing Loan	
3	Personal Loan	
4	Hire Purchase Loan	
5	Auto Loan	

4. How much saving (Disposable Income) should a person have in order to obtain loan? Please tick the one you feel it the minimum requirement.

a) Installment to saving ratio should be less than 50%.
b) Installment to saving ratio should be between 50%-60%.
c) Installment to saving ratio should be between 60% - 70%.
d) Installment to saving ratio should be between 70% - 80%.
e) Installment to saving ratio should be between 80% - 90%.
f) Installment to saving ratio may be more than 90% .

5. Is personal guarantee necessary?

a. Yes b. No

6. If your answer to question no. 5 is yes, then tick the appropriate box of each row.

S.N.	Guarantee	must	If possible	Few would Be enough	Not necessary
1	Guarantee of Family Members				
2	Guarantee of Brother and Sisters Who have separated				
3	Guarantee of Neighbors				
4	Guarantee of Friends				

7. Is there change you like to make in the credit policy of the bank? If yes write the aspect you like to change.

……………………………………………………………………………………………

……………………………………………………………………………………………

………………………………………………………………………………

APPENDIX- II

List of Commercial Bank

S.N.	Name of Commercial Bank	Year of establishment A.D.	Head office	Links to Related bank
1	Nepal Bank Limited	1957	Kathmandu	www.nepalbank.com.np
2	RastriyaBanijya Bank Limited	1966	Kathmandu	www.rbb.com.np
3	Nabil Bank Limited	1984	Kathmandu	www.nabilbank.com
4	Nepal Investment Bank Limited(previously Nepal Indosuez Bank)	1986	Kathmandu	www.nibl.com.np
5	Standard Chartered Bank Limited(previously Nepal Grindlays Bank Limited)	1987	Kathmandu	www.standardchartered.com.np
6	Himalayan Bank Limited	1993	Kathmandu	www.himalayanbank.com
7	Nepal SBI Bank Limited	1993	Kathmandu	nsblco@nsbl.com.np
8	Nepal Bangladesh Bank Limited	1993	Kathmandu	www.nbbl.com.np
9	Everest Bank Limited	1994	Kathmandu	www.everestbankltd.com
10	Bank of Kathmandu Limited	1995	Kathmandu	www.bokltd.com
11	Nepal Credit and Commerce Bank Limited(Previously Nepal Bank of Ceylon Limited)	1996	Bhairawa	Nccbank.com.np
12	Lumbini Bank Limited	1998	Narayangrah	www.lumbanibank.com
13	Nepal Industrial and Commercial Bank Limited	1998	Biratnagar	www.nicbank.com.np
14	Machhapuchre Bank Limited	2000	Phokara	Machbank.com
15	Kumari Bank Limited	2001	Kathmandu	www.kumaribank.com
16	Laxmi Bank Limited	2002	Birjung	www.laxmibank.com
17	Siddharth Bank Limited	2002	Kathmandu	www.siddharthabank.com
18	Global Bank Limited	2007	Birjung	Globalbanknepal.com
19	Citizens Bank International Limited	2007	Kathmandu	Ctznbank.com
20	Prime Commercial Bank Limited	2007	Kathmandu	Eprimebank.com
21	Bank of Asia Nepal Limited	2007	Kathmandu	Boanepal.com
22	Grand Bank Nepal limited	2008	Kathmandu	www.dcbl.com.np
23	NMB Bank Limited	2009	Kathmandu	Nmb.com.np
24	Kist Bank Limited	2009	Kathmandu	Kistbank.com
25	Mega Bank Limited	2009	Kathmandu	Megabanknepal.com
26	Sunrise bank limited	2009	Kathmandu	Sunrisebank.com.np

27	Janata Bank limited	2009	Kathmandu	Janatabank.com.np
28	Commerz and Trust bank limited	2010	Kathmandu	Ctbanknepal.com
29	Civil Bank limited	2010	Kathmandu	Civilbank.com.np
30	Century commercial bank limited	2011	Kathmandu	Centurybank.com.np
31	Sanima Bank limited	2011	Kathmandu	Sanimabank.com

APPENDIX -III

Calculating Core Capital and Supplementary Capital

Description		**Amount**
Paid up Capital(Ordinary Shares)		
Proposed bonus Share		
Share Premium		
Irredeemable preferential share		
General Reserve Fund		
Accumulated profit /(Loss)		
Profit and loss a/c per balance –sheet		
Capital Redemption Reserve Fund		
Capital Adjustment Fund		
Calls in advance		
Other Free Reserve		
a	Goodwill	
B	Investment on shares and securities in excess of limits	
c.	Investment to the company having financial interests	
d.	Fictitious Assets	
e.	Investment on Land and Building for self use not complying the Directives of NRB	
f.	Investment on land development and housing construction in excess of limits.	
g.	Underwriting share not sold within the stipulated time	
h.	Credit and other facilities banned by the prevailing laws	
	Total core Capital (A)	
	Description	Amount
	Provision of loan loss made for pass loan	
	Additional loan loss provision	
	Hybrid Capital Instruments	
	Unsecured Subordinated Term Debt	
	Exchange Equalization Fund	
	Assets revaluation Fund (Max, 2% of Supplementary capital is added automatically)	
	Investment adjustment Fund	
	Total Capital Fund (A+B)	

Source : NRB (Unified Directives)

APPENDIX- IV

Format of sending report of Loans and Advances sanctioned to Promoters/ CEO/ Directors and Staff of the bank.NRB Directive Form No. 9.6Name of Bank of Financial InstitutionLoans and Advances to Director/CEO/Promoters/Staff and Shareholder

(Date/ Month-Report)

<table>
<tr><th rowspan="2">Name of Promoters/ Directors/ CEO</th><th colspan="2">Last Quarter's Outstanding</th><th colspan="2">This Quarter Repayment</th><th colspan="2">This Quarter Outstanding</th></tr>
<tr><th>Principle</th><th>Interest</th><th>Principle</th><th>Interest</th><th>Principle</th><th>Interest</th></tr>
<tr><td>a. Directors
1
2</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>b. Executives
1
2</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>c. Promoters
1</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>d.Staff
1
2</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>e. Shareholders
1
2</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Total</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

Prepared By

Sign

Name

Position

Date

Prepared By

Sign

Name

Position

Date

APPENDIX-V

Financial Highlights of Machhapuchhre Bank Ltd.

	2064-65				2065-66				2066-67				2067-68				2068-69			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Total Loans	30.210	120.289	154.310	006.715	391.897	471.892	559,168	662,956	775,832	1,177,924	1,227,66	1,304,800	1,344,148	1,418,162	1,463,439	1,590,311	1,767,308	1,786,004	1,983,993	2,122,446
Deposit	80,489	203,945	211,353	368,683	489,816	601,429	686,655	871,184	1,195,1 20	1,398,294	1,438,127	1,513,874	1,559,830	1,619,802	1,686,083	1,740,570	1,850,341	2,112,681	2,340,375	2,571,918
Interest Income	381	2,854	7,211	15,166	8,643	23,448	38,984	58,733	34,897	60,666	104,194	158,383	52,486	112,566	172,633	249,540	72,986	154,974	235,635	338,294
Interest Expense	425	2,548	5,727	10,847	7,207	15,087	24,465	37,087	18,131	42,467	69,566	100,572	34,440	70,712	110,129	153,354	44,989	93,796	147,935	206,698
Cost of Fund	-	-	-	-	-	-	-	-	-	752%	827%	895%	917%	983%	994%	998%	1008%	994%	880%	804%
CD Ratio	25,36%	49.81%	6223%	7547%	7440%	6962%	7246%	6940%	6061%	7669%	7765%	7839%	7818%	9556%	7518%	7535%	7893%	7232%	7333%	7179%
NPL	.	-	-	.	-	-	-	2,784	-	-	4,309	6,133	26,011	13,735	38,566	5,566	50,368	46,793	46,425	15,918
Provision	.302	1,203	1,543	3,067	3,919	4,719	5,592	7,238	7,758	11,779	13,624	16,206	20,373	17,596	25,146	18,088	32,684	29,017	35,710	28,017
NPL/Total Loan	-	-	-	.	-	-	-	042%	-	-	035%	047%	194%	097%	264%	035%	285%	262%	234%	075%
Provision/ NPL	-	-	-	.	-	-	-	25995%	-	-	34621%	26426%	7832%	12811%	6520%	32496%	6489%	6201%	7692%	17600%
Capital Adequacy	70.00%	1977%	1977%	1137%	894%	1504%	1440%	1155%	1009%	1161%	1140%	1159%	1204%	1773%	1716%	2270%	2168%	2163%	1802%	1774%
Net Profit	(1,282)	(2,349)	(3,306)	(2,200)	(818)	4,200	8,226	5,988	755	3,352	8,052	14,64	2,113	15,590	19,171	32,532	7,528	22,389	30,361	50,005

APPENDIX-VI

Indicators of Machhapuchhre Bank

S.N	Particulars	Unit	Mid Day											
			2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
1	Gross Domestic Produce	Rs. in Million	441519	459443	492231	536749	589412	654.55	727089	818401	960011	1170993	1345767	1578613
2	NO. of Branches of Commercial Banks	In Unit	430	413	447	423	422	437	470	555	752	987	1245	1484
3	Population Per Branch	IN Thousand	53.84	57.31	54.14	58.49	59.95	59.18	56.26	48.7	36.76	28.37	21.38	22.52
4	Deposits in Commercial Banks	Rs. In million	181767	185145	203879	233811	252410	291246	337497	426080.3	563604.4	630880.8	687587.9	703451.8
5	Per capital Deposit	Rs. in Unit	7851.71	7997.61	8806.88	10099.8	10903	11515	13344	15763.24	20390.9	22324.95	2582975	28930.15
6	Loan& Advanced of Commercial Banks	Rs. in Million	109121	113175	124522	140031	163719	176820	231830	302913.4	398143	469279.8	528023.1	609213.2
7	Per Capital Loan	Rs. In Unit	473.66	4888.75	5378.94	6048.87	7072.1	6991.2	9166.2	11206.56	14404.59	16606.39	19835.58	22352.03
8	Paid up Capital & Reserve Fund	Rs. In Million	823.2	10202.5	11814.6	14854.4	15153	16567	28641	41208.2	56912.9	66877.97	83578.54	90753.71

Source Nepal Rastra Bank (Banking and Financial Statistics), Mid- July 2012

APPENDIX-VII
Calculation of Risk Weight Assets

A. On Balance Sheet Items		
S.N	**Name of Assets**	**Risk Assigned to the Assets (in %)**
1.	Cash Balance	0
2.	Gold (Tradable)	0
3.	NRB Balance	0
4.	Investment to Govt. Bond	0
5.	Investment to NRB Bond	0
6.	Loan against Own FD	0
7.	Loan against Govt. Bond	0
8.	Accrued interests on Govt. Bond	0
9.	Investment to Youth and Small Entrepreneurs Self- employment Fund	0
10	Balance on domestic banks and financial institutions	20
11	Loan against other banks ' and financial institutions	20
12	Foreign Bank Balance	20
13	Money at call	20
14	Loan against internationally rated bank guarantee	20
15	Investment to internationally related banks	20
16	Inter-bank lending	20
17	Investment on shares/debentures/bonds	20
18	Other investments	100
19	Loans & advances, bills purchase/discount	100
20	Fixed assets	100
21	Net interest receivables (Total IR – 8 – Internet suspense)	100
22	Other assets (Except advance tax payment)	100
23	Real estate/ residential housing loans exceeding the limits	100
Total On-Balance-sheet Items (A)		
B. Off Balance Sheet Items		
S.N	**Name of Assets**	**Risk Assigned to the Assets (in %)**
1.	Bills collection	0
2.	Forward foreign exchange contract	10
3.	L/C with maturity less than six months (Outstanding value)	20
4.	Guarantee against International rated bank's counter guarantee	20
5.	L/C with maturity more than six months (Outstanding value)	50
6.	Bid bond, performance bond and underwriting	50
7.	Loan sale with repurchase agreement	100
8.	Advance payment guarantee	100
9.	Financial and other guarantee	100
10	Irrevocable loan commitment	100
11	Possible liabilities for income tax	100
12	All types of possible liabilities including acceptance	100
13	Rediscounted bills	100
14	Unpaid Portion of partly paid share investment	100
15	Unpaid guarantee claims	200
Total Off-Balance-sheet Items (B)		
Total Risk Weighed Assets (A) + (B)		

Source: NRB(Unified Directives).

APPENDIX-VIII

Balance Sheet of Machhapuchhre Bank Ltd.					
	Audited Figures			**Projected Figures**	
	2065-66	**2066-67**	**2067-68**	**2068-69**	**2069-70**
Assets					
Current Assets					
Cash	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Accounts Receivable	270,000	297,000	445,500	490,050	539,055
Inventory	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Total Current Assets	270,000	297,000	445,500	490,050	539,055
Long term Assets					
Furniture	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Utensils	270,000	297,000	445,500	490,050	539,055
Machinery	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Less: Accumulated Depreciation	270,000	297,000	445,500	490,050	539,055
Total Long Term Assets	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Total Assets	270,000	297,000	445,500	490,050	539,055
Capital and Liabilities					
Current Liabilities					
Accounts Payable	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Total Current Liabilities	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Long term Liabilities					
Long term loan	270,000	297,000	445,500	490,050	539,055
Total long term loan	270,000	297,000	445,500	490,050	539,055
Capital					
Shareholder's equity	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Retained Earnings	270,000	297,000	445,500	490,050	539,055
Total Capital	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Total Capital and Liabilities	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407

Source: NRB(Unified Directives).

APPENDIX –IX

Table No:	Sources
1.1	Directives of Nepal Rastra Bank
1.2	Nepal Rastra Bank
4.1	CPG of MBL
4.2	CPG of MBL
4.3	Gold Loan Working Manual of MBL
4.4	Internal file Study of MBL
4.5	Monthly Report of MBL
4.6	Single Obligor Group Report of MBL to NRB.
4.7	Single Obligor Report to NRB and Unaudited Report of MBL.
4.8	NRB Reporting of MBL.
4.9	Field Survey 2013
4.10	Credit Manual of MBL.
4.11	Credit Manual of MBL.
4.12	Structured Question asked to the staff of MBL.
4.13	Financial Statement of MBL .
4.14	Financial Statement of MBL .
4.15	Financial Statement of MBL .
4.16	Financial Statement of MBL.
4.17	Financial Statement of MBL.
4.18	Financial Statement of MBL.
4.19	Financial Statement of MBL.
4.20	Financial Statement of MBL
4.21	Financial Statement of MBL.
4.22	Financial Statement of MBL.
4.23	Credit Files of MBL.
4.24	NRB (Unified Directives for Banks and Financial Institutions).
4.25	Credit Manual of MBL.
4.26	Financial Report of MBL.[Annex –XI]
4.27	Financial Report of MBL.[Annex-XI]
4.28	Financial Report of MBL.[Annex-XI]
4.29	Financial Report of MBL.[Annex-XI]
4.30	Financial Report of MBL.[Annex-XI]
4.31	Financial Report of MBL.[Annex-XI]
4.32	Financial Report of MBL.[Annex-XI]
4.33	Financial Report of MBL.[Annex-XI]

ANNEX-X

Ratio Analysis of Machhapurchhre Bank

	6064-065	2065-066	2066-067	2067-068	2068-069
Fixed Asset Turnover Ratio	5.88	7.86	4.79	6.91	10.31
Return on investment	45.41%	67.44%	28.71%	42.67%	51.29%
Gross Profit	50.00%	50.00%	50.00%	50.00%	50.00%
Equity Total Rebtpatio	0.61	0.45	0.43	0.29	0.15
cu sent Ratio	9.25	9.23	10.88	10.52	10.00
Inventory Turnover Ratio	18.00	19.80	13.50	14.85	16.34
Inteust Coverage Ratio	7.96	12.97	6.53	10.73	16.77
Re Ceviche Turnover Ratio	100	100	100	100	100
Payable Turnover Ratio	20	20	20	20	20

APPENDIX-XI

Financial Analysis of Machhapuchchhre Bank Ltd.

	2064-65	2065-66	2066-67	2067-68	2068-69
Interest Income	15,166	58,733	158,383	2,48,540	3,38,294
Average yield on Loan	9.92%	11.26%	14.12%	17.16%	17.67%
Cost of Fund	5.02%	5.60%	7.25%	9.29%	9.32%
Spread Rate	4.90%	5.66%	6.87%	7.88%	8.35%
CD Ratio	75.45%	69.40%	78.39%	75.35%	71.79%
NPL		2784	6232	5566	15918
Provision	3067	7238	16205	18087	28016
Capital Adequacy	11.37%	11.55%	11.59%	22.70%	17.74%