

# Chapter-I

## INTRODUCTION

### 1.1 Background of the Study

The banking sectors play a vital role in the overall development of an economy. Financial sector is related with the monetary and capital markets. Banks are the financial institutions are the major activities of financial market. Such financial institutions play a vital role for the effective and specific financial performance. Different types of institution like financial companies, commercial banks, micro financing institutions, provident fund, insurance companies, security market, citizen investment fund and credit security corporation etc. are performing in their own way for the national financial strength. But in the context of Nepal, specific institutions are still to be promoted and encouraged. There is scarcity of subsidiary institution to support the economic stability in the country.

Government of Nepal has been implementing financial sector reforms program as major instrument of economic reform policy & focus has been given on financial institutions.

After the financial liberalization in 1980s we can see noticeable changes in the financial sector. Work specification, increase in new banking services and excess to banking facilities for the general people are considered as positive signals in the financial market. The concept of fair competitions in the sector is emerging. However, financial institutions are facing problems like traditional style of work, poor information system and effective management. The countries implementing the open market policy emphasize on the role of private sector in order to get sustainable economic growth. it realized that the government has to encourage private sector to upgrade the economic growth. It realized that the government has to encourage private sector to upgrade the economic and social standard of general people by focusing its resources on employment generation; education, infrastructure are development and social services.

Financial sector include a wide range of economic activities of the country. It covers from national growth to individual saving. Financial sector is basically administered by economic policy. Financial policy, monetary policy and policies for financial institutions are also equally important for the balances national economy. Nepal Rastra Bank has the authority to implement the monetary policy with different targets and tools. Financial institution reform is one of the effective tools to reform the financial sector.

Among the financial institution, the commercial banks are the major components in implementing the reforms policy. Making loan and their management is a crucial part of loan management in financial institutions. Loan management focus, types of loan provide by commercial bands, loan approval process, loan document, loan distribution loan follow up, payment of debt and interest, credit renew and security. Nepal Investment Bank is rolled as such type of bank from 1986.

## **1.2 Introduction of Nepal Investment Bank Ltd. (NIBL)**

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world.

With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd.

The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank's Annual General Meeting, Nepal Rastra Bank and Company Registrar's office with the following shareholding structure.

A group of companies holding 50% of the capital

Rashtriya Baniya Bank holding 15% of the Capital.

Rashtriya Beema Sansthan holding the same percentage.

The remaining 20% being held by the General Public (which means that NIBL is a Company listed on the Nepal Stock Exchange).

## **1.3 An Overview of Loan Management**

Commercial Banks perform a wide spectrum of functions. Loan management is the most critical factor in determining the strength of any Bank. Primary factor that can be considered as the quality of loan portfolio, mix of risk assets and credit administration system. However, advancing loans in is one of their major function. Bank loans contribute a lot to the growth of new business, which ultimately improved the economic health of the country. The role of Bank loan in the economic development of the country is of great value. Normally Bank loans in four forms namely overdraft, cash credit, direct loan and discounting bills of exchange. Loans and advances constitute a major portion of the assets of a Bank and the interest income earned from loans and

advances is a major contributor to a Bank's profit. In the loan asset of the Bank turns out to be non-performing or least liquid, the Bank cannot obtain the targeted return from loans and advances. Thus an effective management of loan is a must.

The given table and bar diagram shows the total loans (TL), non performing loans (NPL), and loan loss provision of NIBL of five different years.

Table No.1  
Factors affecting the loan management  
Rs. in million

	TL	NPL	LLP
Year 061/61	7339	181	208
Year 061/62	10453	281	327
Year 062/63	13178	272	402
Year 063/64	17769	421	482
Year 064/65	27592	309	532

*Source NIBL Web side (www.nibl.com.np)*

In the above table lower NPL ratio indicates the better risk assessment and robust credit management systems in place and vice versa. At the same time, while higher loan loss provision indicates poor credit management, it also indicates adequate reserve for possible loan loss and protects balance sheet of respective bank.

#### **1.4 Statement of the Problem**

There were only two government owned commercial banks before the establishment of joint venture and private sector commercial banks. In present context, there is vast competition among commercial banks. The number of commercial banks is increasing day by day. Thus to establish sound loan management is a major issue in commercial banking sector during these days.

Loan is the major source and building better lending position is the major strategy of every commercial bank. It is necessary to access the appropriate loan management in commercial banks for performance effectiveness. There is lack of scientific and empirical

research that could identify the issue of loan management of commercial banks. In this regards the performance of Nepalese commercial banks is to analyzed in terms of their credit. Therefore the study surrounds and deals with following aspect of the banks.

- Is there an appropriate environment for bank loan?
- Is the bank management is sincere to establish better loan management?
- What is the relationship between loans and advances and net profit?
- What are the future strategies to improve better creditability?

### **1.5 Objectives of the Study**

The fieldwork is done with the basic purpose of having practical exposure to the theoretical knowledge gained, and to fulfill the requirement for the degree of Master of Business Studies. The objective of the study is given below;

- To show the present condition of Loan management in NIBL.
- To examine various stages involved in loan management process in NIBL.
- To evaluate the contribution of loans given by NIBL to the country.
- To examine the trend of loans and advances and interest income of NIBL.
- To provide suggestion for the future betterment of loan management system of NIBL.

### **1.6 Significance of the Study**

The following are the few points, which throw lights on the importance of this thesis.

- As a business student, it is a golden opportunity to show skill in financial analysis; this report will show the intelligence and skill of the student. This report is a criterion for evaluation of the student's qualification.
- This thesis will provide student an experience in financial analysis.
- This thesis will provide information to the student as to how the business house is running.
- This thesis might be useful for those who are willing to know something about the loan management in Bank.
- This thesis may be useful for the library purpose so that any student wanting to prepare a report can have some ideas about it.
- This thesis can be used as a guideline while preparing a small project report.

- This Thesis is prepared for the partial fulfillment of the requirement for the Master's Degree of Business Studies.

## 1.7 Limitations of the Study

Though best possible efforts have been made to prepare this fieldwork report, this report is still not free of some limitations. The limitations inherent in this report are :

- The statistics, which is used for the purpose of the study, is secondary, which consist of banks publication, audited reports and other secondary sources. Bank publications may not be always reliable because they may publish the reports according to their profit policy and market situation. And personal interviews and questionnaires may not be factual. But the audited data, which used are more reliable.
- Some information relating to the subject matter could not be obtained because of the bank's secrecy. So, there are some difficulties to get the sufficient information as banks hesitate to provide data easily.
- A deep knowledge of the subject matter could not be gained because of time restriction. So this study is helpful to study the loan management, procedure of NIBL only but the overall position of Bank cannot be judged by this report.

## 1.8 Organization of the Study

This study is divided into five chapters, which are as below:

**Chapter I:** This chapter has included introduction, general background of the study, focus of the study, significance of the study, objectives of the study and limitation of the study.

**Chapter II:** This chapter has included the review of literature. The review from books, journals, thesis and independent studies will be taken into account.

**Chapter III:** This chapter has included the total population, sample of the study, data collection procedures and the analytical tools and techniques used in the study.

**Chapter IV:** In this chapter the data has analyzed and presented which will in help in drawing the conclusions.

**Chapter V:** This chapter has included the summary of the whole study, relevant conclusion and recommendation.

Finally bibliography and appendix have included.

# Chapter II

## REVIEW OF LITERATURE

### 2.1 Conceptual Framework

Scientific research must be based on past knowledge. The previous studies cannot be ignored because they provide the foundation to the present study. In other words, there has to be continuity in research. This continuity in research is ensured by linking the present study with the past research studies.

To explore the relevant and true facts for the research purpose, this chapter highlights the literature available related to the study. An attempt has been made to look into bank publication periodicals and centre bank's rules and regulations. In addition, informed interviews with bank personnel have been aimed to receive.

### 2.2 General Principles of Good Lending

Bank collects scattered saving from the public and invests those savings in different securities. In between these intermediations bank earns a profit from difference in interest rates paid and charged. Thus the income and profit of each bank and every financial institutions depend upon its lending policy in different securities The greater the credit created by the bank, the higher will be the profitability. Banker is essentially a dealer in lending the funds of others. But it is a risky business. Therefore a banker follows a cautious policy in the matter of lending and is generally governed by the well known principles of sound lending which are explained below. .

#### **Safety:**

The main business of banking consists in borrowing various types of deposits such as current saving and fixed and lending such deposits to needy borrowers in the form of advances and discounting of bills. This obviously implies that safety of such funds should be ensured. Otherwise the banker will not be in a position to repay his deposits and once the confidence of the depositors is shaken, he cannot carry on the banking business.

If the banker has to ensure safe lending, he has to look to the three c's of the borrowers namely character, capacity and capital. Character of the borrower is important because

that determines his willingness to repay the loan. His capital and capacity to run the business successfully determine his to pay. The safety of the loan depends on both his capacity to repay and willingness to repay.

**Liquidity:**

Liquidity refers to that state or position of a bank that pronounces its capacity to meet all of its obligations. Shortly, it refers to the capacity to pay cash when demanded by depositors. Moreover, banking is a serious business and people deposit money at the bank in different account with confidence that the bank will repay their money when they need to maintain such confidence of the depositors, the bank must be alert while lending its excess fund in different securities, so that it can meet current or short term obligations when they become due for payment. There is no sense if the bank has adequate assets but not ability to meet the demand of depositors.

**Profitability:**

Commercial banks have obtained funds shareholders and naturally if dividend is to be paid on such shares earning profits can only pay it. Even in the case of public sector banks although they are service motivated they will have to justify their existence by earning profits. From out of the revenue earned the banker has to pay interest on deposits, salary to the staffs, meet other establishment expenses, build-up reserves and the balance must permit the payment of dividend to shareholders. However, the banker will not give undue importance to this aspect because a particular customer may offer a higher rate of interest but an advance made to him result in a bad debt. Therefore for the sake of profitability, the other two principles, liquidity and safety cannot be sacrificed.

**Suitability:**

Although to achieve the goal of bank, it should invest but it should know the reason of need of loan. This has become a vital task for each bank. If borrower misuse the loan granted by the bank, they can never be able to repay loan. In order to avoid such circumstances loan should be allowed to the suitable borrowers and detailed information about the scheme of the project of activities should be examined before lending.

**Diversification:**

Banker should try to diversify loans as far as possible so that he may minimize his risk in lending. The bank must not invest their funds in only one sector but to the various sectors so that when something goes wrong in one particular sector others will recover. Moreover, diversification spreads risk and prevent from being insolvent.

**Legality:**

Any organization operating in the country should follow the rules and regulation of the country. For this purpose, a bank must follow the rules and regulations as well as different directives and guidelines issued by NRB, Ministry of law and other while mobilizing the collected funds.

**2.3 Meaning of some important terms**

In this section of the study efforts have been made to clarify the meaning of some important terms frequently used, which are as follows.

**Deposits:**

Deposit is the most important source of the liquidity. From bank's financial strength, it is treated as the barometer. Deposits constitute the great bulk of bank liabilities. The source of the bank greatly depends upon the extent to which it may attract more and more deposits. Mainly deposits are collected through three accounts; they are current deposit, saving deposit and fixed deposit.

**Loans and advances:**

Loans and advances are the source of income of commercial banks. Bank deposits can be crossed beyond a desired level but level of loans advance and overdraft will never cross it, the facilities of granting loan, advance and overdraft are the main services in which customers of the bank can enjoy. Funds borrowed from banks are much cheaper than those borrows from unorganized money lenders.

**Interest:**

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

**Non-performing loan (NPL):**

Non performing loans means an outstanding loan not repaid i.e. neither payment on interest nor principal are made. In case of the banks the loans and advances are the assets as the banks flow loans from the funds generated through shareholders equity, money deposited by the people and fund having through the borrowings. Hence the term NPL means the loans and advances that are not performing well. Thus all the irregular loans and advances can be termed as NPL.

## 2.4 Loan Management Process

Commercial Bank provides short-term loans such as demand loan, overdraft and time loan for one-year period as a working capital loan. It also provides long-term loans for financing fixed assets for a maximum of seven years with repayment on installment basis. NIBL provides loan in both trading sector and industrial sector and also in priority and deprived sector.

Lending is the most profitable activity of NIBL and also the greatest contributor to the profit. Loans and advances occupy the largest portion of the total assets of Bank. If the loan turns out to be non-performing asset then the outcome may be terrible. Thus, loan should be properly managed.

### **Credit & Trade Finance:**

- NIBL provides various types of loan and advances and trade finance services:
- Overdraft (Corporate and Multinational)
- Working Capital/Short term Loan
- 90 Days Cash Credit
- Term Loan
- Other Loan
- Export Credit
- Trust Receipt/Importer's Loan
- Term Loan
- Export Credit
- Overdraft
- Working Capital Short Term Loan
- Trust Receipt Importer's Loan
- Priority Sector
- Deprived Sector
- Hire Purchase Loan
- Loan against Govt. Bonds
- Loan against 1<sup>st</sup> Class Bank Guarantee
- Loan against Fixed Deposits held with NIBL Bank
- Loan against Pledge of USD
- Housing Loan

### **2.4.1 Loan Approval**

Whenever a potential borrower comes to Commercial Banks to borrow fund, the following steps are followed before the loan proposal:

#### **A) Loan Application**

A loan application has to be submitted by borrower. This application contains a variety of information. Loan application must contain information regarding the following aspects:

- Introduction of Business (either trading or industry)
- Constitution of business (proprietorship or partnership or company)
- Authorized, issued and paid-up capital
- Address of factor , go down and office
- Detail of following business activities :
- Trading items/Raw materials
- Sources of items or raw materials
- Name of the supplier(s)
- Distribution network
- Current and /or expected sales turnover
- Market demand
- profit and loss account of last three years
- Plan of future expansion
- Other necessary information, if any

#### **B) Interview**

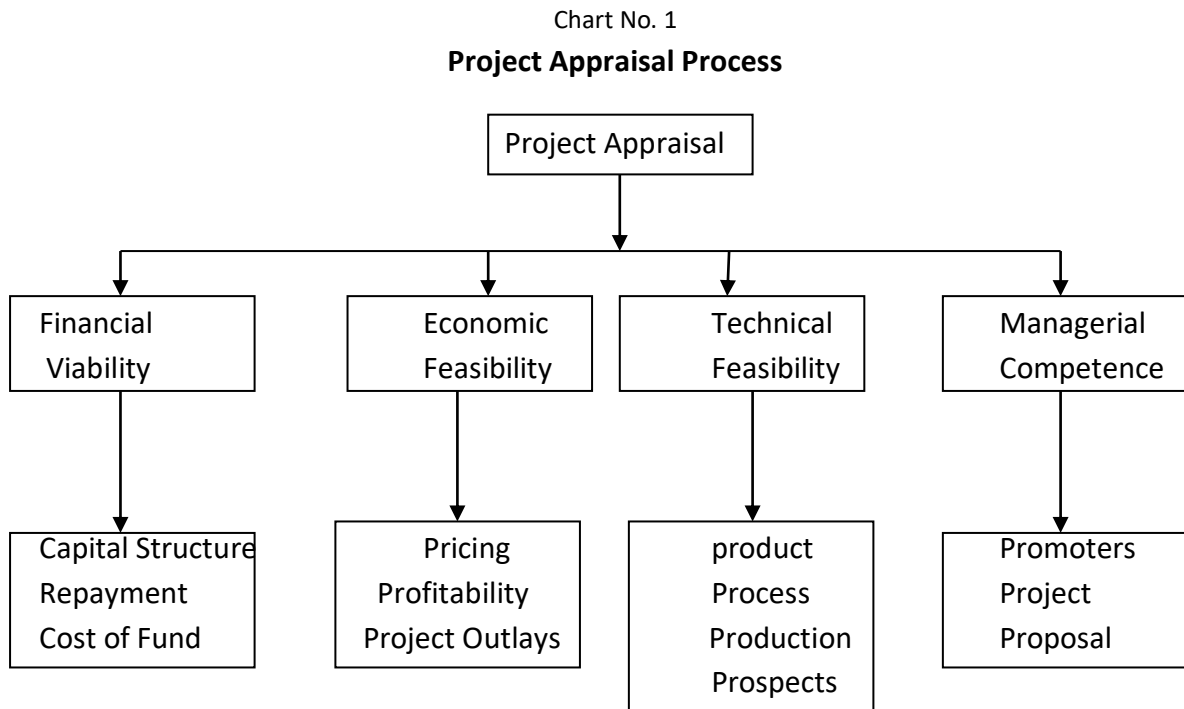
Interview helps in extracting essential and critical information that are not covered by a loan application. Additional information can be gathered by interviewing the borrower.

#### **C) Credit Analysis**

After interviewing the borrower, the personal of bank carry out credit analysis. A credit analysis is mainly concerned with the measurement of the friskiness of a loan proposal. Various aspects such as loan repaying capacity of the borrower, loan purpose, securities offered by the borrower etc are analyzed and inspected. A credit analysis is s crucial aspect of loan approval process.

## D) Project Appraisal

Bank generally carries out project appraisal before accepting medium and long-term loan proposals. A project appraisal can simply be understood as a process of assessing the viability of projects to judge the soundness of loan proposals. A number of factors are taken into account while appraising a project. The factors may differ as per the types of the project. However, banks generally consider the factors as summarized in the figure:

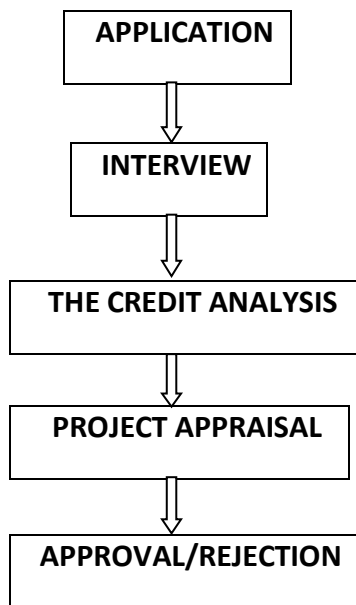


Thus, it is after appraising the project from all corners the bank personnel comes to the conclusion that whether the amount lent for that particular project can be repaid safely or not. It is on the basis of this appraisal process that medium and long-term loan proposals are accepted or rejected in Banks.

Finally, upon the fulfillment of all necessary requirements, the loan proposal is submitted to the approving authority for final decision. Banks sometimes approach some reputed businessmen in the banking sector, which requires making market efforts for sustaining the business.

Chart No. 2

**The Loan Approval Process can be shown as below :**



#### **2.4.2 Loan Documentation:**

Bank does not disburse the approval loan until all necessary documents have been obtained. The necessary documents are given below.

- All companies are required to submit their board resolution authorizing to execute loan/security documents with the bank to avail credit facility.
- Corporate guarantee should be supported by resolution of Board of Directors.
- Original certificates should be presented for verification while submitting this form.
- Salary certificates must be in the office's letterhead having seal and must contain net salary, your designation, years of service, date of retirement or expiry of contract and type of employment (permanent or contract). It should be signed along with the name and designation of the signatory.
- Bank can demand any additional documents at its own discretion.

- For commercial vehicles, detail breakdown of the income from and expenses of the vehicle (scheme) is necessary.
- In case of swapping loan, loan statements from current bank/ a financial institution is required.

### **2.4.3 Loan Disbursement**

In Bank, a request for disbursement of loan from the borrower with an authorized signature should be obtained for disbursing amount of loan. A bank personnel verifies the signature of the borrower and the requested amount is credited to the respective borrower's account.

#### **Loan disbursement procedure:**

Disbursement procedures for different types of loan are given below.

- Long-Term Time Loan: The fund is disbursed as per the schedule normally fixed in advance by debiting long-term loan account.
- Short-Term Time Loan: The fund limit is disbursed at once by debiting time loan account and normally crediting current account.
- Demand Loan: The loan is disbursed as and when demanded by the borrower by debiting demand loan account and by normally crediting current account.
- Overdraft Loan: A borrower can draw a cheque in current account up to the approved limit at any time.

### **2.4.4 Loan Follow-up**

The loan follow-up can simply be understood as a post assessment of the approved loan. The Bank personnel keep close contact with the borrowers to know the developments that may under the repayment of loan. At the same time loan follow-up helps to build up a good rapport of borrowers that ultimately may result in good future prospects for the bank itself.

### **2.4.5 Payment of Debt and Interest**

Bank collects principal and interest from the borrower on the basis of "bullet payment Method". A bullet payment method means the method in which interest is received on quarterly basis and principal is received upon maturity. Bank charges interest on Ashwin-end, Poush-end, Chairta-end and Ashadh-end.

#### **2.4.6 Credit Renew**

Bank provides the facility of renewal of loan to the borrowers based on the utilization of loan amount without any adverse record, with regular interest payment and also if the bank is satisfied with the transactions of the borrower throughout the year.

#### **2.4.7 Security**

Bank asks both primary and secondary security from the borrower. The securities are viewed on various grounds such as possibility of marketability, valuation, validity, enforcement and other necessary economic considerations. In bank, non-repayment of loan sometimes takes place because of wrong valuation of securities or the wrong assessment of loan requirement itself.

To sum up, it is found that all the aspects of loan management such as loan approval, loan documentation, loan disbursement, loan follow-up etc in Bank have been paid proper attention. Bank is able to perform loan management satisfactorily till date.

#### **2.5 Credit Risk Management of NIBL:**

Credit risk is the probability that a borrower or counterparty will fail to meet its obligations in accordance with the terms of approval of the credit. This includes non-repayment of capital and/or interest within the agreed time frame, at the agreed rate of interest and in the agreed currency.

Bank's various branches are the business units of NIBL. Each branch forwards business proposal to the Head of Credit Division, Head Office, The Credit Division critically analyses the proposal from different perspectives in line with statutory, regulatory and internal guidelines. Thereafter, if the business proposal is found to be creditworthy, it is placed in the Credit Committee. The Credit Committee is comprised of seasoned bankers who evaluate credit proposals. The Committee analyzes in depth financial as well as non financial information regarding the borrower such as business history, market situation, future prospects of the market, managerial capabilities, cash flow and then declines or recommends approval of the designated credit authorities. To ensure proper and adequate risk analysis and timely customer service, NIBL Credit Policy and Procedures Guide (CPPG) provides various layers in the credit approval process. The CPPG has conferred specific credit discretions ranging from the General Manager to the Executive Credit Committee, the penultimate authority of the Bank.

- Adoption of international standards via Bank's in-house Credit Policy and Procedures Guide.
- Formation of Credit Quality Control (CQC) unit for monitoring the quality of credit, both at the account level and portfolio level.
- Regular review of credit portfolio by the senior Management with periodic reporting to the Board of Director.
- Separate independent audit and inspection of borrowers by internal auditors in addition to audit and inspection by statutory auditors.
- Strict adherence to the prudential guidelines of the Central Bank on Loan Classification, Interest Recognition, Asset Classification, Single Obligor Limit, sectoral Exposure etc.
- Establishing suitable exposure limits for borrowers and sectors and monitoring the limits on a regular basis.
- Risk mitigation steps with a special emphasis on collateral.
- Setting counterparty limits based on financial strength.
- Training of lending and legal officers on documentation and professional valuations
- Developing skills and expertise of lending officers to scientifically assess project viability and customer integrity.
- Educating the staff on provisions in the Banks and Financial Institution Act and other relevant stature and the regulatory guidelines of the Central Bank.
- Seeking external legal opinion and advice.
- Identifying Early Warning Signals (EWS) and taking prompt action thereon.
- Constant post sanction monitoring with special independent team for verification of hypothecated stocks.

## **2.6. Review of NRB directives**

NRB is the apex institution in the money and capital market. Being the central bank of the nation, it directs, supervise and control and function of commercial banks and other financial institutions. NRB has issued various directives in order to develop healthy, competitive and secured banking and economic system to ensure to national development. The following are some of the relevant directives that NRB has circulated to the commercial banks:

## **Directives relating to loan classification and Provisioning (Directive no. 2)**

Effective from F/Y 2058/59, banks shall classify outstanding loans and advances on the basis of aging of principal amount into the following four categories.

### **Pass:**

Loans and advances whose principal amount not pass due and pass due and pass due for period u to three months shall be included in this category. These are classified and defined as performing loans.

### **Sub-standard:**

All loans and advances that are pass due for the period of 3 months to 6 months shall be included in this category. These are classified as NPL.

### **Doubtful:**

All loans and advances which are past due for a period of 6 months to 1 year shall be included in this category. These are also classified as NPL.

### **Loss:**

All loans and advances which are past due for a period of more than 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

### **Additional Arrangement in Respect of “Loss Loan”**

- Even if the loan is not due, loans having any or all of the following discrepancies shall be classified as “loss”
- Non-security at all or security that is not in accordance with the borrowers agreement with the bank.
- The borrower has been declared bankrupt.
- The borrower is absconding or cannot be found.
- Purchased or discounted bills are not realized within 90 days from the due date.
- The credit has not been used for the purpose originally intended.
- Owing to non-recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation,
- Loans provided to the borrowers included in the blacklist and where the credit information Bureau blacklists the borrower.

### **Additional Arrangement in Respect of term loan**

In respect of the term loans, the classification shall be made against the entire outstanding loans on the basis of the past due period of overdue installment.

### **Loan loss Provisioning**

The loan loss provisioning on the basis of the outstanding loans and advances and bills purchases classified as per the directive shall be provided as follows.

<b>Classification of loans</b>	<b>Loan loss provision</b>
Pass	1%
Substandard	25%
Doubtful	50%
Loss	100%

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

### **Rescheduling and Restructuring of Loans**

In respect of loans and advances falling under the category of substandard, doubtful or loss, banks may reschedule or restructure such loans on receipt of a written plan of action from the borrower citing the following reason.

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

## **Loan loss provisioning in respect of Rescheduled, Restructured or swapped Loan**

- Except for priority sector, in respect of all types of rescheduled or restructured or swapped loan, if such credit falls under pass category according to NRB directives, loan loss provisioning shall be provided at minimum 12.5%.
- In case of rescheduling or re structuring or swapping of insured or guaranteed priority sector credit the loan loss provisioning shall be provided at one fourth of the percentage mentioned in clause (a).
- In respect of swapped loans, the bank accepting the loans in swapping has to provide loan loss provision classifying the loan under the same classification as where existing. The bank accepting the loan in swapping shall obtain classification from the concerned bank of financial institution as to the existing classification.

## **Provisioning against Priority sector Credit**

Full provisioning as per the normal loan loss provisioning shall be made against the uninsured priority and deprived sector loans. However in respect of insured loans the requisite provisioning shall be 25% of the percentage normal loan loss provisioning. The required provisioning in the case of insured priority/deprived sector credit is as follows.

Pass	0.25%
Substandard	5.00%
Doubtful	12.50%
Loss	25%

In case of rescheduling, restructuring or swapping of insured or guaranteed priority sector. Credit, the proportion of loan loss provision would be 3.125 (being 0.25% of 12.5%).

## **Directives Relating to Interest Rate**

The following directives relating to interest rates were issued for the commercial banks from February 14, 2001.

- The commercial bank should inform NRB in written form regularly and compulsorily and must publish in news media within every three months immediately in case of change.

- The commercial bank could offer interest rates more than published interest rates by fifty basis points on the basis of negotiations with the customer for the deposits of the hundred million and the hundred basis points for the deposits more than two hundred million rupees.
- Over the published lending rates for all types of loans, the bank could make the adjustment up to basis point on the basis of negotiation with the customer.
- While publishing only deposits rates or any lending rates except the provision made as above the commercial banks were allowed to mention the term could be determined on the basis negotiations. If the interest rates are determined against this directive, penalty equivalent to the amount arising such increased or lowered rate of interest should be imposed. (Economic report 2000/01:23)
- The difference between the interest provided and interest charged (spread rate) should not be more than 5%. The difference is calculated on the basis of weighted interest provided and the weighted charged.

#### **Provisioning on Interest Income (Directive no. 4. of circular No. 71/058, 2001)**

- The interest accrual on loans and advances is recognized on cash basis and exhibited under this heading. The amount of interest accepted but not received is debited to "accrued Interest Account" and credited to "Interest suspense Account"
- The balance in such "Accrued Interest Account shall be recognized into income only if cash is realized from the customer or by debiting the "Customers current Account". If balance is sufficient, it falls within the overdraft limit.
- Only the amount realized by the way of cash of debiting the customer's current account within one month from the closure of the fiscal year may be recognized into interest income in the earlier income fiscal year by debiting "Interest Suspense Account".
- In respect of the interest realization by the way of capitalization the same may be done only for interest covering the period specified as per the repayment schedule in the loan agreement. Particulars of loans on which interest are thus realized by the way of capitalization should be submitted to NRB inspection and supervision department.
- In respect of the outstanding loans and advances, till the loans are realized or written bank shall continue to account for the interest accruals under "Accrued Interest Account" and "Interest suspense Account" in the asset side and liabilities side of balance sheet.

## 2.7 Review of Books and Articles

Sound, vibrant and competitive financial sector is a key to the economic development. As the countries are becoming more and more interdependent through globalization and liberalization, most of the poor and developing nations are finding themselves way behind the developed countries in terms of trade and development. To become a successful trade partner and to achieve economic development of a financial sector is a must. Here are some review of books and journal regarding this subject.

Dr. Shyam Joshi and Dr. Hari Prasad Shrestha in the book “Principle of bank and Insurance”. Mention the principle of sound investment policy of commercial bank. In this topic the authors identify the investment policy as profitability, liquidity, shift ability, safety, diversification of risks, capital adequacy, solvency, social welfare etc.

Khan & Jain view in the book “Financial Management, “The type of relationship to be investigated depends upon the objective and purpose of evaluation. The purpose of evaluation of financial statement diggers among various group creditors, shareholders, potential investors, management, government, labour leaders and so on interested in the results and relationships reported in the financial statement. For example, short-term creditors are primarily interested in judging the firm’s ability to pay its currently-maturing obligation.”

Ratna Man Dangol and Keshab Prasad Prajapati in the book : “Accounting for financial Analysis and Planning” mention the use of Ratio Analysis as follows,

- For expressing trend
- For showing changes in financial statement
- For explaining plan for future
- For setting standard
- For effective control
- For comparing efficiency
- For maintaining uniformity

Dilli Raj Bhandari in the book of Banking and Insurance (Principle and Practices), In banking sector or transaction, an unavoidable ness of loan management and its methodology (Working method) is regarded very important. Under this management, many subject matters are considered and thought. For example, there are the subject matters like the policy of loan flow, loan administration, and audit of loan, renewable of loan, the conditions of loan flow, the documents of loan flow, and the provision of

security, the provision of the payment of the capital and its interest and other such procedures. This management plays a great role on healthy competitive activities.

In NIBL Annual report 2006/07 Prithvi B. Pande Chairman and chief executive director of NIBL said "Our deposit base has increased by 29.39% (by Rs 5.5 billion) giving us a total deposit base of Rs. 24.5 billion. This is the highest deposit growth in absolute terms for the private sector banks in Nepal. Loans made during this period increased by 34.84% to reach Rs 17.77 billion due to our efforts to attract more costumers and diversify our loan portfolio. Our assets are managed with a prudent risk management outlook, coupled with local expertise to yield quality credit and investment decisions. As a result our non performing loans are at 2.37% of our total loan portfolio."

## 2.8 Review of Thesis

Sushil Gautam (2002) conducted a study on "Lending Practices and Procedures of Nepal Bangladesh Bank Limited (NBBL)" and found out that complete analysis of the borrowers before granting the loan is the major positive aspect of NBBL. Loan is disbursed at priority as well as deprived sectors that show that the bank is able to follow the rules as issued by NRB.

He has recommended the bank should take the steps to diversify its lending so that risk can be minimized and small borrowers are promoted. He has further recommended that risk can be minimized short-term trade financing and discouraging long-term loan finance.

From this it can be concluded that Gautam has made his conclusion absolutely but has not made any relative analysis of the pros and cons of the entire factors affecting the study and also only secondary data are used for the study.

Shrijana Rana (2007) Carried out a research on "Efficiency of lending Policy of commercial Banks" and found the many causes of lending Inefficiency in commercial banks and she has recommended that capable manpower is always required to any organizations and improvement in internal system and formulation of strategies should be done to improve lending policy system.

## Chapter –III

### RESEARCH METHODOLOGY

Research can be defined as an organized, systematic, database, critical, scientific inquiry or investigation into a specific problem, undertaken with the objective of finding answer or solutions to it. It is the systematic and objective analysis and recording of controlled observations that may lead to the developments.

Research has two important aspects. First, it is sufficiently broad to include all types of investigations requiring solutions to a problem. Second, it explicitly recognizes the systematic nature of the research process in which data are gathered, recorded, analyzed, and interpreted in an orderly manner.

Research methodology refers to the various sequential steps to be adopted by a researcher in studying a problem with certain object(s) in view. It describes the methods and processes applied in an entire aspect of the study. In fact, research methodology is a systematic way of solving the research problems.

#### **3.1 Research Design**

Research design means systematic planning of research, usually including (1) the formulation of a strategy to resolve a particular question; (2) the collection and recording of the evidence; (3) the processing and analysis of these data and their interpretation; and (4) the publication of results.

Research design is an overall framework of plan for the collection and analysis of data that focuses on the data collection method, the research instrument utilized, and the sampling plan to be followed. Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance. The problem, the methodology, data gathering, data analysis and report writing are the basic elements of a research design.

This research study attempts to analyze the loan management of NIBL. The research design basically follows its loan proceed methods, current scenario of management and future planning for this section. Mostly the analysis is based upon secondary data, i.e. of few years' financial statements of the sample firm, collected directly from those firms and their websites.

## 3.2 Data Collection Procedures

### Secondary Data:

Those data which are collected by one agency, organization or person but used by other agencies, organization or person are called secondary data or secondary sources. It refers to those, which are for already gathered by others. Secondary data are often in the form of published data. However, the unpublished data such as the records, reports of statistics gathered or compiled by others prior to our study are also secondary data.

Collection of secondary data is comparatively cheaper than the collection of primary data but the secondary data may not be in the form that the investigator needs.

The required secondary data are collected from the head office of the respective bank. Annual reports are collected from the sample bank the other required data are collected from various sources like the websites, magazines, published & unpublished reports as well.

## 3.3 Population and Sample:

**Population:** The well-specified or identifiable group of people, events or things of interest that the researcher wishes to investigate is known as the population. Population is whole aggregate number in which the researcher has to study.

**Sample:** Sample is the part of the population that we actually examine in order to gather information. Population is a large unit so it is time consuming, tedious and nearly impossible to analyze each and every individual of the population. So, only a part of population is considered. That finite subject of any population is called the sample. The sample of this study is Nepal Investment Bank Ltd.

## 3.4 Method of Data Analysis

Data analysis, in this study, is done according to the pattern of data available. Specific financial and statistical tools are used in this research to show the relationship between different variables related to the study. Regarding presentation, the calculated results are tabulated under different headings and then they are compared with each other to

interpret the results. Mean, Correlation analysis are done to study the relationship between the variables.

Presentation and Analysis of the collected data is the core parts of the research work. The collected raw data are first presented in systematic manner in tabular form and then analyzed by applying different financial and statistical tools to achieve the research objective. Beside that some graph charts and tables have been presented to analyze and interpret of the study.

### 3.5. Data Analysis Tools:

Various statistical and financial tools are used in this study to estimate the relationship between two or more than two variables.

#### 3.5.1 statistical tools

##### Arithmetic Mean:

The sum of all the observations divided by number of observation is called arithmetic mean or simple average. In equation:

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

Where,  $\sum X = X1 + X2 + X3 \dots \dots \dots + Xn =$  Sum of given set of observation

n= Number of items observed.

X= Variables

##### Correlation

Correlation is defined as the "relationship" (of association) between (Among) the one dependent variable (or factor) and one (or more than one) independent variable (s) or factor (s). In the other words, correlation is the relationship between (or among) two or more variables (i.e. only one variable dependent and one or more variable (s) independent).

$$\text{Correlation of coefficient, } r = \frac{N \sum XY - (\sum X)(\sum Y)}{\sqrt{N \sum X^2 - (\sum X)^2} \cdot \sqrt{N \sum Y^2 - (\sum Y)^2}}$$

Where,

N= Number of pairs of observation.

X= Variable  
Y= Variable  
r= correlation of coefficient

The relationship between the two variable can be measured either by graphical method (scatter diagram) or by numerical calculation method.

The numerical measurement of relationship between the two variables is denoted by the symbol "r" whose values ranges from  $-1 \leq r \leq +1$

**Interpretation:**

if  $r = 0$ , there is no relationship between the variables  
if  $r < 0$ , there is negative relationship between the variables  
if  $r > 0$ , there is positive relationship.  
if  $r = +1$ , the relationship is perfectly positive  
if  $r = -1$ , the relationship is perfectly negative

The probable error of the correlation coefficient is applicable for the measurement of reliability of the computed value of the correlation coefficient, 'r'.

The probable error (P.E) is defined by,

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

Where, r= correlation coefficient  
N= Number of pairs of observation

**Conclusion :**

if  $r < 6 P.E.$ , the value of 'r' is not significant no matter how high r value is i.e. there is no evidence of correlation between the variables.

If  $r > 6 P.E.$ , the value of r is significant i.e. correlation is significant.

The following are the statistics used for the above-defined purpose:

Mean  $\bar{X}$   
Coefficient of Correlation (r)  
probable Error (PE)

Besides that some graph charts and table have been presented to analyze and interpret to finding of the study.

### 3.5.2 Financial tools

Financial tools basically help analyze the financial strength and weakness of a firm. Ratio analysis is a part of the whole process of analysis of financial statements of any business or industrial concerned especially to take output and loan management decision. Ratio analysis is used to compare firm's financial performance and status that of the other forms or to it overtime. Even though there are many ratios of analyze and interpret the financial statement, those ratios that are related to the investment operation of the bank have been covered in this study. The following ratios have been used in this study.

#### **Total Assets to Total Liability Ratio:**

The ratio of total asset to total liability measures the volume of total liability in total assets of the firm. Banks create by the way of lending activities and multiply their assets many lines than their liabilities permit. Thus this ratio measures the bank's ability to multiply its liability into assets.

It is always recommended to have higher ratio of total assets to total liabilities ratio since it signifies overall increase of credit and overall development of a bank.

$$\text{Total Asset to total Liability Ratio} = \frac{\text{Total Assets}}{\text{Total liabilities}}$$

#### **Loans and Advances to total Assets Ratio:**

The ratio of loans and advances to total assets measures the volume of loans and advances in the structure of total assets.

The high degree of this ratio indicates the good performance of bank is mobilizing its funds by the way of lending functions.

$$\text{Loans and Advances to Total Asset Ratio} = \frac{\text{Loan and advances}}{\text{Total Assets}}$$

### **Loan and advances to total Deposit Ratio:**

The ratio shows the percentage of loans and advances that have been granted out of total deposits of bank. higher ratio is preferable for the profitability of the bank. Higher ratio indicates higher use of fund and generating more income.

$$\text{Loans and Advances to Total Deposit Ratio} = \frac{\text{Loan and advances}}{\text{Total Deposit}}$$

### **Investment to Loan and Advance Ratio:**

This ratio measures the contribution made by investment in total amount of loans and advances. The proportion between investment and loan and advances measures the management attitudes towards risky assets and safety assets.

$$\text{Investment to Loans and Advances Ratio} = \frac{\text{Investment}}{\text{Loan and Advances}}$$

### **Interest income to total Loans and advance Ratio :**

When loans are granted it can be performing as well as non performing. Whether it is performing or not is judged by the interest earned by the loans.

$$\text{Interest Income to Total Loans and Advances Ratio} = \frac{\text{Interest income}}{\text{Loans and Advances}}$$

Interest income to total Income Ratio: interest income occupies a greater portion of the total income in a bank. This ratio measures the volume of interest income in total income.

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

## Chapter IV

### PRESENTATION AND ANALYSIS OF DATA

This chapter contains the analysis and interpretation of the available and relevant data of NIBL as a sample bank. Five years data period covering from the fiscal year 2060/61 B.S. to 2064/65 B.S have been analyzed and interpreted as per the research methodology defined in chapter III. To have a deep insight of the loan management in Nepal Investment Bank Ltd. Various steps involved in loan management are discussed. Then the trend analysis of various aspects related to loan management in NIBL is done.

NIBL being a commercial bank, functions in a same way by accepting deposits from the savers and giving loans to the needy people. But before giving loans to any firm, company or project, NIBL makes appraisal and if seemed viable then only grants loan. It provides on various headings like overdraft, term loans, personal loan, hire purchase loan, housing loan etc.

#### 4.1 Analysis of Sector-wise Detail of Loan and Advances:

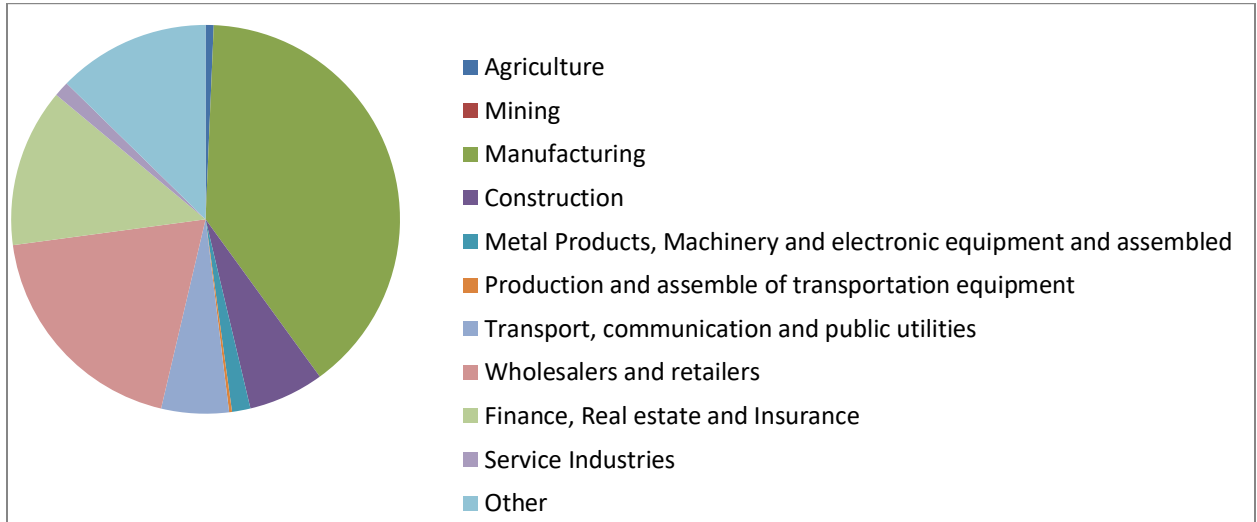
The following table shows the loan amount provided by NIBL in different economic sector

Table No. 4.1  
Analysis of Sector-wise Detail of Loan and Advances  
For the year 2064/065

	Industry/sector	Rs. is million
1	Agriculture	14.27
2	Mining	0
3	Manufacturing	835.37
4	Construction	133.54
5	Metal Products, Machinery and electronic equipment and assembled	32.54
6	Production and assemble of transportation equipment	5.12
7	Transport, communication and public utilities	119.19
8	Wholesalers and retailers	407.77
9	Finance, Real estate and Insurance	279.99
10	Service Industries	26.92
11	Other	269.18
	Total	2752.93

Source NIBL Annual Report 2007/08

Figure No. 4.1  
Sector-wise Detail of Loan and Advances



From the above table we can know that total loan is distributed to different areas. More percentage of loans is given to manufacturing sector i.e. 34% and least to mining and production and Assemble of transportation equipment.

In comparison with other sectors like manufacturing, wholesaler and retailers agriculture sector, the priority sector of the Government of Nepal. Low loan amount. Among various sector listed in the table, agriculture sector has the lower loan amount after production and assemble of transportation equipment industry. This shows that NIBL is not able to flow the loan in agriculture sector in relation to other sectors. It gives more priority to manufacturing sector as well as wholesaler and retailers industries according to the table.

#### 4.2 Analysis of Loans, Advances and Overdraft.

NIBL provides loans on different headings like housing loan, hire purchase loans, loan against pledge etc. The position of loans and advances of NIBL from fiscal year 2060/061 to 2064/065 is presented through table and figure.

Table No. 4.2

Loans, Advances and Overdraft

Rs. In million

Year	Loan and advances	Change in Rs.	Change in %
2060/061	7339	0	0
2061/062	10453	3114	42.44
2062/063	13178	2725	26.06
2063/064	17769	4591	34.83
2064/065	27529	9760	54.93

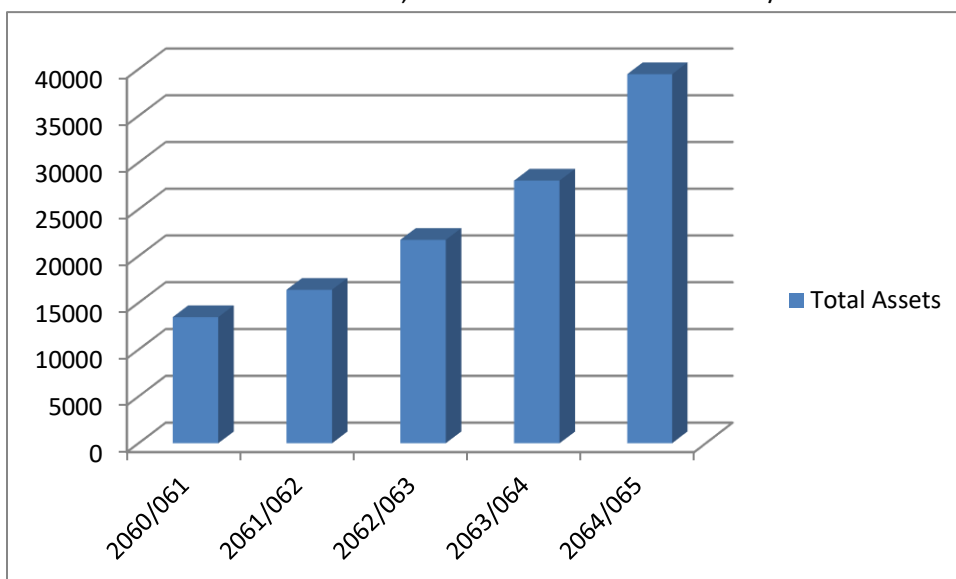
Source NIBL Annual Report 2007/08

The table shows the total loan extended by NIBL. It shows the increment to loan amount in each year. The amount of loans and advances is increasing in each year although change in percentage is fluctuating. This is possible only when there is good loan management.

This can be shown with the help of bar diagram as below.

Figure No. 4.2

Loans, Advances and Overdraft 2060/065



### 4.3 Analysis of Various Ratios

#### 4.3.1 Total Assets to Total Liabilities Ratio:

The ratio of total assets to total liabilities measures the volume of total liabilities in total assets of the firm. Banks create credit by the way of lending activities and multiply their asset many times than their liability permits. Thus this ratio measures the bank's ability to multiply its liability into assets.

It is always recommended to have higher ratio of total assets to total liabilities, since it signifies overall increase of credit and overall development of bank's performance. Higher ratio indicates higher productivity and higher assets conversion and vice versa.

$$\text{Total Asset to Total Liability Ratio} = \frac{\text{Total Assets}}{\text{Total Liabilities}}$$

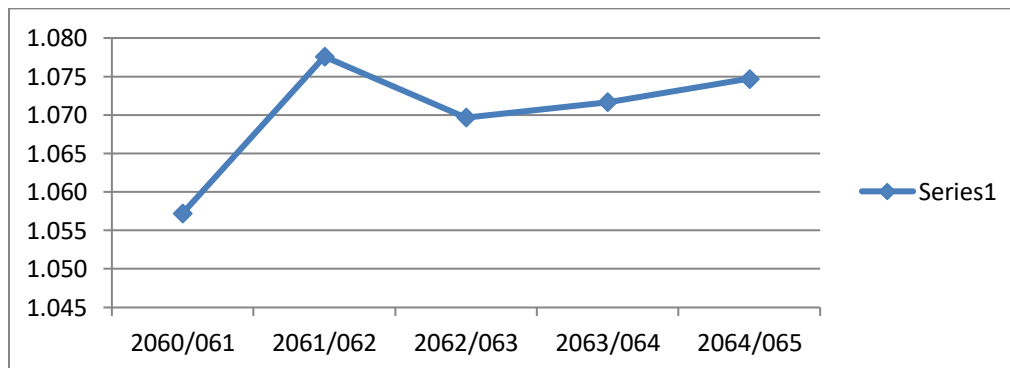
Table No. 4.3  
Total Assets to Total Liabilities Ratio

Rs. in Million

Year	Total Assets	Total Liability Ratio	Ratio
2060/061	13464	12735	1.057
2061/062	16390	15210	1.078
2062/063	21732	20316	1.070
2063/064	28073	26195	1.072
2064/065	39460	36717	1.075

Source NIBL Annual Report 2007/08

Figure No. 4.3  
Total Assets to Total Liabilities Ratio



The above table and figure show the total asset to total liability ratio, the highest ratio of total assets to total liability is considered best which is in the year 2061/062 remaining three years ratios are similar.

#### 4.3.2 Loans and Advances to Total Assets Ratio

Loan and advances of any commercial banks represent the major portion in the volume of total assets. The ratio of loan and advances to total assets measures the volume of loans and advances in the structure of total assets.

The high degree of this ratio indicates the good performance of a bank in mobilizing its fund by the way of lending function. However, in its reverse side, the high degree of this ratio is representative of low liquidity ratio.

Granting the loan and advances always carries a certain degree of risk. Thus, this asset of banking business is regarded as rising asset, low ratio of safety in liquidity and vice versa.

This ratio determined the interaction of risk and return.

$$\text{Loan and advances to total Assets ratio} = \frac{\text{Loan and advances}}{\text{Total Assets}}$$

Table No. 4.4  
Loan and advances to total assets Ratio

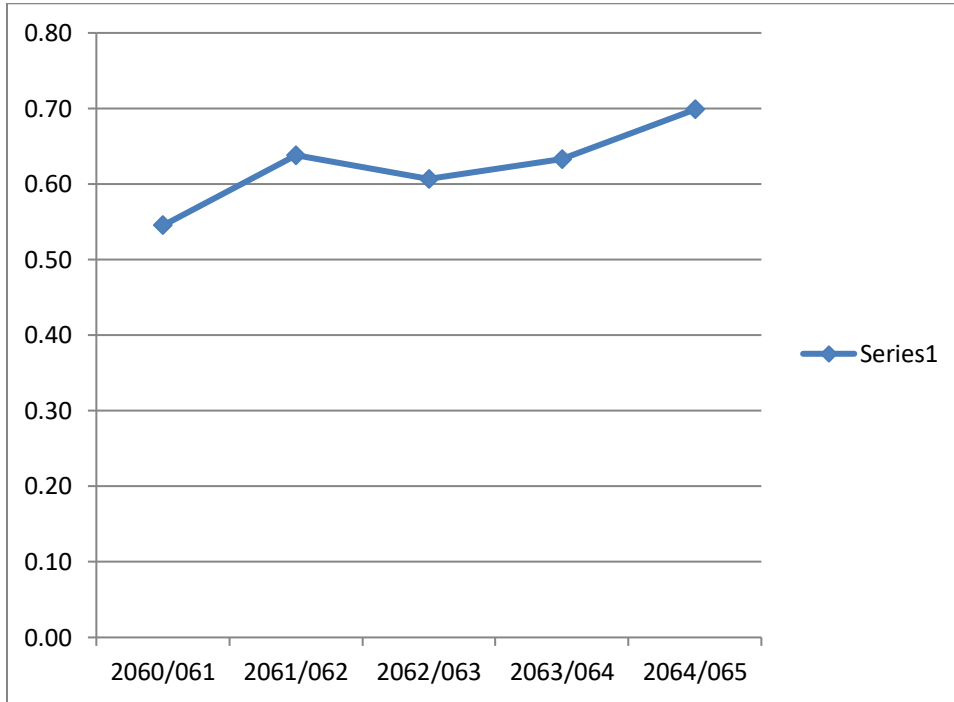
Rs. In million

Year	Loan and Advance	Total Assets	Ratio
2060/061	7338	13463	0.55
2061/062	10453	16390	0.64
2062/063	13178	21732	0.61
2063/064	17769	28073	0.63
2064/065	27529	39406	0.70
Total	76267	119064	0.64
Mean	15253.4	23812.8	0.64

Source NIBL Annual Report 2007/08

From the above figure we can know that the performance of NIBL is good with its mean ratio 0.62. The ratio is higher which indicates the good performance of NIBL in mobilizing its fund by the way of lending.

Figure No. 4.4  
Loan and advances to total assets Ratio



#### 4.3.3 Loans and advances to total deposit:

The ratio shows the percentage of loans and advances that have been granted out of total deposits the bank has higher ratio is preferable for the profitability of the bank. Higher ratio indicates higher use of fund and generating more income.

Loan and advances and investments are the major area of fund mobilization of commercial banks. Loan and advances are the first type of application of funds which have more risk as compared to investment and gives more return, the ratio indicates the firm's fund mobilization power in gross. The main sources of bank's lending and investment is its deposits. This ratio measures how well the deposits have been mobilized.

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

Table No. 4.5  
Loans and advances to total deposit ratio

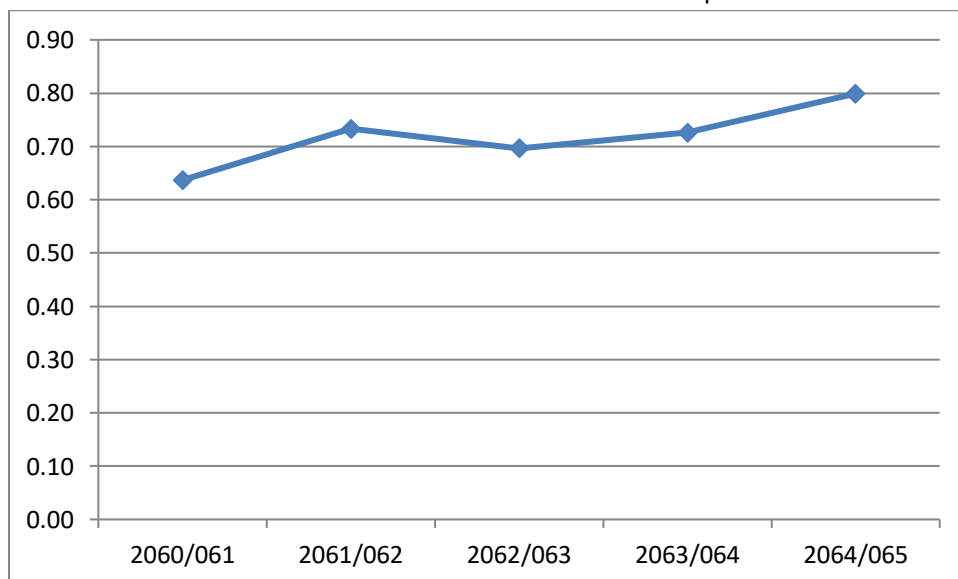
Rs. In million

Year	Total loans & advances	Total Deposit	Ratio (%)
2060/061	7339	11525	0.64
2061/062	10453	14254	0.73
2062/063	13178	18927	0.70
2063/064	17769	24488	0.73
2064/065	27529	34452	0.80
Total	76268	103646	3.59
Mean			0.72

Source NIBL Annual Report 2007/08

This ratio is employed to measure the bank's ability to utilize its deposits in terms of granting loans and advances. Higher the ratio higher the utilizing of deposit and higher the chance to make more profit. The table and diagram 4.4 show that the ratio is higher in the year 2064/065. It means that, in the year 2064/065 the bank has utilized the higher deposit. The more decreasing trends of loan and advances the possibility of less income of a bank.

Figure No. 4.5  
Loans and advances to total deposit ratio



#### 4.3.4 Investment to Loan and Advance Ratio

This ratio measures the contribution made by investment in total amount of loans and advances. The proportion between investment and loan and advances measures the management attitudes towards risky assets and safety assets.

Here, the total mobilized fund i.e. investment and loan and advances in whole does not provide the quality of assets that a bank has created. Thus it measures the risk of banking business too. The high ratio indicates the mobilization of fund in safe area and vice-versa, However, safety does not provide with satisfactory return. So a compromising ratio between risk and profit should be maintained.

$$\text{Investment to Total Loan \& Advance Ratio} = \frac{\text{Investment}}{\text{Loan and Advances}}$$

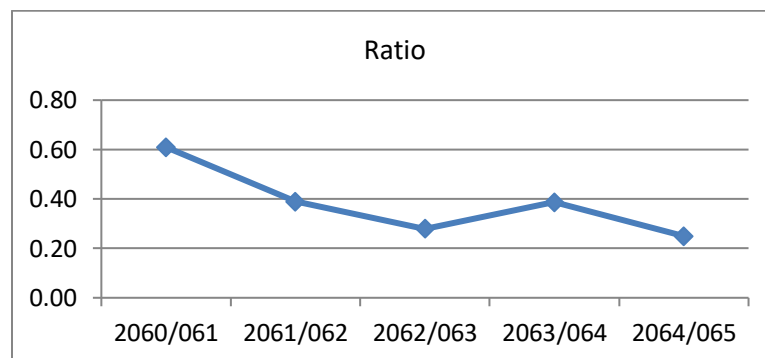
Table No. 4.6  
Investment to Total Loan & Advance Ratio

Rs. in million

Year	Loan and Advance	Investment	Ratio
2060/061	7338	4472	0.61
2061/062	10453	4074	0.39
2062/063	13178	3673	0.28
2063/064	17769	6868	0.39
2064/065	27529	6874	0.25
Total	76267	25961	2.94
Mean	15253.4	5192.2	0.59

Source NIBL Annual Report 2007/08

Figure No. 4.6  
Investment to Total Loan & Advance Ratio



The above table and figure show the ratio of investment to total loans and advances. Since, this ratio measures the contribution made by investment. The trend of the ratio is fluctuating the high ratio i.e. 0.57 in the year 2060/061 shows that the bank has mobilized its fund in safe area at that year.

**4.3.5 Interest Income to total loans and advance Ratio:**

When loans are granted it can be performing as well as non-performing and whether it is performing or not is judged by the interest earned by the loans. So, to arrange whether the loan is performing or not can be viewed from the following table and figure.

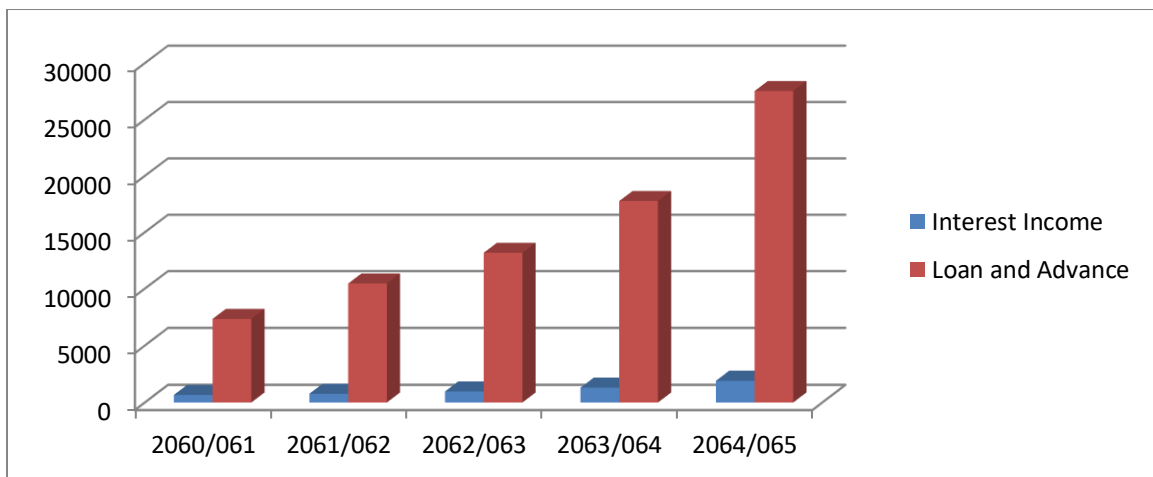
$$\text{Interest Income to Total Loans and advance Ratio} = \frac{\text{Interest Income}}{\text{Loans \& Advances}}$$

Table No. 4.7  
Interest Income to total loans and advance ratio  
Rs. in million

Year	Interest Income	Loan and Advance	Ratio %
2060/061	663	7338	9.04
2061/062	769	10453	7.36
2062/063	964	13178	7.32
2063/064	1302	17769	7.33
2064/065	1907	27529	6.93
Total	5605	76267	

Source NIBL Annual Report 2007/08

Figure No. 4.7  
Interest Income to total loans and advance ratio



The ratio shows the percentage of interest earned from loans and advances. The higher ratio is preferable for the profitability of the bank. Higher ratio indicates the higher utilization of fund in loans and advance and income from it.

From the above table and figure, it is clear that both the loan amount and interest income is increasing simultaneously. It indicates that all loans are performing loans, which earns interest in regular basis. This is possible due to Nepal Investment Bank's systematic credit policy only. In the year 2064/065 the ratio has decreased it means that the loan is not performing well.

#### 4.3.6 Interest Income to Total Income Ratio

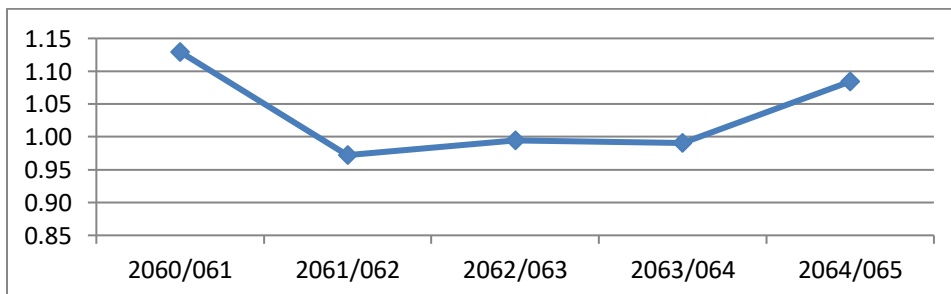
Income is one of the most important factors of each and every organization. Interest income occupies a greater portion of the total income in a banking business. This ratio measures the volume of interest income in total income. The high ratio indicates the high contribution made by lending and investment whereas low ratio indicates low contribution made by lending and investment in total income.

Table No. 4.8  
Interest Income to Total Income Ratio  
Rs. in million

Year	Interest Income	Total Income	Ratio
2060/061	663	587	1.13
2061/062	769	791	0.97
2062/063	965	970	0.99
2063/064	1302	1314	0.99
2064/065	1907	1758	1.08
Total	5606	5420	

Source NIBL Annual Report 2007/08

Figure No. 4.8  
Interest Income to Total Income Ratio



From the above table and diagram, the ratio is higher in the year 2060/061 i.e. 1.087 it means that there is high contribution made by lending and investment. Similarly the ratio is lower in the year 2061/062, which indicates low contribution made by lending and investment in total income.

#### 4.3.7 Loan Loss provision to Loan and Advance Ratio

Provision for loan losses has been made in accordance with Nepal Rastra Bank's directives.

Provision for loan losses have been deducted from the loan and advances as for the directives of Nepal Rastra Bank and accordingly loan & advances net of provision has been presented in the balance sheet.

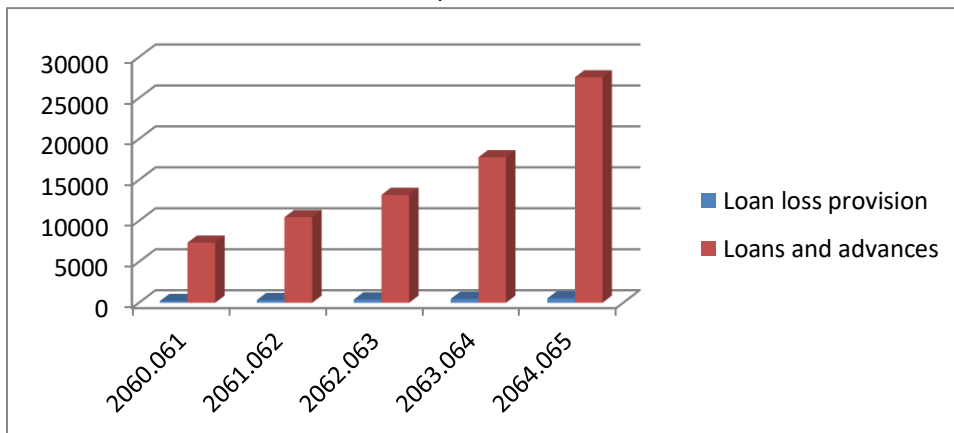
While writing off of bad debts it will be charged to profit & loss account and provision made for the same will be written bank as per NRB directives

Table No. 4.9  
**Loan loss Provision to Loan and Advance Ratio**  
 Rs. in million

Year	Loan loss provision	Loans and advances	Ratio
2060/061	208	7338	0.028
2061/062	327	10453	0.031
2062/063	401	13178	0.030
2063/064	482	17769	0.027
2064/065	532	27529	0.019

Source NIBL Annual Report 2007/08

Figure No . 4.9  
 Loan loss provision to loan and Advance Ratio



The above table presents the loan loss provision to total loan of NIBL for the study period of 2060/061 to 2064/065 of the financial sector reform program. The ratio for the study is 0.028 which means loan loss provision is 0.028 of the total loan. The trend of total loan is increasing while the trend of loan loss provision is increase.

According to the general standard banks should make higher percentage of provision for the non performing loan. NRB has directed the commercial banks to maintain the level, based on the quality of the loan. The loan loss provision helps to overcome the unnecessary burden of non performing assets.

#### 4.3.8 Non-performing Loan to Total Loan and Advances Ratio

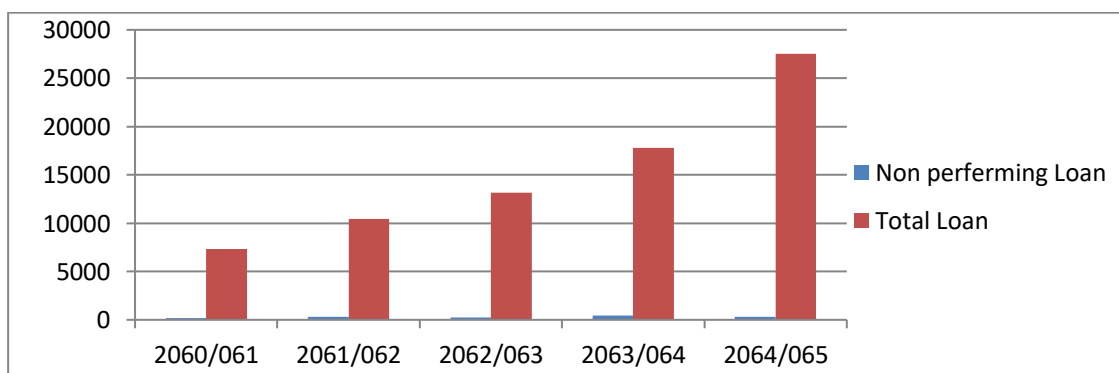
The ratio measures the proportion of non performing loan to the total volume of loss and advances. Non performing loans include provision made for sub-standard, doubtful and loss loan. Thus, this ratio is the aggregate ratio of sub-standard, doubtful and loss loan. The high ratio indicates the bad performance of the bank in mobilizing loans and advances and bad recovery rate and vice versa. This ratio is computed dividing NPL by total loans and advances.

Table No. 4.10  
Non performing Loan to Total Loan and Advances Ratio  
Rs. in million

Year	Non-performing Loan	Total Loan	Ratio
2060/061	181.43	7339	0.025
2061/062	281	10453	0.027
2062/063	272	13178	0.021
2063/064	421	17769	0.024
2064/065	309	27529	0.011

Source NIBL Annual Report 2007/08

Figure No. 4.10  
Non performing Loan to Total Loan and Advances Ratio



The table shows that the ratio is higher in F/Y 2061/062 and lower ratio in F/Y 2064/065 in fluctuating trend. The fluctuating trend of ratios shows the satisfactory mobilizing of loans and advances.

#### 4.4 Analysis of correlation between Loan and Deposit

It is also one of the major parts of loan management to see that there is positive relation between loan and deposit or not, so to analyzed such relation the statistical tool named correlation can be used, which defines the change in the value of one variable due to the change in the value of other.

Correlation co-efficient helps to measure the relationship between two variables, It is denoted by 'r'

if  $r = 1$ , the variables are perfectly co-related .

if  $r = 0$ , they are not related.

if  $r < 1$ , the relation id perfectly negative (negatively co-related)

Table No. 4.10  
Correlation between Loan and Deposit of NIBL

Rs. in million		
Year	Loan (x)	Deposit (y)
2060/061	7339	11524
2061/062	10453	14254
2062/063	13178	18927
2063/064	17769	244889
2064/065	27529	34452
Correlation (r)		0.99
Probable Error (P.E.)		0.006

Source NIBL Annual Report 2007/08

Decision :

As  $r = +0.99$  there is high degree of positive relationship between loan and deposit or we can say that loan and deposit is highly correlated with each other. It means that there is optimum utilization of deposit fund in the bank.

Probable error is the measurement of testing the reliability of computer value of correlation (r), since r is greater than 6P.E. i.e. 0.036 (0.99>0.36) calculated value of r is significant.

#### 4.5 Correlation between Non Performing Loan and Net Profit

Correlation coefficient between NPL and net profit measures the degree of relationship between these two variables. In this analysis, non performing loan is independent variable and net profit is dependent variable. The main reason of computing 'r' between these two variables is to find out whether the net profit is significantly correlated with non performing loan or not.

Table No. 4.11  
Correlation between Non Performing Loan and Net Profit

Year	Non performing Loan	Net Profit
2060/061	181.43	152
2061/062	281	232
2062/063	272	330
2063/064	421	501
2064/065	309	698
Correlation (r)		0.67
P.E.		0.16

Source NIBL Annual Report 2007/08

From the above table we found the value of  $r = +0.67$  which means that there is positive relationship between NPL and Net profit, and the probable error with the help of r it is possible to determine the reliability value of coefficient of correlation. Since  $r < 6P.E.$  which indicates that 'r' is not significant.

#### 4.6 Major Findings of the Study

By analyzing the sector-wise details of loans and advances of NIBL, it has contributed lesser percentage of loan to the priority sector of government i.e. agriculture. The bank has provided only 14.27 million loan to the agriculture sector. It is lesser in comparison with manufacturing and wholesalers and retailers.

NIBL is increasing loan amount in each year but increasing rate is fluctuating.

From the analysis of loans and advances to total deposits ratio, in the year 2064/065 the bank has utilized higher deposit.

From the analysis of loan and advance to total assets ratio, the performance of NIBL is good with its mean ratio. The ratio is higher which indicates the good performance in mobilizing its fund by the way of lending. In the year 2061/062 the ratio of total assets to total liability is higher which is considered as vest.

By analyzing investment to loan and advance ratio, in the year 2060/061 the ratio is higher i.e. 0.57 which indicates that the bank has mobilized its fund in safe area at that year.

In the year 2064/065 the ratio of interest income to loans and advances has decreased which means that the loan is not performing well.

Interest income to total income ratio indicates that there is high contribution made by lending in the year 2060/061 and low in the year 2061/062.

Non performing loan to total loan and advance ratio shows the satisfactory mobilizing of loans and advances.

By analyzing the correlation between loan and deposit, there is optimum utilization of deposit fund in the bank.

## Chapter V

### SUMMARY, CONCLUSION AND RECOMMENDATIONS

This is the final chapter of this thesis, which has been divided into summary, conclusion and recommendations. In this chapter, we examine the processed data to come into new concluding upon the performance of these commercial banks individually and with comparatively. It also aims to give forth some suggestion that must be helpful for further enhancement of the lending operation and practices of the sampled bank i.e. NIBL.

#### 5.1 Summary:

The first chapter of the study dealt about basic introduction of the study. It highlighted the concept and significance of the study. It has also presented research problems, objective of the study and background of the study. Lastly it discusses about the limitations of the study.

Second chapter helped the researcher to provide knowledge about the development and progress made by the earlier researchers on the concerned field or topic of the study. It helped to know the research work undertaken by them. Moreover, it summarized the previous findings of the study to provide knowledge about the background of the work done by them. Lastly an attempt id made to review the findings of the study related to the concept.

Third chapter discussed about various research methodologies used for the study. Basically, research methodology here signifies research design, sources of data, population and sample of data, data collection methods and tools used for analysis of data.

Fourth chapter of the study dealt about data presentation and analysis. It first presented the generated data in tabular form and analyzed it systematically as per the objectives mentioned above data were analyzed through figure also wherever necessary. The researcher tried to analyzed loan management of NIBL through certain ratio calculation.

The sector wise details of loans and advances indicated that, NIBL has contributed lesser percentage of loan to the priority sector of the government i.e. agriculture.

Loans and advances and total deposit ration measured the bank's ability to utilize its deposits in terms of granting loans and advances. The bank has utilized higher deposit in the year 2064/65.

Loans and advances to total assets ratio measured the performance of bank, which indicated the good performance in mobilizing its fund by the way of lending.

In the year 2060/61, the bank has mobilized its most of the fund in safe area after that it has mobilized in risky area also.

In the year 2064/65 the ratio of interest income to loans and advances has decreased. Similarly in the year 2060/61, interest income to total income ratio is high in the year 2060/61.

Non performing loan has decreased in the year 2064/65 although the amount of total loan is increased. NPL to total loan ratio has showed the satisfactory mobilizing of loans and advances.

## **5.2 Conclusion**

Most of the Nepalese commercial banks have still lack of effective credit policy for loan management. However it is necessary to access the appropriate credit policy in commercial banks for performance effectiveness.

After conducting a thorough study of loan management of NIBL, it can be concluded that NIBL is able to perform the loan management satisfactorily till date. All the aspects of loan approval to loan settlement have been paid due attention. The loan asset of NIBL is increasing during the study period of five years. It also increases its lending capacity.

The reason of fluctuation in the interest income on loan and advances is the fluctuation in the interest rate itself. A decline in the interest income to loan and advances is not a good sign for a commercial bank.

Positive correlation between total deposit and loan and advances is a good sign until the deposit follows an increasing trend. But once the total deposit suffers decline, loans and advances will also be adversely affected.

The total loan loss provision of banks shows that the bank is safe in case of non-repayment of loan since there is adequate provision. But at the same time it is not possible to rule out the fact that a higher loan loss provision reflects the inefficiency of management.

Higher non performing loans to total loan and advances ratio show the less effective performance of bank.

### **5.3 Recommendations**

'Most major banking problems have been caused by weaknesses in loan management. Banks should now have a keen awareness of the need to identify measure, monitor and control credit as well as to determine that they hold adequate capital against these risk that they are adequately compensated for risks incurred. Over the past year, banks have seen a pronounced rise in non-performing assets as certain segments in their portfolios continue to deteriorate. With such great exposures come the needs for even greater safety measures. A sound application of these measures, combined with enhanced measuring, pricing and managing credit can provide enormous business benefits.

While substantial progress has been made in solving individual aspects of loan management problem, the development of a consistent framework for managing all sources of credit risk has been much slower to evolve. In fact, even the most sophisticated financial institutions have yet to integrate the disparate components of loan that are needed to support consistent risk and reward management on an enterprise-wide basis.'

There is no doubt that an effective management is must for all banking function. However, it is more important for lending function of commercial banks. Based on the conclusions derived from the study of loan management NIBL, the bank is suggested to work in the light of following recommendation:

Total loan loss provision of the bank shows that the bank is safe in case of non repayment of loan. But at same time it is not possible to rule out the fact that a higher loan loss provision reflects the inefficiency of management. In the year 2064/65, the ratio of Interest income to loan has decreased although the amount of loan loss provision has increased so the bank is recommended to manage the loan loss provision.

Low level of lending in agriculture sector constitutes the low level of investment resulting in low level of productive and employment generation and this cause slack of economy since agriculture is the main and priority sector of Nepalese Economy. Thus NIBL is recommended to give extra priority on productivity and priority sector loan.

The bank should always threatened by the fear of default while in vesting maximum amount of its funds in risky assets (i.e. loan). Thus the bank is recommended to divert some amount of its funds from lending and invests it in less risky investment alternatives. This will help the bank diversity the risk.

The bank should provide the facility of interest rate rebate to the borrower who repays the loan before stipulated time. This may help to increase the number of early payers that will help in reduce default risk.

The bank should conduct a market research program on a periodic basis for the effective loan management.

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