

# **CHAPTER-I**

## **INTRODUCTION**

### **1. General background**

The pace of development of country depends merely upon the level of economic development. Economic development depends upon capital formation and its proper utilisation. “Economic development depends upon transformation of saving into the production investment. Capital formation leads to increase in the national output, income and employment solving the problem of inflation and balance of payment and making the economy free from the burden of foreign debt. Domestic capital formation helps in making a country self-sustainable”. For this reason, financial institution is necessary.

Financial institutions collect scattered saving of the country and invest them into the most desirable and high yielding sectors of the economy to fuel the process of economic development. It has been well established that the economic activities of any country can hardly be carried forward without the assistance and support of financial institutions. The development of the country is possible only when financial services reach each and every corner of the country. Commercial banks are major financial institutions, which occupy an important place in the framework of every economy because they provide capital for the development of industry, trade and business and other resource deficit sectors by investing the saving collected as deposits. Commercial banks are the heart of our financial system. They hold the deposits of millions of persons, government and business units. They make funds available through their lending and investing activities to borrowers-individuals,

business forms and governments (Reed, Cotter, Gill and Smith, 1976).

They are media through which monetary policy is affected. Commercial banks play an important role in directing the affairs of the economy in various ways. The operations commercial banks record the economic pulse of the economy. They have played a vital role in giving a direction to economy's development overtime by financing the requirements of trade and industry in the country. They grant loans in the form of cash credits and overdrafts. Apart from financing, they also render services like collection of bills and cheques, safe keeping of variables, financing advising, etc. to their customers. So, we cannot deny the role of a bank plays in developing an economy.

Every bank formulates and investment policy statement in order to define the objectives of bank's liquidity management and investment portfolio. Investment policy is one fact of the overall range of policies that guides banks' investment operation. There are two types of funds for investment i.e. capital and deposits and deposits constitute the major portion for its investment purpose. The investment policy of banks is highly influenced by the nature of funds available for its investment.

A healthy development of any bank depends upon its investment policy. A sound and viable investment policy can be effective one to attain the economic objectives which is directed towards the acceleration of the pace of development. A sound investment policy of a bank is such that its funds are distributed on different types of assets with good profitability on the one hand and provides maximum safety and security to the depositors and banks

on the other hand. There are five basic principles which commercial bank follows while making loans and advances. They are liquidity, profitability, safety and security, suitability and dispersal.

Investment is the major decision of commercial banks. It involves the decisions of capital or commitment of funds to long term assets that would yield benefit in future. The features of investment decisions are profit, risk, speculation and wealth, the future benefit of investment is uncertain and so cannot be predicted easily. Thus, investment decision should be evaluated in terms of return and risk. Good investment policy should ensure maximum return and minimum risk. Good investment policy ensures maximum amount of investment to all sectors with proper utilization. The proper investment policy help the bank to make profitable investment which help in the development of a country as well as to achieve the objectives of profit making.

### **1.1 Origin and development of commercial banks**

In the context of Nepal, the development of banking is relatively recent. The record of banking system in Nepal gives detail account of mixture of slow and steady evolution in the financial and global economy of Nepalese life. Involvement of landlords, rich merchants, the goldsmiths and moneylenders conducted the lending and borrowing activities.

Though establishment of banking industry was very recent; some crude bank operations were in practice even in the ancient times. During 8<sup>th</sup> century, Gunkamdev had borrowed money to rebuild the Kathmandu Valley. In 11<sup>th</sup> century, during Malla

regime, there was evidence of professional money lenders and bankers. The establishment of the Tejerat Adda during the year 1877 AD helped the general public to provide credit facilities at a very low rate of 5%. Crude banking operation started in 1879 AD after Shankadhar, a merchant of Kantipur, announced “Nepal Sambat” after having paid all the outstanding debts in the country. In order to remove all inconveniences in past time, a systematic step was implemented.

Nepal’s modern banking system had begun with the establishment of the first commercial bank and first bank of Nepal i.e. Nepal Bank Ltd on 30<sup>th</sup> Kartik, 1994 B.S. However, its activities were confined to deposit mobilization and commercial wending. With the increasing need of the economy, Nepal Rastra Bank was set on 14<sup>th</sup> Baisakh 2013 B.S. as the Central Bank of Nepal. Besides proving banking services, commercial bank provides industrial term loans and short working capital to business and industrial enterprises. Nepal Bank Ltd. and Rastra Banijya Bank are the two biggest indigenous commercial banks with a wide network of branches in the country.

In modern times, commercial banks, which are facilitated, regulated and supervised by the Central Bank, confined them and concentrated in their activities of fulfilling the financial needs of their customers. As per the Commercial Bank Act 2013 BS. A commercial bank means the bank which deals in exchanging currency, accepting deposits, giving loans and doing commercial transactions. According to American Institute of Banking, commercial bank is corporation which accepts demands deposits subject to cheque and makes short-term loans to business

enterprises, regardless of the scope of its other services. In order to promote banking sectors, government adopted open economic policies and allowed the entry of foreign bank on joint venture basis with a maximum of 50% equity shareholders. NABIL Bank Ltd was the pioneer bank to set up under such arrangement in Nepal. The arrangement was followed by the establishment of other commercial banks.

## **1.2 Functions of commercial banks**

The functions of commercial bank can be hardly defined. The prime function is to collect scattered idle money from general public as deposits and charge a certain amount of interest by lending the fund to trade and industries. It also provides other banking services and assistances to its customer, ex. Agency banking services, transfer of fund, discounting bill of exchange, exchanging foreign currencies, overdraft facilities, letter of credit facilities, underwriting of securities, etc. Major functions of commercial bank are as follows:-

### **1. Accepting deposit**

Commercial banks accept deposit from general public in different type of accounts. They are current account, saving account and fixed deposit account.

#### **a. Current account:**

A current account is running account with amounts being paid into and drawn out of the account continuously. This is also called the demand deposit, which never becomes time-barred. Banks do not pay any interest on credit balance on this account. Any balance below minimum will be liable to incidental charges. The minimum balance and the charges shall be as determined by the bank time to time.

**b. Saving account:**

A saving account is mainly meant for non-trading customers who have some potential for saving and don't have numerous transactions entering their accounts. The normal rate of interest is provided in this account and clients are restricted to freely operate their accounts by some rules such as maintaining minimum balance. Any balance below minimum will be liable to incidental charges as fixed by the bank time to time, which may differ from one bank to another.

**c. Fixed deposit:**

A fixed deposit constitutes a very important resource for bank as bank need not keep greater reserve in respect of such deposit. As per the regulation of NRB, different banks follow different interest policies having regard to the size of deposits held by them. These are deposited by the customers for a fixed period of minimum 14 days and maximum no time limit. This is withdrawn on maturity and not on demand, so it is also known as time deposit.

**2. Advancing loan**

Banking performs the function of loan to the needy. The needy may be any individual or other institution. Banks provide various types of loans such as overdraft, priority sector loan, importers loan, deprived sector loan, hire purchase loan, pre-export loan, direct loan with collateral, term loan, discounting bills of exchange, loan against fixed deposit, working capital loan, loan on government bond, etc.

**3. Agency services:**

Bank performs various functions as an agent on behalf of its clients. Under these services, it performs the services such as collection of cheque, fund transfer, payment of cheque, bills and

promissory note, security brokerage services, letter of credit and guarantee, receipt of payment of certain dividend and interest, etc.

#### **4. Miscellaneous services:**

The additional functions of bank are assurances of traveler's cheque, safe deposit locker service, collection of trade information, financial advisory service, credit creation, etc.

## **2. Profile of concerned bank**

In this chapter, it has been discussed about the profiles of concerned banks. These profiles are related to the establishment, objectives, capital structure and facilities granted by the concerned banks.

### **NABIL Bank Limited (NABIL)**

One of the well known commercial banks of Nepal can be named as the NABIL Bank Limited, which commenced its operations on 12<sup>th</sup> July 1984 AD as the first joint venture bank in Nepal. Its main objective is to provide facility to the customers by giving loans on commerce and industry. Dubai Bank Ltd was transferred to Emirates Bank International Ltd, Dubai by virtue of its annexation with the later. Later on, Emirates Bank International Ltd sold its entire 50% equity holding to National Bank Ltd, Bangladesh. NABIL started knocking the doors of the customers breaking the trend of knocking the door of bank by the customers. NABIL had the official name Nepal Arab Bank Ltd till 31<sup>st</sup> December 2001.

The bank has been functioning with a total network of 28 branches across the country. There are 7 branches in Kathmandu at Kantipath, Kamalidi, New Road, Jorpati, Thamel, Maharajgunj and

Credit Card Counter at Tribhuvan International Airport & Thamel. It has branches in Birgunj, Parsa, Biratnagar, Itahari, Butwal, Rupandehi, Pokhara, Bhairawaha, Nepalgunj, Dharan, Narayangadh, Baglung, Tulsipur, Ghorahi, Dhagadhi, Mahendranagar, Damak and Birtamod.

NABIL provides a full range of commercial banking services through its 10 points of representation across the kingdom and over 170 reputed correspondent banks across the globe. It is the only bank having its presence at Tribhuvan International Airport. The success of NABIL is a milestone in the banking history of Nepal as it paved the way for the establishment of many commercial banks and financial institutions. NABIL has a high prestige in the market for its highly personalized services to the customers. It is the pioneer in introducing many innovative products and marketing concept in banking sector of Nepal. It is Customer oriented, Result oriented, Innovative, Synergistic and Professional (C.R.I.S.P). “The Banker”, the publication of the Financial Times, London, has honoured the NABIL as “Bank of the year 2004” and it is a matter of prestige to be a leading bank of the country.

### **Mission Statement**

To be the “Bank of 1<sup>st</sup> Choice”

### **Values**

Customer Focused, **R**esult oriented, **I**nnovative, **S**ynergistic and **P**rofessional

### **Promise**

To always be “Your Bank at Your Service”



## Present capital structure of NABIL

Table 1 shows the present capital structure of NABIL. Authorized capital, of NABIL is Rs1, 600million, whereas issued capital and paid up capital both are Rs689, 216,000

**Table 1**  
**Present Capital Structure of NABIL**

| PARTICULAR                                                  | AMOUNT           |
|-------------------------------------------------------------|------------------|
| <b>Share Capital</b>                                        |                  |
| ➤ Authorized capital:16,000,000ordinary share of Rs.100each | Rs.1,600.000,000 |
| ➤ Issued Capital:6,892,160 ordinary share of Rs.100each     | Rs689,216,000    |
| ➤ Paid up Capital6,892,160 ordinary share of Rs.100each     | Rs689,216,000    |

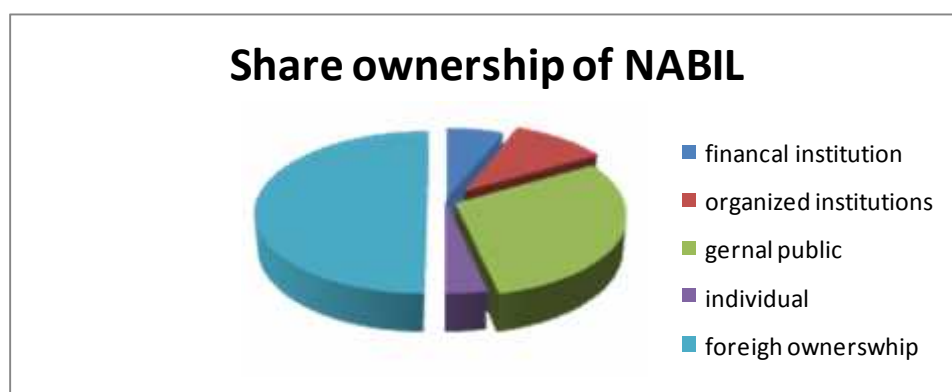
## Share ownership of NABIL

Table 2 and figure 1 show the share ownership of NABIL50 % of shares is owned by local owners. Among this ownership, 6.15% of share is owned by financial institutions and 10.42%of share is owned by others entities, 3.44% of share is owned by individual and 30% of shares are owned by general public. Remaining50% of shares is owned by foreign bank.

**Table 2**  
**Share ownership of NABIL**

| Share ownership            | Percentage | Percentage |
|----------------------------|------------|------------|
| 1. Local ownership         |            | 50%        |
| 1.1 Nepal Government       | -          |            |
| 1.2 Commercial Banks       | -          |            |
| 1.3 Financial Institutions | 6.15%      |            |
| 1.4 Organized Institutions | 10.42%     |            |
| 1.5 General Public         | 30%        |            |
| 1.6 Individual             | 3.44%      |            |
| 1.7Others                  | -          |            |
| 2. Foreign ownership       |            | 50%        |
| <b>Total</b>               |            | 100%       |

**Figure 1**  
**Share ownership of NABIL**



### **Facilities granted by NABIL**

Various facilities (products & services) have been provided by NABIL. It provides loan as Bills discounting facility under supplier's credit, Import/Export loan, and Hire purchase. Project finance, Consortium / Syndication loan, Mortgage loan, Loan against deposit and Govt. securities, Housing finance, Auto finance, NABIL property, and Personal finance. It receives deposits as Current, Call, Time, Normal savings, and Provident fund, Retirement fund. Similarly, it is also serving for Trade finance, Remittance facilities, cards & ATMs, E-Banking; Clean bills etc. others facilities are U.S. VISA fee, Safe deposit locker, Balance certificate and Advance Payment Certificate.

### **Himalayan Bank Limited (HBL)**

Himalayan Bank Limited was incorporated in 1992 AD by a few distinguished business personalities of Nepal in partnership with Employees Provident Fund and Habib Bank Limited, one of the largest commercial bank of Pakistan. Banking operation commenced from January 1993. It is the first commercial bank of Nepal whose maximum shares are held by the Nepalese private sector. Besides

commercial banking services, the bank offers industrial and merchant banking services.

The bank has been functioning with a total network of 19 branches across the country. There are 6 branches in Kathmandu Valley at the following locations: Thamel, New Road, Maharajgunj, Pulchowk, Suryavinayek and Card centre in Pulchowk. In addition, it has branches in Banepa, Tandi, Bharatpur, Birgunj, Hetauda, Bhairahawa, Biratnagar, Pokhara, Dharan, Butwal, Nepalgunj, Itahari and palpa. It is aggressively opening new branches at different parts of the kingdom to serve its customer better.

HBL is always committed to providing a quality service, with a personal touch, to its valued customers. The bank offers modified facilities to its clients to meet unique needs and requirement. It had adopted the latest banking software Globus on IBM platform. It cannot improve its service level but also can prepare for future adaptation to new technology with an identical Disaster Recovery System, offsite.

### **Mission Statement**

To become the preferred provider of quality financial services in the country

### **Vision**

To become a leading Bank of the country by providing premium products & services

### **Objectives**

To become the bank of first choice

### **Present capital structure of HBL**

Table 3 shows an idea about the present capital structure of HBL. Authorized capital, of NABIL is Rs1, 000 Million, whereas

issued capital and paid up capital both are and Rs.810, 810,000 respectively.

**Table 3**  
**Present Capital Structure of HBL**

| <b>PARTICULAR</b>                                           | <b>AMOUNT</b>    |
|-------------------------------------------------------------|------------------|
| Share Capital                                               |                  |
| ▪ Authorized capital:10,000,000ordinary share of Rs.100each | Rs.1,000,000,000 |
| ▪ Issued Capital:81,08,100 ordinary share of Rs.100each     | Rs.810, 810,000  |
| ▪ Paid up Capital: 81,08,100 ordinary share of Rs.100each   | Rs.810, 810,000  |

### **Share ownership of HBL**

Table 4 and figure 2 indicate that the local owner's covers 80% of total shares is HBL. Among this ownership, 14% of share is owned by financial institutions, 51% shares are owned by others entities and 15 % of shares are owned by general public. Remaining 20 % of shares are owned by foreign bank.

**Table 4**  
**Share ownership of HBL**

| <b>Share ownership</b>     | <b>Percentage</b> | <b>Percentage</b> |
|----------------------------|-------------------|-------------------|
| 1. Local ownership         |                   | 80%               |
| 1.1 Nepal Government       | -                 |                   |
| 1.2 Commercial Banks       | -                 |                   |
| 1.3 Financial Institutions | 14%               |                   |
| 1.4 Organized Institutions | 51%               |                   |
| 1.5 General Public         | 15%               |                   |
| 1.6 Others                 | -                 |                   |
| 2. Foreign ownership       |                   | 20%               |
| <b>Total</b>               |                   | 100%              |

**Figure 2**  
**Share ownership of HBL**



### **Facilities granted by HBL**

HBL is providing loan/credit facilities such as overdraft loans, demand loans, time loans, trust, receipt loan, fixed term, project financing, revolving cash credit, packing credit, post shipment, personal loan, loan against fixed deposit, counter guarantee, letter of credit (sight/issuance), bid bond, performance bond, advance payment guarantee, hire purchase loan, housing loan, flexi (subidha loan). It receives deposits as current, normal savings, call, fixed term, accidental death insurance, and PSA scheme. Other facilities provided by HBL are funds transfer, HBL credit card facilities, letter of credit service, SMS banking, etc.

### **3. Focus of the study**

This study focuses on the investment policy adopted by the commercial banks. With regard to investment policy of a commercial bank, they follow five basic principles while making loans and advances.

The main focus of the study is to make comparative study of NABIL and HBL regarding financing performance in term of liquidity, asset and management, profitability and risk. It also

focuses on fund mobilization and investment policy. The period of the study is 7 years i.e. from fiscal year 2000/2001 to 2006/2007.

#### **4. Statement of problems**

Investment is the backbone of economic development of the country. The increasing number of the banks due to liberalization of economic sectors is a good indication of economic growth. At the same time, it creates challenge to the commercial banks as it is also an indication of increasing competition among the banks of Nepal. Domestic commercial banks are facing maximum competition than joint venture foreign banks due to their nature of work and social responsibility.

The traditional of capital market i.e. investment, banking, stock exchange, mutual funds, market makers, etc. is also a serious threat to the activity of commercial banks in Nepal. Banking market in any country is determined by a number of factors like political, economic and social. However, it is also influenced by economic development, real economic growth, banking awareness, growth of population, international activity of bank in the country, level of urbanization, etc.

Commercial banks accumulate their funds by accepting deposit such as current, saving and fixed. They also raise capital by issuing shares. One of the most important problems in the banking industry is industry is investing its deposits and capital in various forms of earning assets. This is also known as the portfolio management. Since there are two types of funds for investment i.e. capital and deposits, and deposits constitutes the major portion for its investment purpose, the investment policy of bank is highly influenced by the nature of funds available for its investment. So,

the basis of loan portfolio depends on the deposits mix it has. If the funds are of permanent nature, the chances of acquiring profitable assets are high. On the contrary, if the funds are of short term nature, the banks must also give full attention for its liquidity position than its investment. As a result, chances of earning profit are always at risk. The investment policy must be such that it ensures that it is sound and prudent in order to protect public funds. The environment in which the bank operates influences its investment policy.

Bank in Nepal generally acted as depositories and lent such savings to need investors who are acceptable to them to certain criteria. They are guided by the objectives of profit maximization which in turn depended on the ability to ensure the maximization which in turn dependent on the ability to ensure the maximization of community's savings flowing through banking and lending such funds to investors who would safely and efficient use them. Therefore, they are active in developed regions. The majority of banking institutions are concentrated in urban areas. In such a situation, it has been a must for those institutions to search for new possible areas of investment. Investment policy is the main factor for the every banks and financial institutions. Thus the study will try to explain the following points specially related to the investment function of NABIL and HBL.

- 1) What is the relationship between investment and loan and advances with total deposits and total net profit?
- 2) Do NABIL and HBL have proper and equal utilization of collected funds?

- 3) Does the investment decision affect the total earning of banks?
- 4) What is the proportion of non-performing asset on total loans and advances of the bank?
- 5) Is NABIL's fund mobilization and investment policy more effective and efficient than the HBL?

## **5. Objectives of the study**

The basic objective of the study is to analyze the investment policies adopted by NABIL and HBL. The main objectives of this study are given as:-

- 1) To make comparative study of NABIL and HBL on investment policy.
- 2) To analyze, evaluate and interpret financial performance of NABIL and HBL in term of liquidity, asset management, profitability and risk.
- 3) To find out various variables like deposit, loan and advances, investment, net profit and asset of NABL and HBL.
- 4) To provide suggestions and recommendations to NABIL and HBL, this will help the management to improve investment policy and the performance.

## **6. Importance of the study**

Commercial banks can affect the economic condition of the whole country; hence the effort is made to highlight the investment policy of commercial banks expecting that the study can be bridge gap between deposits and investment policies. In Nepal, there is less availability of research and articles in investment policy of commercial banks. As investment is the backbone of development of the country and commercial banks have great contribution in the



economic growth, this study will try to highlight investment policy of commercial banks. The study will certainly help management of the NABIL and HBL to improve their performance and would help them to take collective action.

Similarly, this study will be summarizing, sensible and precious to the people having interest in the investment policy of NABIL and HBL. This will be beneficial for shareholders, and customers. Furthermore, this will be useful for teachers and students related to the accountancy and finance. In conclusion, the importance of the study focuses at following points:

- ❖ It will be helpful for commercial banks and financial institutions.
- ❖ It will provide required information and data to required persons, readers, shareholders, decision makers, traders, investors, general public, etc.
- ❖ It will be valuable property for decision making.
- ❖ This study can also be used as reference for future research.

## **7. Limitation of the study**

Although this research will be helpful to know the economic condition of the country but it doesn't cover whole sector. Generally, the limitations of this study are as follows:

- 1) The study is mainly concentrated on two bank only : NABIL and HBL
- 2) The study is based on secondary data.
- 3) There are many factors that affect investment decision and valuation of the firm. This study concentrates only on those factors which are related with investment.

- 4) The study cannot cover all the dimensions of the subject and cannot penetrate the depth.
- 5) The study covers only 7-years data.

## **8. Research Methodology**

### **1. Introduction**

The study focuses on the investment policy of NABIL and HBL. The main objective of the study is to highlight the investment policy of NABIL and HBL. The methodology consists of research design, data collection procedure, data processing procedure and techniques of analysis.

### **2. Research design**

Research design will be basically the comparative study of investment analysis of NABIL and HBL. Analytical and descriptive approaches are used to evaluate the investment policy of these banks.

### **3. Data collection procedure**

The study is mainly based on secondary data. The required data are collected from website of concerned banks. The annual data and bulletin are main sources of data. Data are tabulated since past seven fiscal years up to fiscal year 2006/2007.

### **4. Techniques of analysis**

For presentation and interpretation of data, some tools have been used. These tools include financial and statistical tools. Similarly, other techniques such as graph, pie-chart, table, etc. are also used to analyze the data.

## **9. Organization of the study**

This study has been divided into five chapters, which are as follows:

## **Chapter I: Introduction**

This chapter includes background of the study, focus of the study, statement of problem, objective of the study, significance/ importance of the study and limitation of the study.

## **Chapter II: Review of literature**

It deals with conceptual/ theoretical review and review of related studies.

## **Chapter III: Research methodology**

It includes research design, population and sample, sources of data, data collection techniques, data analysis tools, limitation of methodology and review of related studies.

## **Chapter IV: Data presentation and analysis**

It tries to analyze and evaluate data through various tools and interprets major findings of the study.

**Chapter V:** This chapter summarizes the study, create conclusions and recommends suggestions.

## **CHAPTER – II**

### **REVIEW OF LITERATURE**

Review of literature is an essential part of all studies. It helps the researcher to develop a thorough understanding previous research works that relates the present study. This chapter is concerned with review of literature relevant to the investment policy of commercial theoretical framework from which hypothesis can be developed for testing. Therefore, this chapter has its own importance in this study. This chapter is categorized into conceptual review, review of legislative provisions, review of thesis and review of articles.

#### **1. Conceptual review**

This chapter focuses to discuss briefly about the theoretical concept of the investment and its relation with other subject matter in relation to banks. This chapter is further divided into different parts as below:

##### **1.1 Investment**

Investment means employing money to generate more money in the future. It is the use of capital to create more money, through more risk-oriented ventures designed to result in capital gains. Investment is the forfeit of current rupees for future rupees. The forfeit takes place in the present, and is certain. The reward comes later and is uncertain. Hence there are three elements in investment which are return, risk and time.

Investment, in its broad sense, means the sacrifice of current Rupees(dollars) and resources for the sake of future Rupees(dollars) and resources. In another words it is commitment of money resources that are expected to generate additional money

and resources in the future. Such commitment takes place in the present and is certain to occur but the reward comes in the future and always remains uncertain. Therefore, every investment entails some degree of risk.

An investment is a commitment of funds made in the expectation of some positive rate of return (Fischer and Jordon, 1988). Likewise, an investment is simply deferred consumption: instead of spending today, we choose to wait because we wish to have more to spend later (Corrado and Jordon, 2002).

Similarly investment is any vehicle into which funds can be placed with the expectation that will preserve or increase in value and generate positive returns (Gitman and Joehnk, 1990). In the same way, the sacrifice of current dollars for future dollars is termed as investment. The sacrifice takes place in the present and is certain. The reward comes later, if at all, and the magnitude is generally uncertain (Sharpe and Gordon, 1995).

From these definitions, it is clear that investment is simply the conversion of money into claims on money and use of funds for productive and income earning assets. It is the employment of funds with the target of achieving additional income or value in the future. It involves saving of resources from current consumption in the hope that some benefits will accrue in the future.

## **1.2 Policy**

A policy is a plan of action to guide decisions and actions. It is the course of action to obtain objectives. Policy means rules and regulations set by organization. Policy determines the type of internal and external information resources. Policies in short can be

understood as political management, financial and administrative mechanisms arranged to reach explicit goals.

### **1.3 Investment policy**

Investment policy can be defined as the action plan by which its funds are distributed on different types of assets with good profitability on the one hand and provide maximum safety and security on the other hand. Investment policy is the cornerstone of the investment process. Without it, investors have no appropriate context in which to make decisions.

Bexley (1987), expresses his views as, investment policy fixes responsibilities for the investment disposition of the bank's assets in terms of allocating funds for investment and loan and establishing responsibility for day to day management of those assets.

Commercial bank should consider the national interest followed by borrower's interest and the interest of the bank itself before investing to the borrowers (Clemens, 1963). To further pursue his view, bank lending must be for such purposes of the borrowers that are in keeping with the national policy and bank's overall investment policy. A bank's overall investment should be basically of short term characters, well spread, repayable on demand profitable and well inadequate security.

### **1.4 Investment environment**

The investment environment refers to all internal and external forces, which have a bearing on the functioning of investment decisions. It encompasses the kinds of marketable securities that exist and where and how they are bought and sold through the broker's network and financial intermediaries. Thus, the investment environment is a combination of securities, markets and

intermediaries. Any securities transaction conducted without using broker is directly illegal in accordance with rules and regulation.

Security is a piece of paper representing the investor's rights to certain prospects of property and the conditions under which he or she may exercise those rights. It serves as evidence of property rights. It may be transferred to another investor. The term "security" refers to a claim to receive prospective future benefits under certain conditions.

Security markets are mechanisms created to facilitate the exchange of financial assets. It brings the buyers and sellers together. On the basis of securities traded, security market can be classified into primary and secondary market. On the basis of life-span of securities, it can be divided into money market and capital market.

Financial intermediaries are organization that issue financial claims against themselves and use the proceeds to purchase primarily the financial assets of others. They actively participate as both suppliers and demanders of funds. They include savings and loan associations, savings banks, credit unions, life insurance companies, mutual funds, pension funds, etc.

### **1.5 Characteristics of good investment policy**

The income and profit of the bank depends upon lending procedure, policy and investment of its fund in different securities. The greater the credit created by the bank, the higher will be the profitability, In choosing specific investment, investors need define ideas regarding a number of features that their portfolios should

possess. Their features should be consistent with the investors' general objectives and should afford them.

Some characteristics of sound lending and investment policies from which many successful investors compound their selection policies are as follows:

### **1. Liquidity**

Liquidity means the capacity of the bank to pay cash against deposits. 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, the bank must be prepared with sufficient degree of liquidity of its assets. To maintain an acceptable degree of loan quality and liquidity, a bank must have an adequate policy of loan liquidation.

### **2. Profitability**

Investor should invest their fund where they earn maximum profit. The profit of banks mainly depends on the interest rate, volume of loan, time period and nature of investment in different securities.

### **3. Safety and security**

The investor should never invest its funds in those securities, which are subject to too much depreciation and fluctuations because a little difference may cause a great loss. It must not invest into businessman who may be bankrupt at once and who may earn millions in a minute also. The investor should accept that type of securities, which are commercial, durable, marketable and high market prices.



#### **4. Stability**

An investor must consider stability of monetary income and stability of the purchasing power of income. However, emphasis on income stability may not always be consistent with other investment principles. If the income stability is stressed, capital growth and diversification will be limited.

#### **5. Diversification**

One of the acceptable methods of reducing risk is by diversification, a basic and important rule of any investment policy. The bank should not invest all his funds in only one area. To minimize risk, a bank must diversify its investment in different sectors. Diversification helps to sustain loss to the law of average because if securities of a company deprived, there may be appreciation in the securities of other companies.

#### **1.6 Commercial banks and their investment policy**

The term "bank" derives from the Latin "bancus", which refers to the bench on which the banker would keep its money and records. Some person traces its origin to the Italian word "banca", which means a bench for keeping, lending and exchanging of money. A bank is one who in the ordinary course of his business receives money which he pays by honouring cheques of persons from whom or whose account receives (Hart, 19945).

Shakespeare (2001) in his book "Banking and Insurance Management" has classified banks as:

- |                             |                           |
|-----------------------------|---------------------------|
| <b>1. Central Bank</b>      | <b>4. Industrial bank</b> |
| <b>2. Commercial bank</b>   | <b>5. Exchange bank</b>   |
| <b>3. Agricultural bank</b> | <b>6. Savings bank</b>    |

**7. Co-operative bank**

**10. Pension funds**

**8. Merchant bank**

**11. Housing bank**

**9. Mutual bank**

**12. Equipment bank**

Commercial banks are those banks which perform all kinds of banking functions as accepting deposits, advancing loans, credit creation, and agency function. They provide short term, medium term and long term and long term loans to trade and industry. They also operate off balance sheet functions such as issuing guarantee, bonds, letter of credit, etc. Commercial banks are institutions which provide services such as accepting deposits and giving business loans. They are one of the vital aspects of banking sector, which deal in the process of channelizing the available resources in the needed sectors.

As per the commercial Bank Act 2031 BS, "A commercial bank means the bank which deals in exchanging currency, accepting deposits, giving loans and doing commercial transactions." Commercial banks bring into being the most important ingredient of the money supply, demand deposits through the creation of credit in the form of loan and investments (Crosse, 1963).

Commercial banks deal with other people's money. They have to find ways of keeping their liquid assets so that they could meet demands of their customers. Their motive is wealth maximization and giving maximum benefit to its shareholders. In the anxiety to make profit, the bank cannot afford to lock up their funds in assets, which are not easily releasable. The depositors must be to understand the bank is fully solvent. The depositors'

confidence could be secured only if the bank is able to meet the demand for cash promptly and fully. The Banker has to keep adequate cash for this purpose. Cash is an idle asset and bankers cannot afford to keep a large possession of his assets in the form of cash, Cash brings in no income to the bank. Therefore, the banker has to distribute his assets in such a way that he can have adequate profits without sacrificing liquidity.

Commercial banks are profit making organization. A bank established without the aim of gaining the profit is the central bank. Other banks are inspired with the object of earning profit and helping the economic development. They should have the ability to use the policy of banking investment to implement it much more carefully otherwise a bank may be unsuccessful in its goal.

Without investment, a bank can't gain profit. Therefore, after the establishments of bank it collects deposits. It also collects capital by selling its shares. Thus, a great capital is collected in the bank. It is not better to keep such capital fund inactive. The bank should able to clear the policy of its investment by making deep study. Every commercial bank has an investment policy. The basic factors that will determine the objectives of a bank's investment policy are its income and liquidity needs and management's willingness to trade liquidity for greater income opportunities and vice versa, which means accepting greater or less risk. A bank that has a portfolio of high quality loans and relatively stable deposits can assume more risk. It might be preferable for the bank to pursue an aggressive lending policy. The higher risk in the loan portfolio would be countered with a very liquid investment portfolio. One of

the acceptable methods of reducing risk is by diversification, a basic and important rule of any investment. The investment process includes following steps:

- 1. Setting investment objectives**
- 2. Performing security analysis**
- 3. Constructing a portfolio**
- 4. Revision of portfolio**
- 5. Evaluation portfolio evaluation**

Banks have developed format, written lending policies in recent years. They provide guidance for lending officers by establishing a greater degree of uniformity in lending practices.

Emphasizing the importance of investment policy, lending is the essence of commercial banking; consequently the formulation and implementation of sound policies are among the most important responsibilities of bank directors and management (Crosse, 1963), Crosse further adds, the formulation of sound lending policies for all banks should have adequate and careful consideration over community needs, sizes of loan portfolio, character of loan, credit worthiness of borrower and asset pledged to security borrowing, interest rate policy.

The investment policy of a bank should be reviewed occasionally and modified as economic conditions change. It should be reviewed when developments occurring within or outside the bank dictate.

## **2. Review of legislative provisions**

In this section, the review of legislative framework under which the commercial banks are operating has been discussed. All

the commercial banks have to conform to the legislative provisions specified in the "Commercial Bank Act 2031" and the rules and regulations formulated to facilitate the smooth running of commercial banks.

Some of the important rules and regulations affecting the investment policy of commercial banks that have been directed by Nepal Rastra bank are discussed below.

### **NRB rules regarding fund mobilization of commercial banks**

NRB may establish a legal framework by formulating various rules and regulation to mobilize bank's deposit in different sectors. These directives have direct and indirect impact while making decision in terms of investment and credit to priority sector, deprived sector, CRR, loan loss provision, capital adequacy ratio, interest spread, productive sector investment. The main provisions, established by NRB in the form of prudential norms in relevant area are briefly discussed below:

#### **i) Provision for investment in priority and deprived sector**

NRB has taken a policy of gradual phasing out of the priority sector lending requirement since 2002/003. According to the provision, which effect from the third quarter of FY 1995/96, investment in shares of the rural development bank by commercial banks, which used to be counted for the priority sector lending only is now to be included under the deprived sector lending.

Commercial banks in Nepal are required to earmark a portion of their loan portfolio to priority lending (agricultures,

cottage industry, services), which includes 0.25% to 3% to the deprived sector (poor population). Under this obligation, commercial banks lend, or provide wholesale funds or equity to microfinance providers serving the poor.

Recently, the priority lending was set at 12% of the loan portfolio. It is now being phased out ending completely in 2007/08 while the 3% deprived sector requirement will stay in place, and therefore loan and investment in microfinance with it.

## **ii) Cash reserve requirement(CRR)**

Commercial banks shall maintain liquid assets (also called cash reserve) to ensure adequate liquidity in the commercial banks, to meet the depositors' demand for cash at any time and to inject the confidence in depositors regarding the safety of their deposited funds.

Since the past few years, the bank had adopted the medium term policy to gradually decrease the CRR, as an instrument to reduce the operating cost and narrow the interest rate differentials, to 3 %. However, considering the inflationary pressure in the economy, the CRR has been kept unchanged at 5 % that will be revised downwards given the favourable situation. To absorb/inject liquidity, open market instruments such as sale auction, repurchase auction and reverse repurchase auction will be continued.

## **iii) Loan classification and loss provision**

Loan can be classified into performing and non-performing loans. As per directives of NRB, bank and financial institutions (BFIS) classify their loans and advances into pass loan, sub-

standard loan, doubtful loan and loss loan. Pass loans are performing loans. Any loan and advances classifies as sub-standard, doubtful and loss are considered as NPL. Pass loan has duration up to 3 months. Sub-standard has duration of 3 months to 6 months. Doubtful loan has the duration up to 1 year. Loss loan has duration of more than 1 year.

Furthermore, NRB has directed commercial banks to maintain certain reserves as loan loss provision (LLP) as given in Table 5:

**Table 5**  
**Loan provision**

| Loan classification | Duration                          | LLP  |
|---------------------|-----------------------------------|------|
| Pass                | Up to 3 months from maturity      | 1 %  |
| Sub-Standard        | 3-6 months from maturity          | 25 % |
| Doubtful            | 6 months-1 year from the maturity | 50%  |
| Loss                | Above 1 year of maturity          | 100% |

**Source: NRB directive 2/061/062; clause 1 and 8.1**

**iv) Directives to raise capital funds:**

According to current provisions, a minimum paid up capital of Rs. 1 billion is required for the establishment of a new national level commercial bank. The existing national level commercial banks are required to increase their paid up capital gradually to Rs. 1 billion by the end of mid –July 2009. For this purpose, all commercial banks are appropriating some amount from their profit to 'capital adjustment fund'. Accordingly, some commercial banks may maintain Rs. 1 billion paid up capital by the end of mid-July 2009 or make adjustment in above stated fund. Commercial banks are free to decide on any of these options and may go for combination of these two. However, those banks increasing paid up capital through fund are required to maintain a minimum paid up

capital of Rs.500 million. Following measures will be initiated for those banks, which fail to make provisions of capital requirement as stated above:

- a) Distribution of dividend will be banned.
- b) Branch expansion will not be allowed.
- c) A limit on deposit mobilization will be imposed.
- d) Single obligor limit relating to loans to an individual and a company will be reduces.
- e) Any other actions can be initiated.

NRB is in the process of implementing BASEL II from 2007. Accordingly, required capital adequacy (CAR) will be decided according to BASEL provision. In this context, and the difficult situation through BFIS had to pass through in the previous years the CAR has been set based as 11% (to be accounted from 2005/06) until new CAR is set based on BASEL II . Up to 2004/05, BFIS were required to maintain a CAR of 11%. They were required to raise it to 12% from 2006/07.

### **3. Review of related thesis**

Various students regarding the various aspects of commercial banks as financial performance, lending policy, investment policy, resources mobilization policy, resources mobilization and capital structure have concluded several thesis works. Some of them, as supposed to be relevant for the study as prescribed below:

Bohara (1992) in his thesis, "A comparative study on the financial performance of Nepal Arab Bank Ltd. and Nepal Indosuez Bank Ltd." has made endeavor to examine the comparative financial performance of NABIL and NIBL in terms



of liquidity, activity, profitability along with other parameters. He has concluded that bank performance cannot be judged solely in terms of profits, as it may have earned profit maintaining adequate liquidity and safety position. But it should also be evaluated on the ground of the contribution, it has made to the community, government and national economy. This means, the bank should come forward with national priority tasks. The tasks are possible when they expand branches, more, employment opportunities, services to more customers, developing skills and expertise in local staff satisfactions on profit earning and exchange of autonomy provided by them.

Mahato (1998) in his thesis paper, "A comparative study of the financial performance of NABIL AND NIBL," concludes that NABIL pays more attention towards the attainment of national objectives through participation in the task of economic development with liberal attitude towards the government and being more responsive to the national priorities like branch expansion, more employment opportunities and more resource mobilization. So, from the point of view of shareholders and government, NABIL is performing much better than NIBL. He has recommended all the commercial banks to increase portion of equity capital in their capital structure, control operating costs, increase liquidity as per the new regulation of NRB, meet social responsibility, investment in productive sectors.

Khadka (2000) in his thesis, "A study on investment policy of NABIL in comparison to their joint venture banks of Nepal", has compared investment policy of NABIL with other joint ventures

banks NGBL. The main objective of the study was to evaluate the liquidity, asset management, efficiency, profitability and risk position.

Khadka has found that liquidity position of NABIL is worse than that of NGBL and NIBL. NABIL has more portion current assets as loan and advances but less portion as investment on government securities. NABIL is less successful in on balance sheet operations as well as off-balance sheet operations that of NGBL and NIBL. NIBL is more successful in deposit mobilization but fails to maintain high growth rate of profit in compare to BGBL and NIBL.

He has strongly recommended NABIL to utilize its risks assets and shareholders fund to gain highest profit margin and reduce its expenses and collect cheaper fund for more profitability. He has recommended investing its fund in different sectors of investment and administering various deposits schemes to collect fund such as cumulative deposit scheme, price bonds scheme, gift cheques scheme, etc. He has recommended adopting liberal lending policy however he has not explained his idea of liberal lending policy.

Thapa (2001) in her thesis, “A comparative study on investment policy of NBBL) and other JVBS has compared investment policy of NBBL with NABIL and NGBL. She concludes that NBBL is in a weak position regarding its on balance as well as off balance sheet activities. Profitability position of NBBL is comparatively worse than that of NABIL and NGBL. She adds that NBBL has good deposit collection enough liquidity but it has made negligible amount of investment in Government securities. She further adds that the position of NBBL in regard to

utilization of fund to earn profit is not better in comparison to NABIL and NGBL

Shrestha (2003), in her thesis, "Investment Analysis of commercial banks", has compared investment policy of HBL and NSBIL. She concludes that % of HBL's investment is extremely higher than NSBIL. Both banks have invested on Govt. Securities but HBL has invested in NRB bonds as well as in other productive sectors. NSBIL is better than HBL from liquidity point of view. HBL has higher profitability position than NSBIL. HBL is exposed to more risk than NSBIL. He further adds that HBL has maintained higher growth rate in net profit in comparison to NSBIL.

Lamichhanne (2005), in her thesis, "Investment policy in Nepal: A comparative study of ADB with NBBL and HBL Ltd.", has compared investment policy of Agriculture Development Bank with NBBL and HBL. She concludes that risk in banking sector tends to be concentrated in the loan portfolio, when bank gets into serious financial trouble its problem usually spring from significant amounts of loan that have become un-collectible due to mismanagement, illegal manipulation of loan,

Misguided lending policy or unexpected economic downturn. Therefore, the banks investment policy must be such that it is sound and prudent in order to protect public funds. She has found that the liquidity position of ADB is comparatively better than that of HBL and NBBL. The asset management of ADB is good as compared to HBL and NBBL. She recommends the ADB should focus on the collection of expired loans and advances to reduce the loan loss ratio.

Vishal (2005), in his thesis, "A study of investment policy of Joint venture Commercial bank", has compared investment policy of NABIL and SCBNL. He finds that cash and bank balance of SCBBL with respect to current assets is higher than NABIL. He concludes that it shows greater capacity of SCBNL to meet its customer's requirement but that does not mean that NABIL cannot meet its daily requirements. SCBNL has invested more portions of its current assets and total working fund in govt. securities than NABIL, where as NABIL has invested more of its fund to other productive sectors. BABIL has been more successful in mobilizing its deposits and working fund as loan and advances and achieving higher profits in comparison to SCBNL. He adds that NABIL has invested more of its funds in purchasing shares and debentures of other companies than SCBNAL. He further adds that liquidity risk and credit risk of SCBNL is comparatively lower than NABIL. NABIL has more exposure to risk than SCBNL.

#### **4. Review of related articles**

Mr. Shiba Raj Shrestha, Director of NRB, has presented an article, "Modus Operandi of Risk Appraisal in Bank Lending." His article endeavors to highlight some of the basic issue pertaining to the aspect of credit appraisal, in respect of domestic bank lending. He has written that the tradeoff between risk and return is on of the prime concerns of any investment decision, whether long or short term, as the effective risk management is central to good banking. With more deregulation setting in, evaluation of risk appraisal is assuming more importance. According to him, absolute quantitative credit deposit ratio has no relevance if the assets are not performing ones. Hence, He has, felt that appraisal techniques

of bank lending in competitive areas has to be more attuned towards risk evaluation. (Shrestha, 2004).

He further suggests, "Effective credit risk management allow a bank to reduce risks and potential NPAS. Once banks understand their risks and their costs, they will be able to determine their most profitable business and, thus, price products according to the risks. Therefore, the banks must have an explicit credit-risk strategy supported by organizational changes, risk-measurement techniques and fresh credit processes and system." He has given five crucial areas that credit-risk management should focus on:

- v) Credit sanctioning and monitoring process.**
- vi) Approach to collateral.**
- vii) Credit risks arising from new business opportunities.**
- viii) Credit exposures relative to capital or total advances.**
- ix) Concentration on correlated risk factors.**

Pyakural (1987) in his article, "Workshop on banking and National Development" has written the present changing context of the economy call for a substantial revitalization of the resources. How much they have gained over the years depends chiefly on how far they have been able to utilize their resources in an efficient manner. Therefore, the task of utilization of resources is as much crucial as the mobilization. Therefore, the task of utilization of resources is as much crucial as the mobilization. The under utilization of resources not only result in loss of income but also goes further to discourage the collection of deposits.

Thus, in his article he has emphasized on proper utilization of mobilized resources and profitability increment.

Bajracharya (1991) in his article, "Monetary policy and Deposit mobilization in Nepal," has concluded that mobilization of domestic savings is one of the prime objectives of the monetary policy in Nepal. Commercial banks and financial intermediary for accepting deposit of private sector and providing credit to the investor in different sectors of the economy. He further adds that the public deposit is the major source of credit and investment of the commercial bank in Nepal.

Sharma (2000) in his article, "Banking the future on competition," writes, 'Nepali financial sector (especially the banking sector) has undergone drastic changes in the past one and half decades. One of the most important achievements as a result of the growth in the number of commercial banks in the past liberalization period is in the area of domestic saving. Quantitative growth of the banking sector has positively contributed in raising domestic banking savings, which crossed the 152 billion mark in mid-August, 2000. In addition, deposit GDP ratio also rose from 0.128 to 0.199.

He further adds post liberalization era competition has forced commercial banks to broaden their lending portfolio that has resulted in the expansion of loan extension from the trading sector to the industrial sector. He adds increasing credit flow to both trading and industrial sector and canalize domestic savings into capital investments towards which the contribution of the banking sector cannot be questioned, will ultimately bolster the country's rate of economic growth. In addition, the sector has actually done more than just providing mere safety to small investor's capital.

He has also highlighted that majority of CBs are being established and have operation in urban areas only. He has added that private banks have mushroomed only in urban areas where large volume of banking transaction and activities are possible. According to him, banks are tempted to invest without proper credit approval and on personal guarantee, whose negative side effects would show true colors only after four or five years. The CBs are also charging higher interest rates on lending.

Shrestha (1998) in her article, "Lending operation of commercial banks of Nepal and its impact on GDP", has presented with the objectives to make an analysis of contribution of commercial banks lending to the gross domestic product (GDP) of Nepal. Thus, in conclusion, she has accepted the hypothesis i.e. there has been positive impact on GDP. She has accepted that there has been positive impact by the lending of commercial banks in various sectors of economy, except service sector investment.

## **CHAPTER-III**

### **RESEARCH METHODOLOGY**

Research methodology is the study of methods used in different disciplines. This chapter contains the discussion about the methods and processes that has been used for the study and analysis of the investment strategy of NABIL and HBL. It includes general introduction, research design, and sources of data, population and sample and methods of data analysis.

#### **1. General introduction**

In research methodology, different types of research and their principles, process, methods, techniques and tools are studied. This study helps to conclude the real position of NABIL and HBL.

#### **2. Research design**

Research design serves as a framework for the study, guiding the collection and analysis of the data, the research instruments to be utilized, and the sampling plan to be followed. Kerlinger (1986) describes a research design as the plan, structure and strategy of investigation conceives so as to obtain answers to research questions and to control variance. Descriptive cum analytical research design have been used in this study.

#### **3. Sources of data**

This study is conducted on the basis of secondary data. The data required for the analysis are directly obtained from the Balance Sheet, Profit and Loss account, and annual reports of concerned banks and publications of NRB. Supplementary data and information are collected from number of institutions like SEBON, NEPSE, ministry of finance, budget speech of different fiscal year,



economic survey, etc. Likewise various data and information are collected from the economic journals, magazines and other published and unpublished reports.

#### **4. Population and sample**

There are altogether 25 commercial banks functioning all over the country and most of their stocks are traded actively in the stock market. The populations are presented by Table 6.

**Table 6**  
**List of licensed Commercial Banks in Nepal**

| S.N | Name of commercial bank              | Estd. Date (B.S.) |
|-----|--------------------------------------|-------------------|
| 1.  | Nepal Bank Ltd.                      | 1994/07/30        |
| 2.  | Rastriya Banijya Bank                | 2022/10/10        |
| 3.  | NABIL Bank Ltd.                      | 2041/03/29        |
| 4.  | Nepal Investment Bank Ltd.           | 2042/11/16        |
| 5.  | Standard Chartered Bank Nepal Ltd.   | 2043/10/16        |
| 6.  | Himalayan Bank Ltd.                  | 2049/10/05        |
| 7.  | Nepal SBI Bank Ltd.                  | 2050/03/23        |
| 8.  | Nepal Bangladesh Bank Ltd.           | 2050/02/23        |
| 9.  | Everest Bank Ltd.                    | 2051/07/01        |
| 10. | Bank of Kathmandu Ltd.               | 2051/11/28        |
| 11. | Nepal Credit and Commerce Bank Ltd.  | 2053/06/28        |
| 12. | Lumbini Bank Ltd.                    | 2055/04/01        |
| 13. | Nepal Industrial and Commercial Bank | 2055/04/05        |
| 14. | Machhapuchhre Bank Ltd.              | 2057/06/17        |
| 15. | Kumari Bank Ltd.                     | 2056/08/24        |

|     |                                  |            |
|-----|----------------------------------|------------|
| 16. | Laxmi Bank Ltd.                  | 2058/06/11 |
| 17. | Siddhartha Bank Ltd.             | 2058/06/12 |
| 18. | Global Bank Ltd.                 | 2063/10/01 |
| 19. | Citizens Bank International Ltd. | 2064/01/07 |
| 20. | Citi Commercial Bank             | 2064/03/12 |
| 21. | Prime Bank Ltd.                  | 2064/06/11 |
| 22. | Bank of Asia Ltd.                |            |
| 23. | Sunrise Bank Ltd.                |            |
| 24. | Development Credit Bank Ltd.     |            |
| 25. | NMB Bank Ltd.                    |            |

**Source: Nepal Stock Exchange**

From these populations, **NABIL Bank Ltd.** and **Himalayan Bank Ltd.** are selected as sample for the study.

## **6. Methods of data analysis**

In this study, various financial and statistical tools have been used. The various tools are presented as follows:

### **5.1 Financial tools**

Financial tools are used to examine to examine the financial strength and weakness of bank. The analysis of the financial position of any firm to examine its performance is known as financial analysis. It is the process of evaluating the position of a firm by establishing relationship with various components parts of the financial statements. According to Pandey (1999), financial analysis is the process of identifying the financial strength and weakness of a firm by properly establishing the relationship between the items of balance sheet and profit and loss account.

### **5.1.1 Ratio analysis**

Ratio is the mathematical relationship between two accounting figures. Ratio analysis is the main tools of financial statement analysis. Ratio means the numerical or quantitative relationship between two items or variables. It can be expressed as percentage, fraction or a stated comparison between two numbers (Pandey, 1999). Hence, ratio analysis is the calculation and interpretation of financial ratios to assess the forms performance and status. Qualitative judgement can be done with the help of ratio analysis. In this study, some of the relevant financial ratios are used. They are presented into three broad groupings.

#### **I. Financial policy measures**

A. Liquidity ratios

#### **II. Operating efficiency measures**

A. Asset management ratios ( Activity or performing ratios )

#### **III. Performance measures**

A. Profitability ratios

B. Risk ratios

C. Growth ratios

D. Capital adequacy ratios

#### **I. Financial policy measures**

##### **A. Liquidity ratios**

Liquidity simply means short-run solvency of a firm. It reflects the short term financial strength of banks. Liquidity means the ability of a firm to satisfy its short term obligation. It is the measurement of speed with which a bank's assets can be converted into cash to meet deposits withdrawal and other current obligations. The certain percentage of deposit should be kept in bank in the form of cash .It the bank will keep

greater deposit in cash, it loses the opportunity cost. Similarly, if bank keeps low amount in deposit, it could not be able to pay depositors on time. Liquidity can be measured in following ways.

**i. Current ratio**

It measures short-term debt paying ability of a bank. It measures the availability of current liabilities. It is computed by dividing current assets by current liabilities. Current assets consists of cash in hand, cash at bank, short term marketable securities, bills receivable, sundry debtors, prepaid expenses, inventory and accrued income. Current liabilities consist of bills payable, sundry creditors, short-term loan, income tax draft.

Mathematically,

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

Current ratio is considered to be satisfactory one when 2:1. Higher current ratio indicates that the firm is in liquid and has ability to pay its current obligation in time. On the other hand, lower current ratio represents that liquidity position is not good and the bank will face difficulty in payment of current obligation.

**ii. Cash and bank balance to total deposit ratio (CRR)**

This ratio also known as cash reserve ratio shows the percentage of deposit maintained as liquid assets. This ratio is maintained to meet any unexpected demands of the depositors. A higher ratio represents a greater ability to meet any unexpected demand of the depositors. If the bank is not able to maintain adequate amount of deposit it cannot operate day to day

transactions. Keeping idle cash is not desirable as it blocks the capita. Therefore, this ratio is designed to measure the bank's ability to meet the immediate obligation. It is calculated by dividing cash and bank balance by total deposits.

Mathematically,

$$\text{Cash and bank balance to total deposit ratio} = \frac{\text{Cash \& bank balance}}{\text{Current liabilities}}$$

### iii. Cash and bank balance to current assets ratio

This ratio shows the percentage of readily available fund with the bank. It measures the proportion of the most liquid assets among the current assets of bank. Higher ratio shows the bank ability to meet demand for cash. It is calculated by dividing cash and bank balance by current assets.

Mathematically,

$$\text{Cash \& bank balance to current assets ratio} = \frac{\text{Cash \& bank balance}}{\text{Current assets}}$$

### iv Investment on government securities to total deposit ratio

Government security is a risk free security. The banks instead of keeping their funds idle, invest in various government securities i.e. treasury bills and development bonds which are liquid in nature as they can be traded any time. This ratio measures how much of the total deposit is utilized in investing in government securities. It is calculated as dividing investment in government securities by total deposit.

Mathematically,

$$\text{Government securities to total deposit ratio} = \frac{\text{Government securities}}{\text{Total deposits}}$$

## **I. Operating efficiency measures**

### **A. Assets management ratios/Activity or performing ratios**

Asset management or activity ratio measures the effectiveness of the bank's investment decision and the utilization of its resources. It indicates the speed with which assets are being converted or turnover. The greater the rate of turnover or conversion, the more efficient is the management or utilization of assets. Here, some of these ratios are computed to assess the bank's efficiency in utilization of available assets in following ways:

#### **i. Loan and advances to total deposit ratio**

This ratio is calculated to find out how successfully the banks are utilizing their total deposits on loans and advances for profit generating purpose. Greater ratio implies the better utilization of total deposits. This can be obtained by dividing loan and advances by total deposits.

Mathematically,

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

#### **ii. Total investment to total deposit ratio**

Investment implies the utilization of firm's deposit on investment in government securities, shares, debentures and bonds of other companies and bank. It can be computed by dividing total investment by total deposit.

Mathematically,

$$\text{Total investment to total deposit ratio} = \frac{\text{Total investment}}{\text{Total deposits}}$$

**iii. Loan and advances to working fund ratio.**

Loan and advances is the major component in the total working fund, which indicates the ability of bank to canalize its deposits in the form of loan and advances to earn high return. This ratio is calculated by dividing loan and advances by total working fund. Total working fund includes all assets of on balance sheet items i.e. current assets, net fixed assets, loan for development banks and other miscellaneous assets but excludes off balance sheet items such as Letter of Credit, Letter of Guarantee, etc.

Mathematically,

$$\text{Loan and advances to working fund ratio} = \frac{\text{Loan and advances}}{\text{Total working fund}}$$

**iv. Investment on government securities to total working fund ratio**

This ratio shows bank's investment on government securities in comparison to the total working fund. It is computed by dividing investment on government securities by total working fund.

Mathematically,

$$\text{Government securities to working fund ratio} = \frac{\text{Government securities}}{\text{Total working fund}}$$

**v. Investment on shares and debentures to total working fund ratio**

This ratio shows the bank's investment in shares and debentures in comparison to the total working fund and calculated by dividing investment in shares and debentures by total working fund.

Mathematically,

$$\text{Shares and debentures to working fund ratio} = \frac{\text{Shares and debentures}}{\text{total working fund}}$$

**vi. Performing loan loss provision**

Performing loan is a loan which had due up to 90 days. This ratio shows how much the banks are successful in utilizing their assets for the purpose of profit generation. Higher ratio indicates efficiency in utilizing the good loans.

Mathematically,

$$\text{Performing Loan Ratio (PLR)} = \frac{\text{Performing loan}}{\text{Total loan}} \times 100\%$$

**vii. Non performing loan loss provision**

Loan is said to be non-performing with the due date of more than 90 days. Non-performing loan consists of substandard loan, doubtful loans and bad loans. Higher non-performing loan ratio indicates worse management of assets. If the ratio is low, it indicates a favourable credit management position.

Mathematically,

$$\text{Non – performing Loan Ratio} = \frac{\text{Non – performing loan}}{\text{Total loan}} \times 100\%$$

**viii. Loan loss provision ratio**

This ratio depicts how much provision a bank has to create for its loan provided. It is the ability of the management to have sufficient provision for the non-performing loans. Higher the rate, better is the financial position and vice versa.

Mathematically,

$$\text{Loan loss provision ratio} = \frac{\text{Total loan provision}}{\text{Non – performing loan}} \times 100\%$$



### **III. Performance measures**

#### **A. Profitability ratios**

Profitability ratio is calculated to measure the efficiency of operation of a firm in terms of profit. It is the indicator of the financial performance of any institution. This implies that higher the profitability ratio better the financial performance of bank. Profitability ratio can be calculated through following ways.

##### **i. Return on loan and advances ratio**

This ratio indicates how efficiently the bank has employed its resources in the form of loan and advances. It is computed by dividing net profit (loss) by loan and advances.

Mathematically,

$$\text{Return on loan and advances ratio} = \frac{\text{Net profit}}{\text{Loan and advances}}$$

##### **ii. Return on total working fund ratio (ROA)**

This ratio, also known as return on assets measures the overall profitability of all working funds i.e. total assets. It is computed by dividing net profit (loss) by total working fund.

Mathematically,

$$\text{Return on total working fund ratio} = \frac{\text{Net profit}}{\text{Total working fund}}$$

##### **iii. Return on equity ratio (ROE)**

This ratio measures how efficiently the banks have used the funds of owners. It is calculated by dividing Net profit by total equity capital. Total capital includes shareholder's reserve

including P/L A/C and share capital i.e. ordinary share and preference share capital.

Mathematically,

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

#### iv. Total interest earned to total asset ratio

This ratio measures the interest earning capacity of the bank through the efficient utilization of assets. It is computed by dividing total interest earned by total assets.

Mathematically,

$$\text{Return on equity} = \frac{\text{Total interest Earned}}{\text{Total Assets}}$$

#### v. Total interest earned to total working fund ratio

This ratio is calculated to find out the percentage of interest to total asset. Higher ratio implies better performance of the bank in terms of interest earning on its total working fund. This ratio is calculated by dividing total interest earned by total working fund.

Mathematically,

$$\text{Total interest earned to working fund ratio} = \frac{\text{Total interest Earned}}{\text{Total Working Fund}}$$

### B. Risk ratios

Risk taking is the prime business of bank's investment management. The possibility of risk makes bank's investment a challenging task. Bank has to take risk to get return on its investment. The risk taken is compensated by the increase in profit, So, the bank has to have idea of the level of risk that ultimately influences the bank's investment policy.

### **i. Credit risk ratio**

Credit risk ratio measures the possibility that loan will not be repaid or that investment will deteriorate in quality or go into default with consequent loss to the bank. This is expressed as the percentage of loan and advances to total assets. It helps to check the probability of loan non- repayment loan or the possibility of loan to go into defaults. Risk of non-repayment loan is known as credit risk.

Mathematically,

$$\text{Credit risk ratio} = \frac{\text{Loan \& advances}}{\text{Total Assets}}$$

### **ii. Capital risk ratio**

Capital risk ratio measures banks ability to attract deposit and interbank funds. It also determines the level of profit, a bank can earn. The capital risk is directly related to return on equity. Higher the ratios, higher will be the capital risks. It is computed by dividing total share capital to risk-weighted assets. Risk- weighted asset is the minimum amount of capital that is required within banks and other institutions, based on a percentage of the assets, weighted by risk. It is the total of all assets held by the bank which are weighted for credit risk according to a formula determined by the Regular (Central bank). It includes the sum of on- balance sheet and off- balance sheet items.

Mathematically,

$$\text{Capital risk ratio} = \frac{\text{Share capital}}{\text{Risk weighted assets}}$$

### **C. Growth ratio**

Growth rates of total deposits, loan & advances, total investment and profit are calculated to analyze and examine the expansion and growth of the bank.

Mathematically,

$$D_n = D_o (1 + g)^n$$

Here,  $D_n$  = Total amount in  $n^{\text{th}}$  year

$D_o$  = Total amount in  $n^{\text{th}}$  initial year

$g$  = Growth rate

$n$  = period

### **D. Capital adequacy ratios (CAR)**

Capital adequacy ratio is the measure of the amounts of a bank's capital expressed as a percentage of its risk weighted credit exposures. It is the ratio which determines the capacity of the bank in terms of meeting the time liabilities and other risk. CAR protects depositors there by maintaining confidence in the banking system. The investment of the commercial banks has deep impact in the capital. Therefore, the commercial banks have to maintain the investment policy in such a way that it should also be helpful in maintaining the adequate capital as specified by NRB. Capital fund of bank should be based on the measurement of risks associated with the assets of the bank, the minimum capital fund required to be maintained is based on the risk weighted assets, the bank need to maintain its assets so as to minimize total risk weighted assets or to increase the capital by issuing shares, debentures or generating more and more profit. So, capital adequacy policy of bank also has effect on investment portfolio.

Mathematically,

$$\text{Total capital adequacy ratio} = \frac{\text{Core capital} + \text{Supplementary capital}}{\text{Total risk weighted assets}}$$

$$\text{Core capital adequacy ratio} = \frac{\text{Core capital}}{\text{Total risk weighted assets}}$$

The capital adequacy norm has been set on the basis of total risk weighted assets. As all the credit/advances and investments are the assets of the bank, the banks need to take extra care while making an investment decision. The assets discussed are on-balance sheet as well as off-balance sheet.

On the basis of the types of risks, the assets are classified into four buckets by assigning weight of 0%, 20%, 50% and 100% risk. The highly secured assets weight 0% risk and highly on secured assets weigh 100% risk. So, if the bank has the tendency of investing in 0% risk weighted asset then the total risk weighted asset will be low and hence the minimum capital required to be maintained can be easily met. But if the bank takes the risk and invests heavily in 100% risk weighted assets then the total risk weighted asset will be high and hence the bank will have to increase its capital by different means so as to meet the minimum required capital as prescribed by NRB.

### 5.1.2 Common size analysis

Financial performance of a company can be traced by the preparation of comparative statement. Changes in items of balance sheet and income statement can be shown by relative or proportional changes. They are shown by recording percentages calculated in relation to some common base in special columns. In

case of income statement, sales figure is assumed to be common base (equal to 100) and all other items are expressed as percentage sales. Similarly, the balance sheet items are expressed as percentages of total assets or total liabilities. The financial statements prepared in terms of common base percentages are called common-size analysis. This kind of analysis is also called vertical analysis.

## **5.2 Statistical tools**

After the collection, organization and the presentation of data, the next step is to analyze the data. On this study, various statistical tools like trend analysis, standard deviation, coefficient of variance, coefficient of correlation analysis, etc. have been used to analyze this data. Statistical tool or appropriate technique of analysis depends upon the nature of the data and the purpose of the enquiry. The following tools are used in the analysis of the financial position of the bank:

### **5.2.1 Arithmetic mean (Average):**

It represents the entire data by a single value. It provides the gist and gives the bird's eye view of the huge mass of unwieldy numerical data. It is calculated as:

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

Where:  $\bar{x}$  = Arithmetic mean

N = Number of observations

$\sum X$  = Sum of observations

### **5.2.2 Standard deviation (S.D)**

The measurement of the scatter-ness of the mass of figures in a series about an average is known as dispersion. The standard

deviation measures the absolute dispersion. Standard deviation, usually denoted by the letter  $\sigma$  (sigma: the Greek alphabet) was first suggested by Karl Pearson as a measure of dispersion. It is defined as the positive square root of the arithmetic mean of the squares of the deviations of the given observations from arithmetic mean as is given by:

$$\sigma = \sqrt{\frac{1}{n} \sum (x - \bar{x})^2}$$

Where,

$\bar{x} = \frac{1}{n} \sum x$  is the arithmetic mean of the given values.

### 5.2.3 Coefficient of variance (CV)

Standard deviation is only an absolute measure of dispersion, depending upon the units of measurement. The relative measure of dispersion based on standard deviation is called the coefficient of standard. (Gupta, 1993).

It is given by:  $CV = \frac{\sigma}{\bar{x}} \times 100\%$

For comparing the variability of two distributions, CV is computed of each distribution. A distribution with smaller CV is said to be less variable or more consistent or more homogeneous or more uniform or more stable than the other and vice versa.

### 5.2.4 Trend analysis (Least square method)

A widely and most commonly used method to describe the trend is the method of least square. Under this, a trend line is fitted to the data satisfying the conditions. It is used to describe the

trend of any variable whether it increases or decreases with the passage of time.

The trend line between the two variables x and y is represented by:

$$y_c = a + bx$$

Where,

$$a = \frac{\sum y}{n} \quad \text{and} \quad b = \frac{\sum xy}{\sum x^2}$$

Here,  $y_c$  is used to designate the trend value to distinguish the actual value. The x variable represents the time, 'a' refers to the y-intercept or value of  $y_c$  when  $x=0$  and 'b' is the slope of the trend line. For the trend analysis of different banks, the following heads have been considered:

- i. Total deposit analysis**
- ii. Investment analysis**
- iii. Loan & advances**
- iv. Net profit**

### **5.2.3 Karl Pearson's coefficient of correlation (r)**

One of the widely used mathematical methods of calculating relationship between two variables is the Karl Pearson's correlation coefficient. It is denoted by 'r' and is defined by:

$$r = \frac{\sum xy}{\sqrt{\sum x^2} \cdot \sqrt{\sum y^2}}$$

Where,

$$X = x - \bar{x}$$



$$Y = y - \bar{y}$$

The value of 'r' always lies between (-1) and (+1), and (r=+1) denotes the perfect positive correlation between the two variables and (r=-1) denotes the negative correlation between the two variables.

**Probable error (P.Er):**

It is the measure of testing the reliability of the calculated value of 'r'. If r be calculated value of r from a sample of n pair of observations, then PE is defined by,

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

If the value of 'r' is less than **6 PE (r < 6P.Er)**, it is insignificant; perhaps there is no evidence of correlation. If 'r' is greater than **6 PE (r > 6P.Er)**, then, it is significant. The probable error of correlation coefficient is used to determine the limits within which the population correlation coefficient lies. Limits for population correlation coefficient are **r ± P.Er**.

**Calculations of correlation coefficient are as follows:**

- I. Coefficient of correlation between deposit and loan & advances.
- II. Coefficient of correlation between deposit and total investment
- III. Coefficient of correlation between deposit and net profit.

## **CHAPTER IV**

### **DATA PRESENTATION AND ANALYSIS**

This chapter is concerned with the data presentation and analysis of the study. Likewise major findings of the study are also presented.

#### **1. Data presentation and analysis**

Following financial and statistical tools related to the investment management and fund mobilization are studied to evaluated and analyze the performance of NABIL and HBL.

**A. Financial analysis:** It includes liquidity ratios, asset management ratios, profitability ratios, risk ratios, growth ratios, capital adequacy ratios and common size analysis.

**B. Statistical analysis:** It includes trend analysis and Karl Pearson's coefficient of correlation analysis.

#### **A. Result of financial analysis**

##### **1.1 Liquidity ratios**

##### **1.1.1 Current ratio**

The higher is the current ratio, the greater the margin of safety. The current ratio of NABIL and HBL has been shown in Table 7. The Table 7 shows that the mean of current ratio of NABIL and HBL are less than standard ratio i.e. 2:1. The mean current ratio of NABIL is higher than that of HBL. The coefficient of variance of NABIL is 1.57, which is greater than that of HBL i.e.1.09. Here, both banks have less C.V which denotes that they are more stable.

**Table 7**  
**Current ratio of NABIL and HBL**

| <b>Fiscal Year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 1.0525       | 1.0287     |
| <b>2001/02</b>     | 1.0601       | 1.0456     |
| <b>2002/03</b>     | 1.0762       | 1.0544     |
| <b>2003/04</b>     | 1.0813       | 1.0607     |
| <b>2004/05</b>     | 1.0625       | 1.0604     |
| <b>2005/06</b>     | 1.1077       | 1.0420     |
| <b>2006/07</b>     | 1.0702       | 1.0622     |
| <b>mean</b>        | 1.0729       | 1.0506     |
| <b>s.d</b>         | 0.0168       | 0.0115     |
| <b>C.V.</b>        | 1.57         | 1.09       |

**Source: Appendix 1**

### **1.1.2 Cash and bank balance to total deposit ratio (CRR)**

The cash and bank balance to total deposit ratio of the two banks has been shown in Table 8. This ratio measures the percentage of most liquid fund with the bank to make immediate payment.

**Table 8**  
**Cash and bank balance to total deposit ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.0513       | 0.0814     |
| <b>2001/02</b>     | 0.0678       | 0.0679     |
| <b>2002/03</b>     | 0.0851       | 0.0942     |
| <b>2003/04</b>     | 0.0687       | 0.0909     |
| <b>2004/05</b>     | 0.0383       | 0.0812     |
| <b>2005/06</b>     | 0.0326       | 0.0648     |
| <b>2006/07</b>     | 0.0599       | 0.0585     |
| <b>mean</b>        | 0.0576       | 0.0769     |
| <b>s.d</b>         | 0.0170       | 0.0125     |
| <b>C.V.</b>        | 29.49        | 16.28      |

**Source: Appendix 2**

Presently, NRB has prescribed CRR of 5%. In the Table 8, HBL bank has maintained above NRB. According to the table, mean CRR of NABIL is 5.76% which is less than that of HBL i.e.7.69% In the F.Y.2006/07, CRR of NABIL is only 5.59% which is greater than the standard rate given by NRB. This table shows, HBL's solvency position is higher than NABIL.

### **1.1.3 Cash and bank balance to current assets ratio**

The cash and bank balance to current assets ratio of both banks from F.Y.2000/2001 to 2006/07 are shown in Table 9. It shows the mean cash & bank balance to current assets ratio of NABIL is lower than that of HBL.

**Table 9**  
**Cash and bank balance to current assets ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.0464       | 0.0769     |
| <b>2001/02</b>     | 0.0606       | 0.0623     |
| <b>2002/03</b>     | 0.0703       | 0.0857     |
| <b>2003/04</b>     | 0.0592       | 0.0819     |
| <b>2004/05</b>     | 0.0341       | 0.0732     |
| <b>2005/06</b>     | 0.0279       | 0.0595     |
| <b>2006/07</b>     | 0.0518       | 0.0533     |
| <b>mean</b>        | 0.050        | 0.0704     |
| <b>s.d</b>         | 0.0014       | 0.0113     |
| <b>C.V.</b>        | 28.00        | 16.04      |

**Source: Appendix 3**

Table 9 indicates that the ratio of NABIL is the highest during F.Y. 2002/03 which is 7.03% Similarly, HBL has also the highest ratio during same year i.e 8.57% The co-efficient of variance of NABIL is higher than that of HBL. This table shows that they have capacity to manage the deposit withdrawal from the customers.

### 1.1.4 Investment on government securities to total deposit ratio

Investment on government securities on total deposit ratio reflects that out of total deposits, how much percentage of it has been occupied by the investment on government securities. Table 10 represents the ratio between investment on government securities and total deposit.

**Table 10**  
**Investment on government securities to total deposit ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.1725       | 0.1261     |
| <b>2001/02</b>     | 0.2657       | 0.1391     |
| <b>2002/03</b>     | 0.2669       | 0.1904     |
| <b>2003/04</b>     | 0.2601       | 0.1559     |
| <b>2004/05</b>     | 0.1654       | 0.2204     |
| <b>2005/06</b>     | 0.1189       | 0.1942     |
| <b>2006/07</b>     | 0.2060       | 0.2147     |
| <b>mean</b>        | 0.2084       | 0.1773     |
| <b>s.d</b>         | 0.5464       | 0.0343     |
| <b>C.V.</b>        | 26.22        | 19.37      |

**Source: Appendix 4**

Table 10 indicates that NABIL has higher amount of deposit on government securities than HBL in average. However, it also shows that the investment trend of NABIL is decreasing whereas the trend followed by HBL is fluctuating. The C.V of NABIL and HBL are 26.22 and 19.37 respectively.

### 1.2 Asset management ratios

Assets management ratio also known as activity ratio indicates the speed with which assets are being converted or turnover.

### 1.2.1 Loan and advances to total deposit ratio

1.2.2 The ratios between loan and advances and total deposits of NABIL and HBL are shown in Table 11. It indicates the engaged amount of total deposits on loan and advances for the profit generation.

**Table 11**  
**Loan and advances to total deposit ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.5255       | 0.5111     |
| <b>2001/02</b>     | 0.5032       | 0.5133     |
| <b>2002/03</b>     | 0.6034       | 0.5163     |
| <b>2003/04</b>     | 0.6055       | 0.5870     |
| <b>2004/05</b>     | 0.7505       | 0.5421     |
| <b>2005/06</b>     | 0.6864       | 0.5950     |
| <b>2006/07</b>     | 0.6813       | 0.5921     |
| <b>mean</b>        | 0.6223       | 0.5509     |
| <b>s.d</b>         | 0.0829       | 0.0363     |
| <b>C.V.</b>        | 13.34        | 6.59       |

**Source: appendix 5**

Table 11 reveals that the mean loans and advances to total deposit ratio of NABIL is higher than that of HBL. The C.V of NABIL is also higher than that of HBL. The ratio of HBL is more stable than that of NABIL. The ratio of NABIL was the highest in F.Y 2004/05 i.e.75.05% whereas that of HBL was the highest in F.Y 2005/06. During F.Y. 2006/07, the ratios of NABIL and HBL are 0.6813 and 0.5921 respectively.

### 1.2.2 Total investment to total deposit ratio

Total investment to total deposit ratio of NABIL and HBL from F.Y. 2000/01 to 2006/07 us given in the Table 12.

**Table 12**  
**Total investment to total deposit ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.4868       | 0.2315     |
| <b>2001/02</b>     | 0.5288       | 0.4918     |
| <b>2002/03</b>     | 0.4485       | 0.4844     |
| <b>2003/04</b>     | 0.4133       | 0.4222     |
| <b>2004/05</b>     | 0.2927       | 0.4712     |
| <b>2005/06</b>     | 0.3195       | 0.4110     |
| <b>2006/07</b>     | 0.3822       | 0.3934     |
| <b>mean</b>        | 0.4102       | 0.4151     |
| <b>s.d</b>         | 0.0794       | 0.0829     |
| <b>C.V.</b>        | 19.36        | 19.97      |

**Source: Appendix 6**

Table 12 shows that mean total investment to total deposit of NABIL is lower than HBL. The ratio of NABIL has decreased from F.Y. 2002/03 to 2004/05 and has increased in F.Y. 2006/07 to 38.22%. Its mean ratio is 41.02% & C.V. is 19.36. The ratio of HBL has shown the fluctuation between 23.15% and 49.18%. In last seven years. Its mean ratio is 41.51% and C.V. is 19.97%. The C.V of both banks shows that they are less stable.

### **1.2.3 Loan and advances to working fund ratio**

It reflects the extent to which the commercial banks are successful in mobilizing their assets on loans & advances for generation of income.

According to the Table 13, the mean loan and advances to working fund ratio of NABIL is greater than that of HBL. The ratio of NABIL is in increasing trend from F.Y. 2001/02 to 2004/05 but has decreased in F.Y 2006/07 to 57.66%. HBL has fluctuating ratio between 46.23%& 51.85%.

**Table 13**  
**Loan and advances to working fund ratio**

| Fiscal year | NABIL  | HBL    |
|-------------|--------|--------|
| 2000/01     | 0.4532 | 0.4623 |
| 2001/02     | 0.4336 | 0.4483 |
| 2002/03     | 0.4796 | 0.5106 |
| 2003/04     | 0.4998 | 0.5021 |
| 2004/05     | 0.6238 | 0.4659 |
| 2005/06     | 0.5853 | 0.5164 |
| 2006/07     | 0.5766 | 0.5185 |
| mean        | 0.5216 | 0.4892 |
| s.d         | 0.677  | 0.0272 |
| C.V.        | 12.98  | 5.55   |

**Source: Appendix 7**

#### **1.2.4 Investment on government securities to total working fund ratio**

Table 14 shows the level of investment of working fund on government securities. It represents the ratio between investments on government securities and working fund of NABIL i.e. 17.39% is greater than that of HBL which has the ratio of 15.76%.

**Table 14**  
**Investment on government securities to total working fund ratio**

| Fiscal year    | NABIL  | HBL    |
|----------------|--------|--------|
| <b>2000/01</b> | 0.1488 | 0.1140 |
| <b>2001/02</b> | 0.2290 | 0.1215 |
| <b>2002/03</b> | 0.2121 | 0.1883 |
| <b>2003/04</b> | 0.2147 | 0.1334 |
| <b>2004/05</b> | 0.1375 | 0.1895 |
| <b>2005/06</b> | 0.1014 | 0.1685 |
| <b>2006/07</b> | 0.1741 | 0.880  |
| <b>mean</b>    | 0.1739 | 0.1576 |
| <b>s.d</b>     | 0.0437 | 0.0312 |
| <b>C.V.</b>    | 25.13  | 19.77  |

**Source: Appendix 8**



Since, the investment of NABIL on government securities is decreasing; the ratio is in decreasing trend. During F.Y 2005/06, the ratio of NABIL is lower than of HBL. C.V of NABIL and HBL are 25.13 % and 19.77% respectively.

#### **1.2.5 Investment on shares and debentures to total working fund ratio**

Nowadays commercial banks invest their fund not only on government securities, but also invest on the shares and debenture of other different types of companies. Table 15 shows the level of investment of working fund on shares and debentures of other banks and companies.

**Table 15**  
**Investment on shares and debentures to total working fund ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.0010       | 0.0006     |
| <b>2001/02</b>     | 0.0012       | 0.0016     |
| <b>2002/03</b>     | 0.0013       | 0.0016     |
| <b>2003/04</b>     | 0.0013       | 0.0013     |
| <b>2004/05</b>     | 0.0251       | 0.0014     |
| <b>2005/06</b>     | 0.0046       | 0.0013     |
| <b>2006/07</b>     | 0.0103       | 0.0021     |
| <b>mean</b>        | 0.0064       | 0.0014     |
| <b>s.d</b>         | 0.0082       | 0.0004     |
| <b>C.V.</b>        | 128.89       | 29.62      |

**Source: Appendix 9**

Since, NABIL has been investing larger amount of money on shares and debentures since F.Y 2004/05 than HBL, the mean ratio between investment on shares debentures and working fund of NABIL is greater than of HBL. The C.V of NABIL is comparatively higher than HBL. It means the distribution of NABIL is more variable.

According to the F.Y 2006/07, the ratio of NABIL and HBL are 1.03% and 0.21% respectively.

### 1.2.6 Performing loan loss provision

Table 19 shows the performing loan loss provision of NABIL and HBL. The data of non-performing loan of HBL for the year 2000/01 is not available. So, only six years data are taken. From Table 16, it is cleared that NABIL has higher ratio than HBL. It indicates that NABIL has proper utilization of assets on good loans.

**Table 16**  
**Performing loan loss provision**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2001/02</b>     | 0.9286       | 0.8790     |
| <b>2002/03</b>     | 0.9445       | 0.8992     |
| <b>2003/04</b>     | 0.9664       | 0.9112     |
| <b>2004/05</b>     | 0.9868       | 0.9256     |
| <b>2005/06</b>     | 0.9862       | 0.9340     |
| <b>2006/07</b>     | 0.9887       | 0.9630     |
| <b>mean</b>        | 0.9669       | 0.9187     |
| <b>s.d</b>         | 0.0231       | 0.0266     |
| <b>C.V.</b>        | 2.39         | 2.89       |

**Source: Appendix 10**

However, if we analyze the ratio, NABIL is maintaining the ratio in the increase manner. This shows positive impact on the banks performance as higher performing loan loss provision ratio indicates efficiency in utilizing the good loans. The mean ratio of NABIL is 96.97% while that of HBL is 91.87%. The C.V of NABIL and HBL are 2.39 and 2.89 respectively.

### 1.2.7 Non performing loan loss provision

Table 17 shows that NABIL and HBL both have decreasing

trend in the ratio which shows good utilization of their loan and proper management of assets.

**Table 17**  
**Non performing loan loss provision**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2001/02</b>     | 0.0714       | 0.1210     |
| <b>2002/03</b>     | 0.0555       | 0.1008     |
| <b>2003/04</b>     | 0.0336       | 0.0888     |
| <b>2004/05</b>     | 0.0132       | 0.0744     |
| <b>2005/06</b>     | 0.0138       | 0.0660     |
| <b>2006/07</b>     | 0.0119       | 0.0360     |
| <b>mean</b>        | 0.0333       | 0.0812     |
| <b>s.d</b>         | 0.0230       | 0.0269     |
| <b>C.V.</b>        | 68.88        | 33.16      |

**Source: Appendix 11**

Higher ratio indicates worse management of assets. This table indicates NABIL has lower ratio than HBL, showing better utilization of loan. The mean ratio of NABIL is 3.33% while that of HBL is 8.12%. The C.V of NABIL and HBL are 68.88 and 33.16 respectively.

### **1.2.8 Loan loss provision ratio**

This ratio illustrates the amount of provision of a bank has to create for its loan and advance. Higher loan loss provision ratio is favorable to the bank. Table 18 indicates that the mean ratio of NABIL is higher than that of HBL. The mean ratios are 1.5234 and 0.9189 respectively. The C.V of NABIL is higher than HBL. However, both banks have shown increasing ratio, which is better.

**Table 18**  
**Loan loss provision ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2001/02</b>     | 0.6535       | 0.5562     |
| <b>2002/03</b>     | 0.7956       | 0.7713     |
| <b>2003/04</b>     | 1.2509       | 0.8439     |
| <b>2004/05</b>     | 2.4897       | 1.0260     |
| <b>2005/06</b>     | 1.9454       | 1.0759     |
| <b>2006/07</b>     | 2.0056       | 1.2402     |
| <b>mean</b>        | 1.5234       | 0.9189     |
| <b>s.d</b>         | 0.6714       | 0.2230     |
| <b>C.V.</b>        | 44.07        | 24.26      |

**Source: Appendix 12**

### **1.3 Profitability ratio**

#### **1.3.1 Return on loan and advances ratio**

Return on loan and advance ratio measures the earning capacity of a commercial bank on its mobilized fund based loan and advances.

**Table 19**  
**Return on loan and advances ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.0350       | 0.0307     |
| <b>2001/02</b>     | 0.0347       | 0.0246     |
| <b>2002/03</b>     | 0.0513       | 0.0195     |
| <b>2003/04</b>     | 0.0532       | 0.0204     |
| <b>2004/05</b>     | 0.0475       | 0.0229     |
| <b>2005/06</b>     | 0.0478       | 0.0290     |
| <b>2006/07</b>     | 0.0423       | 0.0276     |
| <b>mean</b>        | 0.0445       | 0.0250     |
| <b>s.d</b>         | 0.0069       | 0.0004     |
| <b>C.V.</b>        | 15.48        | 15.96      |

**Source: Appendix 13**

Table 19 signifies that the ratio of NABIL is much better than HBL. The ratio of NABIL and HBL are 0.0423 and 0.0276 respectively in the F.Y 2006/07. The ratios of both banks are fluctuating over seven years study period. The C.V of NABIL and HBL are slightly different.

### **1.3.2 Return on total working fund ratio (ROA)**

This ratio measures the overall profitability secured by Total Working Fund. Table 20 indicates that the mean ratio of NABIL is better than of HBL. Hence, it is cleared that NABIL has better profitability in terms of total working fund than that of HBL.

**Table 20**  
**Return on total working fund ratio (ROA)**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.0158       | 0.0142     |
| <b>2001/02</b>     | 0.0151       | 0.0110     |
| <b>2002/03</b>     | 0.0246       | 0.0100     |
| <b>2003/04</b>     | 0.0266       | 0.0102     |
| <b>2004/05</b>     | 0.0296       | 0.0107     |
| <b>2005/06</b>     | 0.0280       | 0.0150     |
| <b>2006/07</b>     | 0.0244       | 0.0143     |
| <b>mean</b>        | 0.0234       | 0.0122     |
| <b>s.d</b>         | 0.0053       | 0.0020     |
| <b>C.V.</b>        | 22.74        | 16.65      |

**Source: Appendix 14**

The mean return on working fund of NABIL and HBL are 0.0234 and 0.0122 respectively. The C.V of NABIL is higher than HBL, which clears that the ratios are more variable than the ratios of HBL.

### 1.3.3 Return on equity ratio (ROE)

It measures the effectiveness of funds mobilization. Table 21 clarifies that the mean ratio of NABIL is 30.19% while the mean ratio is 24.92 %. It means the return on equity of NABIL is higher than that of HBL. That indicates NABIL is more effective in fund mobilization than HBL over the 7 years of study period.

**Table 21**  
**Return on equity ratio (ROE)**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.2738       | 0.3847     |
| <b>2001/02</b>     | 0.2363       | 0.2739     |
| <b>2002/03</b>     | 0.3166       | 0.1994     |
| <b>2003/04</b>     | 0.3070       | 0.1986     |
| <b>2004/05</b>     | 0.3136       | 0.1997     |
| <b>2005/06</b>     | 0.3387       | 0.2588     |
| <b>2006/07</b>     | 0.3276       | 0.2292     |
| <b>mean</b>        | 0.3019       | 0.2492     |
| <b>s.d</b>         | 0.0327       | 0.0621     |
| <b>C.V.</b>        | 10.83        | 24.90      |

**Source: Appendix 15**

The ratios of NABIL and HBL are 32.76 % and 22.92% during F.Y 2006/07. The ratio of NABIL indicates that they are more uniform than ratio of HBL during the study period as C.V of NABIL and HBL are 10.83 and 24.90.

### 1.3.4 Total interest earned to total asset ratio

It measures the interest earning capacity of the bank through the efficient utilization of assets. Table 22 reveals that the mean ratio between total interests earned to total assets of NABIL is 6.17% and that of HBL is 5.14%.

Table 22 indicates that C.V of NABIL and HBL are 4.82 and 11.47 which proves the ratio of NABIL is more consistent or less variable than the ratio of HBL.

**Table 22**  
**Total interest earned to total asset ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.0674       | 0.0703     |
| <b>2001/02</b>     | 0.0635       | 0.0556     |
| <b>2002/03</b>     | 0.0615       | 0.0514     |
| <b>2003/04</b>     | 0.0598       | 0.0503     |
| <b>2004/05</b>     | 0.0626       | 0.0519     |
| <b>2005/06</b>     | 0.0586       | 0.0552     |
| <b>2006/07</b>     | 0.0582       | 0.0529     |
| <b>mean</b>        | 0.0617       | 0.0554     |
| <b>s.d</b>         | 0.0030       | 0.0064     |
| <b>C.V.</b>        | 4.82         | 11.47      |

Source: Appendix 16.

### **1.3.5 Total interest earned to total working fund ratio**

This ratio finds out the percentage of interest from total working fund which indicates the performance of the bank. According to Table 23, the mean ratio between total interests to total working fund of NABIL and HBL are 6.09% and 5.45% respectively where as C.V of NABIL and HBL are 6.07 And 11.01 respectively. During F.Y 2006/07, the mean ratio of NABIL is 5.74% and of HBL 5.17%.

**Table 23**  
**Total interests earned to total working fund ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.0690       | 0.0680     |
| <b>2001/02</b>     | 0.0622       | 0.0539     |
| <b>2002/03</b>     | 0.0602       | 0.0565     |
| <b>2003/04</b>     | 0.0586       | 0.0484     |
| <b>2004/05</b>     | 0.0609       | 0.0501     |
| <b>2005/06</b>     | 0.0577       | 0.0533     |
| <b>2006/07</b>     | 0.0574       | 0.0517     |
| <b>mean</b>        | 0.0609       | 0.0545     |
| <b>s.d</b>         | 0.0037       | 0.0060     |
| <b>C.V.</b>        | 6.07         | 11.01      |

Source: Appendix 17

## 1.4 Risk ratios

### 1.4.1 Credit risk ratio

It is expressed as the percentage of total loan & advances to total assets. Table 24 shows that the mean Credit risk ratio of NABIL is 52.93% which is higher than that of HBL i.e. 49.64%

**Table 24**  
**Credit risk ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.4426       | 0.4777     |
| <b>2001/02</b>     | 0.4426       | 0.4623     |
| <b>2002/03</b>     | 0.4899       | 0.4644     |
| <b>2003/04</b>     | 0.5105       | 0.5217     |
| <b>2004/05</b>     | 0.6415       | 0.4831     |
| <b>2005/06</b>     | 0.5947       | 0.5350     |
| <b>2006/07</b>     | 0.5835       | 0.5308     |
| <b>mean</b>        | 0.5293       | 0.4964     |
| <b>s.d</b>         | 0.0724       | 0.0293     |
| <b>C.V.</b>        | 13.39        | 5.91       |

**Source: Appendix 18**

Similarly, C.V of NABIL is also higher than HBL. The ratio of NABIL and HBL are 58.35% and 53.08% respectively during F.Y 2006/07. This concludes that NABIL has higher credit risk in comparison with HBL.

### 1.4.2 Capital risk ratio

Table 25 provides the capital risk ratio of NABIL and HBL during the 7 year of study period. It shows that NABIL has higher capital risk ratio than HBL from F.Y 2000/01 to F.Y



**Table 25**  
**Capital risk ratio**

| <b>Fiscal year</b> | <b>NABIL</b> | <b>HBL</b> |
|--------------------|--------------|------------|
| <b>2000/01</b>     | 0.0454       | 0.0265     |
| <b>2001/02</b>     | 0.0466       | 0.0306     |
| <b>2002/03</b>     | 0.0441       | 0.0292     |
| <b>2003/04</b>     | 0.0414       | 0.0318     |
| <b>2004/05</b>     | 0.0347       | 0.0351     |
| <b>2005/06</b>     | 0.0290       | 0.0388     |
| <b>2006/07</b>     | 0.0256       | 0.0370     |
| <b>mean</b>        | 0.0381       | 0.0327     |
| <b>s.d</b>         | 0.0078       | 0.0041     |
| <b>C.V.</b>        | 20.39        | 12.52      |

**Source: Appendix 19**

2004/05. NABIL has ratio of decreasing trend whereas HBL has ratio of increasing trend. The mean ratio of NABIL and HBL are 3.81% and 3.27% respectively.

## **1.5 Growth ratio**

The average growth rates of deposits, loan & advances, total investment and net profit of NABIL and HBL during the seven years of study period are presented by Table Nos. 26, 27, 28 and 29 respectively.

### **1.5.1 Growth ratio of total deposits**

Table 26 and figure 3 indicate the expansion of total deposits of NABIL and HBL. It indicates that the total deposits of NABIL has been increasing since F.Y 2003/04 and has reached to Rs22342 million during F.Y 2006/07. It was the lowest in the F.Y 2002/03 and the highest in F.Y 2006/07. Its average growth rate during seven years of study period is 7.70%.

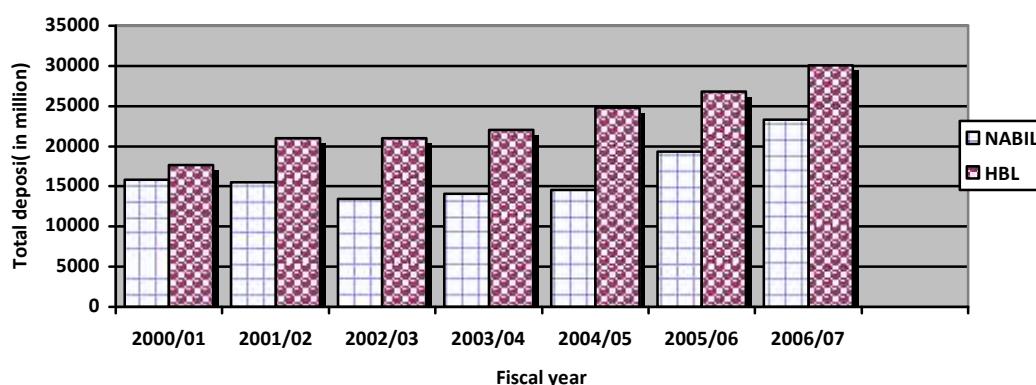
**Table 26**  
**Growth ratio of total deposits**  
**(Rs. in million)**

| F.Y. →<br>Bank ↓ | 2000/01 | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | Average growth |
|------------------|---------|---------|---------|---------|---------|---------|---------|----------------|
| <b>NABIL</b>     | 15839   | 15506   | 13448   | 14119   | 14587   | 19347   | 23342   | <b>7.70%</b>   |
| <b>HBL</b>       | 17637   | 18619   | 21007   | 22010   | 24814   | 26814   | 30048   | <b>9.35%</b>   |

**Source: Appendix 20 – A**

HBL has been increasing trend of total deposits since 2000/01 and has reached to Rs30048 million during last F.Y. It has 9.35% average growth ratio. Here, it is clearly seen that deposits of HBL is increasing rapidly than that of NABIL.

**Figure 3**  
**Growth ratio of total deposits**



### 1.5.2 Growth ratio of loan and advances

Loan and advances is the major which indicates the ability of bank to utilize its deposits in the form of loan and advances to earn high return. Table 27 shows the growth rate of loan and advances of NABIL and HBL. It reveals that the loans and advances of NABIL is fluctuating between Rs 8324 million and Rs15903 million. It has been increasing since F.Y 2000/01. Its average growth ratio of loan and advances is 12.20 %.

**Table 27**  
**Growth ratio of loan and advances (Rs. in million)**

| F.Y. →<br>Bank↓ | 2000/01 | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | Average growth |
|-----------------|---------|---------|---------|---------|---------|---------|---------|----------------|
| <b>NABIL</b>    | 8324    | 7802    | 8114    | 8549    | 10947   | 13279   | 15903   | <b>12.20%</b>  |
| <b>HBL</b>      | 9015    | 9557    | 10845   | 12919   | 13451   | 15762   | 17793   | <b>12.15%</b>  |

**Source: Appendix 20 – B**

The loan and advances of HBL have risen from Rs9015 to Rs17793 million during the seven years of study period. Its average growth ratio is 12.15 %.

**Figure 4**  
**Loan and advances of NABIL and HBL**

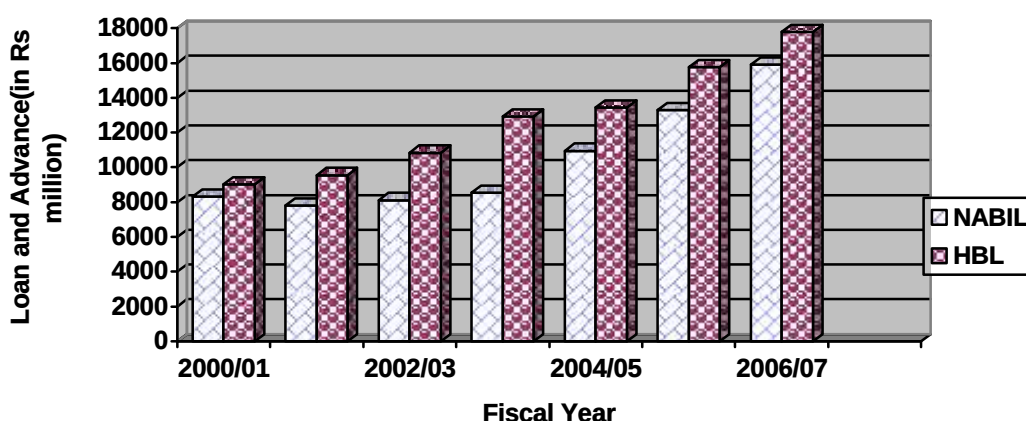


Figure 4 shows that, the loan & advances of both banks is early equal during F.Y 2000/01. However, HBL has shown higher growth in loan and advances since F.Y 2001/02

### 1.5.3 Growth ratio of total investment

Table 28 and Figure 5 indicate the growth rate of investment of NABIL and HBL. On the basis of this table, the total investments of both banks have been fluctuating.

**Table 28**  
**Growth ratio of total investment (Rs. in million)**

| F.Y. →<br>Bank↓ | 2000/01 | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | Average growth |
|-----------------|---------|---------|---------|---------|---------|---------|---------|----------------|
| <b>NABIL</b>    | 7740    | 8200    | 6031    | 5836    | 4270    | 6181    | 8945    | <b>6.57%</b>   |
| <b>HBL</b>      | 4083    | 9157    | 10175   | 9292    | 11692   | 10889   | 11823   | <b>25.71%</b>  |

**Source: Appendix 20 – C**

NABIL has the highest investment in the F.Y. 2006/07 and the lowest in the F.Y. 2004/05. Similarly, HBL has the highest investment in the F.Y. 2006/07 and the lowest in the F.Y. 2000/01. The average growth ratio of NABIL and HBL are 6.57% and 25.71% respectively.

**Figure 5**  
**Total investment of NABIL and HBL**

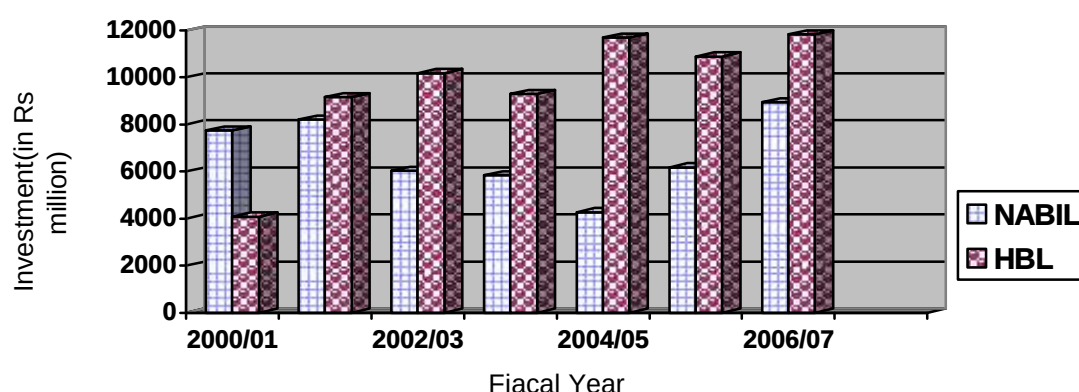


Figure 5 also provides information about total investment of NABIL and HBL. This figure shows that there is quite a difference between the total investment of NABIL and HBL during F.Y. 2004/05. However, this difference is slightly decreased in 2006/07.

#### **1.5.4 Growth ratio of net profit**

Table 29 indicates the growth rate of Net profit of both banks. It is clear from this Table that net profit of NABIL is better than

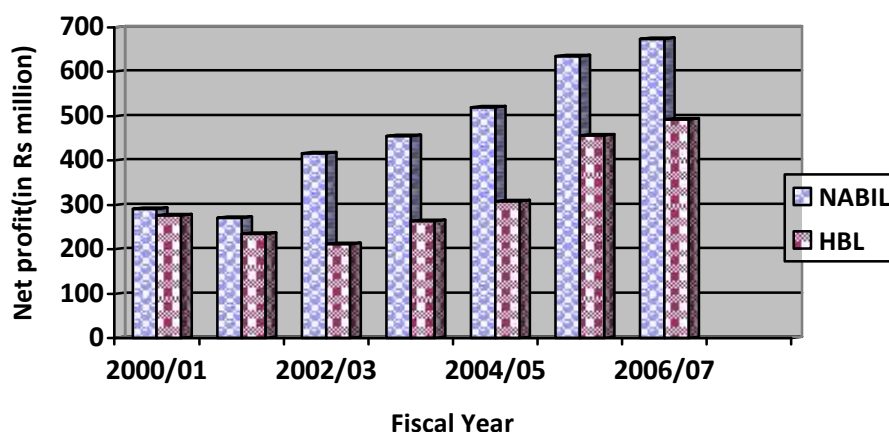
of HBL in each year. During F.Y 2006/07 the net profit of NABIL is 674 million and that of HBL is 429 million. In spite of this, the average growth rate of HBL is 12.04 % and that of NABIL is 16.12%. It clarifies that NABIL has better growth in net profit than HBL has achieved. It indicates NABIL is showing better performance for ahead net profit in future. However, both banks are getting success to raise the net profit since F.Y 2003/04. The Net profits of NABIL and HBL are also given by Figure 6.

**Table 29**  
**Growth rate of net profit (Rs. in million)**

| F.Y. →<br>Bank ↓ | 2000/01 | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | Average growth |
|------------------|---------|---------|---------|---------|---------|---------|---------|----------------|
| <b>NABIL</b>     | 291     | 271     | 416     | 455     | 520     | 635     | 674     | <b>16.42%</b>  |
| <b>HBL</b>       | 277     | 235     | 212     | 263     | 308     | 457     | 492     | <b>12.04%</b>  |

**Source: Appendix 20 – D**

**Figure 6**  
**Net profits of NABIL and HBL**



Here, Net Profit of NABIL is higher than HBL. But it is also clear that net profit of HBL is also increasing rapidly

## 1.6 Capital adequacy ratio

### 1.6.1 Capital fund

Both banks have been increasing its capital so as to abide the direction of NRB. Table 30 grants the capital fund of NABIL and HBL over 6 years. It is cleared the banks have been using necessary tools to boost the capital. Total capital of NABIL is increasing each year and reached to Rs2307 million in F.Y 2006/07. Likewise, total capital of HBL is also increasing and reached to Rs2651 million in F.Y 2006/07. The cumulative profit and current year's profit of both banks are also increasing in remarkable trend which also constitutes the major element in the capital growth.

**Table 30**  
**Capital fund (Rs. in million)**

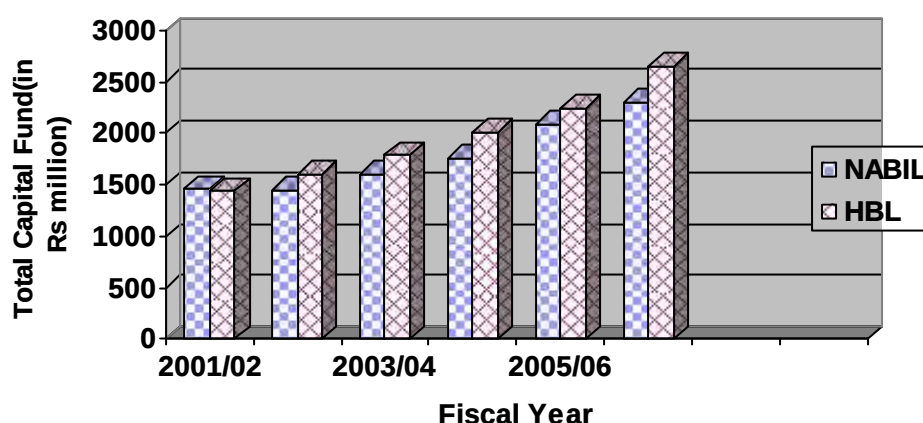
| Fiscal year |                       | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
|-------------|-----------------------|---------|---------|---------|---------|---------|---------|
| NABIL       | Core capital          | 1112    | 1277    | 1439    | 1611    | 1831    | 1992    |
|             | Supplementary capital | 353     | 178     | 170     | 156     | 259     | 314     |
|             | Total capital         | 1464    | 1455    | 1609    | 1766    | 2089    | 2307    |
| HBL         | Core capital          | 835     | 1039    | 1297    | 1526    | 1772    | 2104    |
|             | Supplementary capital | 638     | 566     | 499     | 491     | 521     | 547     |
|             | Total capital         | 1437    | 1604    | 1796    | 2017    | 2243    | 2651    |

**Source: Appendix 21**

The HBL has also issued bond and created bond redemption reserve. Issuance of bond has increased the supplementary capital while bond redemption reserve has been increasing the core capital. Likewise, general reserve and capital adjustment reserve are also increasing. But the supplementary capital of the bank has been showing fluctuating. It is decreased from Rs353 million to Rs156 till F.Y 2004/05 in NABIL and again

is increased in F.Y 2006/07 to Rs314 million Similarly, in HBL it is decreased from Rs638 million to Rs 491 million till F.Y 2004/05

**Figure 7**  
**Total capital funds**



and again is increased to Rs547 million F.Y 2006/07. It has been understandable by figure 7 also. It also indicates total capital of HBL is higher than that of NABIL as paid up capital of HBL is increasing due to distribution of stock dividend every year.

### 1.6.2 Capital adequacy position

Table 31 gives the overview of capital adequacy position of NABIL and HBL and compares the position with the minimum required total capital and core capital prescribed by NRB. NABIL is successful in maintaining the required CAR. But it is also shows that the CAR of NABIL is in decreasing state. This is the result of decreasing core capital as well as supplementary capital. However total capital fund of this bank is still higher than ratio prescribed by the NRB by 4.86%, 3.06%, and 2.56% 1.44%, 1.31% and 0.04% from the fiscal years 20001/2002 to 2006/2007 respectively. Likewise the core capital fund is higher by 6.03%, 6.46% 6.62%,

5.85%, 5.21% and 4.90% from 2001/2002 to 2006/2007 respectively. HBL was successful in maintaining the required total capital for the fiscal years 2001/02, 2002/03, 2004/04, and 2006/2007 by 2.56%, 0.93%, 0.01%, 0.01% and 0.11% respectively but it was not able to maintain in the fiscal year 2003/04 and 2005/2006 by 0.35% and 0.74%. Even though the core capital of the bank was good enough, it was the supplementary capital, which made bank suffer from the low capital adequacy ratio.

**Table 31**  
**Capital adequacy position**

| Fiscal year | Minimum total Capital fund required | NABIL<br>Total capital fund (%) | NABIL<br>Capital fund Excess/(short) | HBL<br>Total capital fund (%) | HBL<br>Capital fund Excess/(short) |
|-------------|-------------------------------------|---------------------------------|--------------------------------------|-------------------------------|------------------------------------|
| 2001/02     | 9.00%                               | 13.86%                          | 4.86%                                | 11.56%                        | 2.56%                              |
| 2002/03     | 10.00%                              | 13.06%                          | 3.06%                                | 10.93%                        | 0.93%                              |
| 2003/04     | 11.00%                              | 13.56%                          | 2.56%                                | 10.65%                        | 0.35%                              |
| 2004/05     | 11.00%                              | 12.44%                          | 1.44%                                | 11.01%                        | 0.01%                              |
| 2005/06     | 12.00%                              | 12.31%                          | 0.31%                                | 11.26%                        | 0.74%                              |
| 2006/07     | 12.00%                              | 12.04%                          | 0.04%                                | 12.11%                        | 0.11%                              |
| Fiscal year | Minimum core Capital fund required  | Total core capital fund (%)     | Core capital fund Excess/(short)     | Total core capital fund (%)   | Core capital fund Excess/(short)   |
| 2001/02     | 4.05%                               | 10.53%                          | 6.03%                                | 6.55%                         | 2.05%                              |
| 2002/03     | 5.00%                               | 11.46%                          | 6.46%                                | 7.07%                         | 2.07%                              |
| 2003/04     | 5.50%                               | 12.12%                          | 6.62%                                | 7.69%                         | 2.19%                              |
| 2004/05     | 5.50%                               | 11.35%                          | 5.85%                                | 8.33%                         | 2.83%                              |
| 2005/06     | 6.00%                               | 10.78%                          | 4.78%                                | 8.65%                         | 2.65%                              |
| 2006/07     | 6.00%                               | 10.40%                          | 4.40%                                | 9.61%                         | 3.61%                              |

**Source: NRB directives Appendix 21**

The supplementary capital is reduced due to the reduction in the loss provision. NRB have directed commercial banks to include the loss provision of good loans only in the calculation of



supplementary capital, Therefore, the decrease in it is not good for the bank for two reason. Firstly decrease in the loan loss provision of good loans means turning of good loans into substandard, doubtful and bad loans. Secondly, the decrease in its has caused the inadequacy of the capital of the bank.

Table 31 also shows that CAR of NABIL is higher than that of HBL in both cases i.e. total capital fund and core capital fund. Hence, NABIL is maintaining better capital adequacy ratio in terms of total capital fund and core capital fund than HBL.

### **1.7 Common size analysis**

Comparative study of financial statement of NABIL and HBL can be done with the help of table 32, 33, 34 and 35. Table 32 and Table 33 show common size balance sheet of NABIL and HBL respectively. Similarly, Table 34 indicate common size income statement of NABIL and table 35 reveals that of HBL.

#### **1.7.1 Common size balance sheet of NABIL**

Table 32 represents common size balance sheet of NABIL. Share capital of NABIL is fluctuating between 2.2% to 3% during the study period. During F.Y 2000/2001, reserve and surplus covers 3.2% of total liabilities and it reached to 5.7% during F.Y. 2006/2007. Deposit percentage is the highest during F.Y. 2000/01 i.e. 89.1%. It covers 85.6% of total liabilities during F.Y. 2006/07.

The percentage of cash and balance is gradually decreasing and reached to 5.1% during F.Y. 2006/07. According to the table, investment has been increasing. Its investment in govt. securities is decreasing while investment in shares and debentures is increasing.

**Table 32**  
**Common Size Balance sheet of NABIL(in percentage)**

| <b>Fiscal year</b>               | <b>2000/01</b> | <b>2001/02</b> | <b>2002/03</b> | <b>2003/04</b> | <b>2004/05</b> | <b>2005/06</b> | <b>2006/07</b> |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <u>Capital liabilities</u>       |                |                |                |                |                |                |                |
| Share capital                    | 2.8            | 2.8            | 3.0            | 2.9            | 2.9            | 2.2            | 1.8            |
| Reserves Surplus                 | 3.2            | 3.7            | 5.0            | 5.9            | 6.8            | 6.2            | 5.7            |
| Borrowings                       | ***            | 2.4            | 5.8            | 1.4            | 0.1            | 0.8            | 3.3            |
| Deposits                         | 89.1           | 88.0           | 81.2           | 84.3           | 84.9           | 86.6           | 85.6           |
| Bills payable                    | 0.4            | 0.4            | 0.7            | 1.0            | 0.7            | 0.5            | 0.3            |
| Proposed & undisturbed dividend  | ***            | ***            | ***            | ***            | ***            | 1.9            | 1.9            |
| Income tax liabilities           | ***            | ***            | ***            | ***            | ***            | 0.2            | ***            |
| Other liabilities                | 4.5            | 2.8            | 4.4            | 4.4            | 4.7            | 1.6            | 1.4            |
| <b>Total</b>                     | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   |
| <u>Assets</u>                    |                |                |                |                |                |                |                |
| Cash & bank balance              | 4.6            | 6.0            | 6.9            | 5.8            | 3.3            | 2.8            | 5.1            |
| Money at call & short notice     | 2.9            | 0.2            | 4.0            | 5.5            | 5.1            | 7.8            | 2.1            |
| investments                      | 43.4           | 46.5           | 36.4           | 34.9           | 24.8           | 27.7           | 32.8           |
| Lone, advance and bill purchased | 43.5           | 42.2           | 46.8           | 48.9           | 61.6           | 57.9           | 57.1           |
| Fixed assets                     | 1.4            | 1.3            | 1.5            | 2.0            | 2.1            | 1.4            | 1.1            |
| Others assets                    | 4.2            | 3.8            | 4.3            | 2.9            | 3.2            | 2.4            | 1.8            |
| <b>Total</b>                     | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   |

**Source: Appendix 22- A**

Loan, advances and bills purchased has been showing fluctuating condition. It occupies the highest percentage i.e. 57.11% of total assets.

### **Common size balance of HBL**

Table 33 indicates common size balance sheet of HBL .It shows the share capital is increasing. Reserves and surplus is increasing and reached to 3.9%.It is reached up to 2.4 % of total liabilities. Deposit covers 93.5% of total liabilities during F.Y.2000/01 and covers 89.6%during 2006/07.It is the highest during F.Y.2000/01 i.e.93.5%.Bills payable covers 0.27% of total liabilities.

**Table 33****Common Size Balance sheet of HBL(in percentage)**

| <b>Fiscal year</b>               | <b>2000/01</b> | <b>2001/02</b> | <b>2002/03</b> | <b>2003/04</b> | <b>2004/05</b> | <b>2005/06</b> | <b>2006/07</b> |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <u>Capital liabilities</u>       |                |                |                |                |                |                |                |
| Share capital                    | 1.6            | 1.9            | 1.8            | 2.2            | 2.3            | 2.6            | 2.4            |
| Reserves Surplus                 | 2.2            | 2.3            | 2.7            | 3.2            | 3.2            | 3.4            | 3.9            |
| Borrowings                       | 0.4            | 2.6            | 2.8            | 2.7            | 1.8            | 1.7            | 1.8            |
| Deposits                         | 93.5           | 90.1           | 89.9           | 88.9           | 89.1           | 89.9           | 89.6           |
| Bills payable                    | 0.1            | 0.3            | 0.2            | 0.3            | 0.2            | 0.2            | 0.27           |
| Proposed & undisturbed dividend  | ***            | ***            | ***            | ***            | ***            | 0.8            | 0.4            |
| Income tax liabilities           | ***            | ***            | ***            | ***            | ***            | ***            | 0.04           |
| Other liabilities                | 2.2            | 2.9            | 2.5            | 2.8            | 3.3            | 2.3            | 1.59           |
| <b>Total</b>                     | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   |
| <u>Assets</u>                    |                |                |                |                |                |                |                |
| Cash & bank balance              | 7.6            | 6.1            | 8.5            | 8.1            | 7.2            | 5.8            | 5.2            |
| Money at call & short notice     | 21.5           | 1.7            | 0.6            | 1.5            | 1.6            | 3.4            | 5.1            |
| investments                      | 21.6           | 44.3           | 43.6           | 37.5           | 42.2           | 37.0           | 35.3           |
| Lone, advance and bill purchased | 45.2           | 43.1           | 42.8           | 48.5           | 44.6           | 49.7           | 50.7           |
| Fixed assets                     | 1.1            | 1.5            | 1.0            | 0.9            | 1.1            | 1.8            | 1.7            |
| Others assets                    | 2.9            | 3.2            | 3.5            | 3.4            | 3.5            | 2.3            | 2              |
| <b>Total</b>                     | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   | <b>100.0</b>   |

Source; Appendix 22-A

In context of assets side, the percentage of cash and bank balance is fluctuating between 5.2% and 8.1%. During F.Y. 2006/07, it occupies 5.2% of total assets. Money at call and short notice occupies 5.1% during 2006/07. It is the highest on F.Y. 2000/01 and the lowest on 2002/03. According to the table, investment has been fluctuating. It covers the highest percent during F.Y. 2001/02, which is 44.3% of total assets. During 2000/01 it occupies 21.6% and during 2006/07, it covers 35.3%. Similarly, Loan, advances

and bill purchased has been showing less variability. The fluctuation is 42.8% to 50.7% only during the study period.

### 1.7.2 Common size income statement of NABIL

Interest Income is considered as common base for the comparative study and is equal to 100% in common size income statement. Table 34 indicates common size income statement of NABIL. Here, Commission and discount, exchange income

**Table 34**  
**Common size income statement of NABIL**  
(In percentage)

| Fiscal year                                      | 2000/01     | 2001/02     | 2002/03      | 2003/04      | 2004/05      | 2005/06      | 2006/07     |
|--------------------------------------------------|-------------|-------------|--------------|--------------|--------------|--------------|-------------|
| Interest income                                  | 100.0       | 100.0       | 100.0        | 100.0        | 100.0        | 100.0        | 100.0       |
| Interest expenses                                | 45.6        | 41.3        | 31.1         | 28.2         | 22.8         | 27.3         | 34.9        |
| <b>Net interest income</b>                       | <b>54.4</b> | <b>58.8</b> | <b>68.9</b>  | <b>71.8</b>  | <b>77.2</b>  | <b>72.7</b>  | <b>65.1</b> |
| Commission& Discount                             | 7.7         | 10.2        | 14.1         | 13.6         | 12.1         | 10.5         | 9.5         |
| Other operating income                           | ***         | ***         | 8.5          | 9.3          | 6.7          | 6.3          | 5.5         |
| Exchange income                                  | 12.6        | 13.8        | 14.1         | 15.7         | 17.3         | 14.1         | 13.2        |
| <b>Total operating income</b>                    | <b>74.7</b> | <b>82.7</b> | <b>105.7</b> | <b>110.3</b> | <b>113.4</b> | <b>103.7</b> | <b>93.3</b> |
| Employees Expenses                               | 11.6        | 12.9        | 20.7         | 18.1         | 18.6         | 16.8         | 15.1        |
| Other operating expenses                         | 9.6         | 12.2        | 16.3         | 15.1         | 17.8         | 13.9         | 11.8        |
| Exchange loss                                    | ***         | ***         | ***          | ***          | ***          | ***          | ***         |
| Provision for possible losses                    | 13.1        | ***         | ***          | 0.1          | 0.4          | 0.3          | 0.9         |
| <b>Operating profit</b>                          | <b>40.3</b> | <b>57.5</b> | <b>68.7</b>  | <b>77.0</b>  | <b>76.6</b>  | <b>72.7</b>  | <b>65.5</b> |
| Nonoperating income/loss                         | ***         | ***         | ***          | ***          | ***          | 0.1          | 0.3         |
| Provision for possible losses write back         | ***         | -39.4       | -5.1         | -8.2         | -2.9         | 0.6          | 0.6         |
| <b>Profit from regular activities</b>            | <b>40.3</b> | <b>18.1</b> | <b>63.6</b>  | <b>68.9</b>  | <b>73.7</b>  | <b>73.4</b>  | <b>66.4</b> |
| Income/(expenses) from extra-ordinary activities | 1.2         | 22.3        | 3.3          | 3.9          | 5.2          | 2.0          | 2.5         |
| <b>Profit from all activities</b>                | <b>41.5</b> | <b>40.4</b> | <b>66.9</b>  | <b>72.8</b>  | <b>78.9</b>  | <b>75.4</b>  | <b>68.9</b> |
| Provision for staff Bonus                        | 4.2         | 3.9         | 6.5          | 7.2          | 7.9          | 6.8          | 6.2         |
| Provision for Income tax                         | 14.4        | 12.3        | 19.5         | 20.2         | 22.4         | 20.1         | 20.2        |
| <b>Net profit / Loss</b>                         | <b>23.0</b> | <b>24.2</b> | <b>40.9</b>  | <b>45.4</b>  | <b>48.7</b>  | <b>48.5</b>  | <b>42.5</b> |

Source: Appendix 22- B

Operating and non operating income, and income from extra ordinary activities are added, whereas, interest expenses, employees expenses, operating and non operating expenses, exchange loss, provision for losses, expenses from extra-ordinary activities, and provision for staff bonus and tax are deducted.

As depicted in Table 34, the net profit percentage of NABIL from F. 2000/01 to F.Y. 2006/07 are 23%, 24.2%, 40.9%, 45.4%, 48.7%, 48.5% and 42.5% respectively. F.Y. 2004/05 shows the highest percentage of Net profit, where as F.Y 2000/01 shows the lowest percentage. Net interest income covers 54.4% during F.Y 2000/01 and covers 65.1% on F.Y. 2006/07. Total operating income is 93.3% during F.Y. 2006/07. Similarly, operating profit of this year is 65.5% Likewise; profit from regular activities is 66.4% and profit before provision for staff and tax is 68.9%.

Table 35 indicates common size income statement of HBL. Table 35 shows that HBL has the highest net profit during F.Y.2006/07 and has the lowest during the F.Y.2000/01. net profit covers 20.9%, 20.5%, 17.7%, 21.1%, 21.3%, 28.1% and 27.5% of the interest income from F.Y.2000/01 to F.Y.2006/07 respectively. During F.Y.2000/01 net profit is 20.9% and during F.Y.2006/07, it is 27.5% of interest income. During this F.Y. the net interest income is 56.8 %, total operating income is 78.4%, operating profit is 38.8 %, profit from regular activities is 62.2%, profit before provision for staff and income tax is 44.5% and Net profit is 27.7%.

## Common size Income statement of HBL

**Table. 35**

### Common size income statement of HBL (In percentage)

| <b>Fiscal year</b>                                | <b>2000/01</b> | <b>2001/02</b> | <b>2002/03</b> | <b>2003/04</b> | <b>2004/05</b> | <b>2005/06</b> | <b>2006/07</b> |
|---------------------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Interest income                                   | 100.0          | 100.0          | 100.0          | 100.0          | 100.0          | 100.0          | 100.0          |
| Interest expenses                                 | 55.4           | 50.3           | 46.1           | 39.5           | 38.9           | 39.9           | 43.2           |
| <b>Net interest income</b>                        | <b>44.6</b>    | <b>49.7</b>    | <b>53.9</b>    | <b>60.5</b>    | <b>61.1</b>    | <b>60.1</b>    | <b>56.8</b>    |
| Commission and Discount                           | 7.2            | 8.9            | 8.6            | 10.0           | 9.2            | 10.2           | 10.8           |
| Other operating income                            | ***            | ***            | ***            | ***            | ***            | 3.2            | 2.3            |
| Exchange income                                   | 9.0            | 9.1            | 9.2            | 9.0            | 9.5            | 12.2           | 8.5            |
| <b>Total operating income</b>                     | <b>60.9</b>    | <b>67.7</b>    | <b>71.6</b>    | <b>79.5</b>    | <b>79.8</b>    | <b>85.6</b>    | <b>78.4</b>    |
| Employees Expenses                                | 6.5            | 8.8            | 10.0           | 12.3           | 12.4           | 14.3           | 15.3           |
| Other operating expenses                          | 10.6           | 13.6           | 14.7           | 16.9           | 19.2           | 20.2           | 19.2           |
| Exchange loss                                     | ***            | ***            | ***            | ***            | ***            | ***            | ***            |
| Provision for possible losses                     | 10.1           | 14.4           | 16.9           | 14.9           | 10.2           | 8.9            | 5.1            |
| <b>Operating profit</b>                           | <b>33.6</b>    | <b>30.9</b>    | <b>30.0</b>    | <b>35.3</b>    | <b>38.1</b>    | <b>42.2</b>    | <b>38.8</b>    |
| Non operating income /loss                        | 0.2            | 0.2            | 0.8            | -0.6           | -0.8           | 3.4            | 0.2            |
| Provision for possible loses write back           | ***            | ***            | ***            | ***            | ***            | ***            | 23.2           |
| <b>Profit from regular activities</b>             | <b>33.8</b>    | <b>31.1</b>    | <b>30.8</b>    | <b>34.8</b>    | <b>37.3</b>    | <b>43.3</b>    | <b>62.2</b>    |
| Income/ (expenses) from extra-ordinary activities | 2.3            | 2.8            | 2.5            | 2.7            | 2.8            | 0.1            | 17.7           |
| <b>Profit from all activities</b>                 | <b>36.1</b>    | <b>33.9</b>    | <b>33.3</b>    | <b>37.5</b>    | <b>40.1</b>    | <b>45.4</b>    | <b>44.5</b>    |
| Provision for staff Bonus                         | 3.6            | 3.4            | 3.3            | 3.7            | 4.0            | 4.1            | 4.1            |
| Provision for Income tax                          | 11.6           | 10.0           | 12.3           | 12.7           | 14.8           | 13.2           | 12.7           |
| <b>Net profit /Loss</b>                           | <b>20.9</b>    | <b>20.5</b>    | <b>17.7</b>    | <b>21.1</b>    | <b>21.3</b>    | <b>28.1</b>    | <b>27.7</b>    |

Source:Appendix22-B

## B. Result of statistical tools

### 1.8 Trend analysis (Least square method)

For the trend analysis of different banks, trend analysis of total deposit, loan and advances, total investment and net profit have been considered:

#### 1.8.1 Trend analysis of total deposit

Table 36 and figure 8 show the trend analysis of total deposit of NABIL and HBL during the study period. From the Table, it is cleared that the total deposit of NABIL and HBL are in increasing trend. It indicates that NABIL's total deposit in comparison with HBL is lower.

**Table 36**

**Trend analysis of total deposit ( Rs. in million)**

| F.Y.<br>Bank | 2000/01 | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
|--------------|---------|---------|---------|---------|---------|---------|---------|
| <b>NABIL</b> | 13232   | 14360   | 15479   | 16598   | 16598   | 18836   | 19954   |
| <b>HBL</b>   | 16862   | 18890   | 20918   | 22946   | 24974   | 27002   | 29030   |

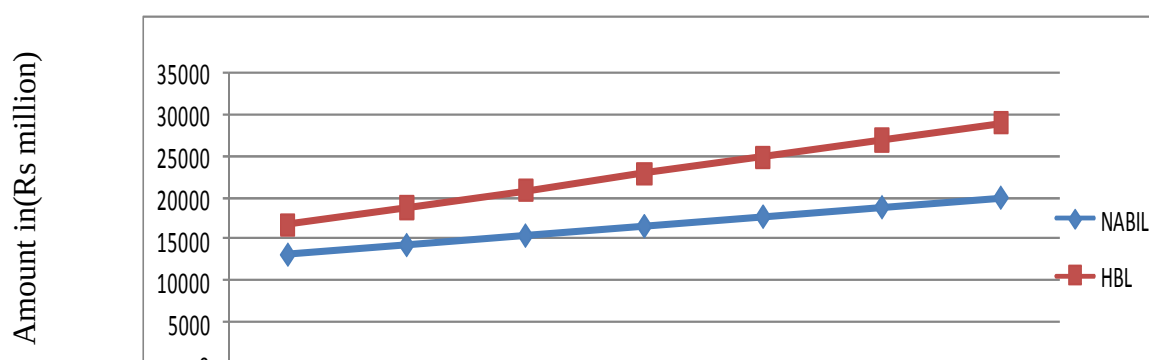
Source: Appendix 23 – A

From the figure, it is proved that Total deposit of HBL is greater than NABIL. The trend line of HBL has more slope than that of NABIL. It means increasing deposit rate of HBL is higher than NABIL.

**Figure 8**

**Trend analysis of total deposit**

***Total deposit Trend of NABIL& HBL***



Fiscal year

### 1.8.2 Trend analysis of loan & advances

Table 37 indicates the trend of loan and advances of both banks. It is cleared that both banks have increasing during the seven years of study period.

**Table 37**  
**Trend analysis of loan & advances( Rs. in million)**

| <b>F.Y.<br/>Bank</b> | <b>2000/01</b> | <b>2001/02</b> | <b>2002/03</b> | <b>2003/04</b> | <b>2004/05</b> | <b>2005/06</b> | <b>2006/07</b> |
|----------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>NABIL</b>         | 7520           | 8485           | 9450           | 10416          | 11382          | 12347          | 13313          |
| <b>HLB</b>           | 8332           | 9809           | 11286          | 12763          | 14239          | 15716          | 17193          |

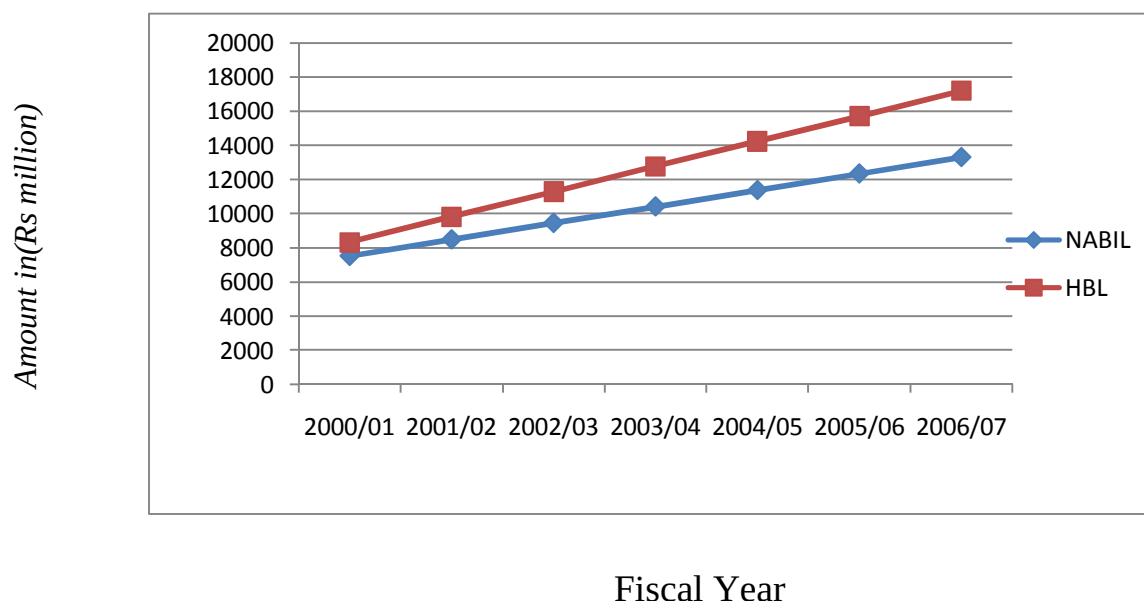
**Source: Appendix 23 – B**

During this study period, loan & advances of NABIL are lower than that of HBL. The rate of increment of HBL is rapid than NABIL. It is also made apparent by the help of figure 9. It shows the increment in loan & advances of both banks with the passage of time. This figure also proves that the trend line of HBL is higher than that of NABIL. The angle of elevation of HBL trend line higher than NABIL.

**Figure 9**  
**Trend analysis of loan & advances**



### Loan & Advances Trend of NABIL & HBL



#### 1.8.3 Trend analysis of investment

Table 38 indicates the trend of investment of both banks. The investment trend of NABIL and HBL are in increasing path. Both are rising upward. In comparison, the increment rate of investment of HBL is quiet higher than that of NABIL.

**Table 38**

#### Trend analysis of investment( Rs. in million)

| F.Y.<br>Bank | 2000/01 | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
|--------------|---------|---------|---------|---------|---------|---------|---------|
| NABIL        | 6961    | 6886    | 6812    | 6738    | 6664    | 6589    | 6515    |
| HBL          | 6566    | 7573    | 8580    | 9587    | 10594   | 11601   | 12608   |

Source: Appendix 23 – C

Investment trend of NABIL is higher than HBL during F.Y2000/01 But, after F.Y2000/01 HBL shows tremendous growth in investment. It is due to less investment policy of NABIL on government securities than HBL.

**Figure 10**  
**Trend analysis of investment**

### *Total investment trend of NABIL & HBL*

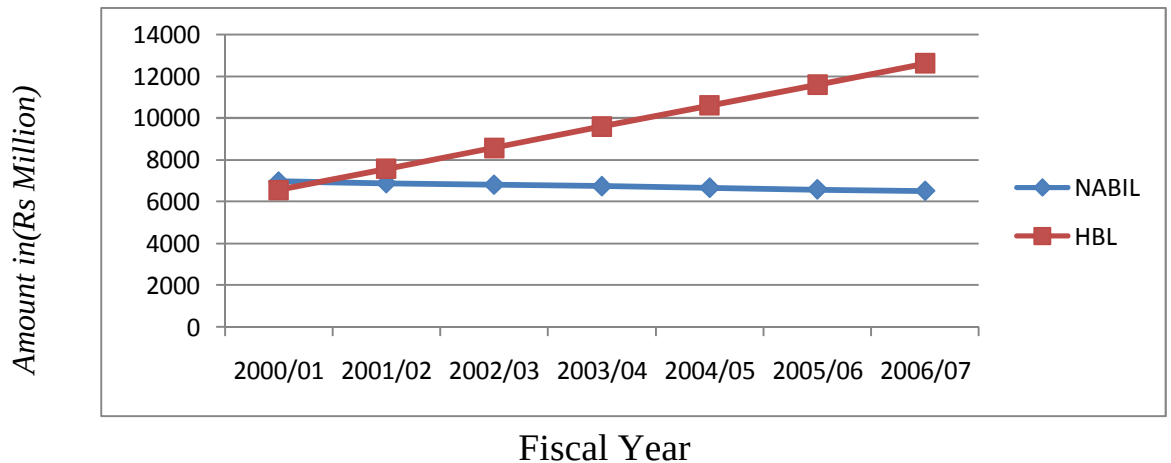


Figure 10 also shows the investment trend of both banks. Here, it is cleared that the investment trend of HBL has increased rapidly from F.Y2000/01. Intersection between two trends lines can be easily seen during this year. During F.Y. 2006/07 the trend line of HBL is quiet higher than that of NABIL,

#### **1.8.4 Trend analysis of net profit**

Table 39 gives glimpse of net profit trend of NABIL and HBL. It represents the net profit trend of both banks which are increasing each year. Net profit of NABIL is higher than that of HBL. Here, net profit of NABIL is increasing rapidly than that of HBL.

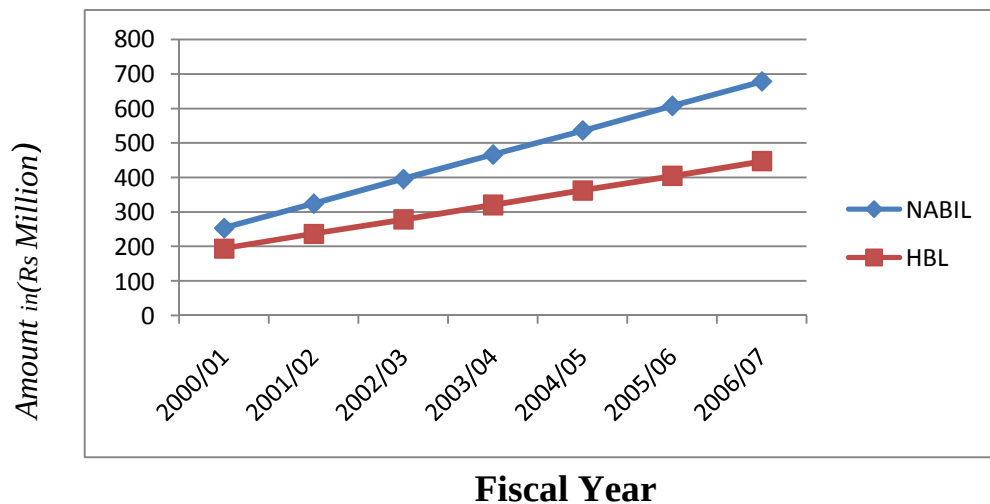
**Table 39**  
**Trend analysis of net profit( Rs. in million)**

| F.Y.<br>Bank | 2000/01 | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
|--------------|---------|---------|---------|---------|---------|---------|---------|
| NABIL        | 253     | 324     | 395     | 466     | 536     | 607     | 678     |
| HBL          | 194     | 236     | 278     | 320     | 362     | 404     | 446     |

Source: Appendix 23 – D

Figure 11 is also drawn to make the above table clear. It shows that the net profit trend line of NABIL is higher than that of HBL. The angle of elevation of NABIL is also higher than that of elevation of HBL. It indicates that NABIL is securing larger amount of profit and showing better utilization of various resources concerned with the profit.

**Figure 11**  
**trend analysis of net profit**  
Net Profit trend of NABIL & HBL



### 1.9 Karl Person's coefficient of correlation (r)

It measures the degree of association between the two variables i.e. one dependent and other independent. This analysis interprets and identifies the relationship between two or more variables. Under this topic, this study tries to find out relationship between following variables:

1. Coefficient of correlation between deposit and loan & advances.
2. Coefficient of correlation between deposit and total investment.
3. Coefficient of correlation between deposit and net profit.

### 1.9.1 Coefficient of correlation between deposit and loan & advances

The coefficient of correlation between deposit and loan & advances measures the degree of relationship between them. In this study, deposit is taken as independent variable (x) and loan & advances is taken as dependent variable (y). The main objective of calculating 'r' between them is to justify whether deposits are significantly used as loan and advances or not. Table 38 shows the value of 'r', P.Er and 6P.Er between total deposits and loan & advances of NABIL and HBL.

**Table 40**  
**Coefficient of correlation between deposit and loan & advances**

| Evaluation Criteria |        |                |        |        |           |
|---------------------|--------|----------------|--------|--------|-----------|
| Banks               | R      | r <sup>2</sup> | P.Er   | 6P.Er  | Remarks   |
| NABIL               | 0.5463 | 0.7391         | 0.1156 | 0.6936 | r > 6P.Er |
| HBL                 | 0.9869 | 0.9741         | 0.0061 | 0.0366 | r > 6P.Er |

**Source: Appendix 24 – A**

In the Table 40, the coefficient of correlation (r) between deposit and loan & advances of NABIL is 0.5463 which indicates that there is positive relationship. Similarly, coefficient of determination ( $r^2$ ) is 0.7391 that reveals 73.91% of variation of the dependent variable has been explained by the independent variable.

Similarly, the coefficient of correlation (r) between deposit and loan & advances of NABIL is 0.9869 which indicates that there is positive relationship. Similarly, coefficient of determination ( $r^2$ ) is 0.9741 that reveals 97.41% of variation of loan & advances (dependent) and deposits (independent).

Here, the values of 'r' of both banks are greater than 6 times P.Er (  $r > 6 \text{ P.Er}$ ), so there is significant relationship between deposits and loan & advances.

From this analysis, it can be concluded that both banks are successful in mobilizing their deposit as loan & advances. HBL has the highest value of 'r' that indicates the better position in comparison with NABIL.

### **1.9.2 Coefficient of correlation between deposit and total investment**

The Coefficient of correlation between deposit and total investment measures the degree of relationship between them. In this study, deposit is taken as independent variable (x) and investment is taken as dependent variable (y). The main objective of calculating 'r' between them is to justify whether deposits are significantly used as investment or not. Table 41 shows the value of 'r', P.Er and 6P.Er between total deposits and investment of NABIL and HBL.

**Table 41**  
**Coefficient of correlation between deposit and total investment**

| <b>Evaluation Criteria</b> |          |                      |             |              |                    |
|----------------------------|----------|----------------------|-------------|--------------|--------------------|
| <b>Banks</b>               | <b>R</b> | <b>r<sup>2</sup></b> | <b>P.Er</b> | <b>6P.Er</b> | <b>Remarks</b>     |
| NABIL                      | 0.4861   | 0.2363               | 0.1946      | 1.1376       | $r < 6\text{P.Er}$ |
| HBL                        | 0.7166   | 0.5136               | 0.1240      | 0.7440       | $r > 6\text{P.Er}$ |

**Source: Appendix 24 – B**

According to Table 41, the value of 'r' of NABIL is 0.48619 which shows positive correlation between deposit and investment. The coefficient of determination indicates only 23.63.% of dependency of investment on deposit. Here, ' $r$ ' < 6P.Er, which means there is not significant relationship between deposit and investment. In other words there is no evidence of correlation.

Similarly, the value of 'y' of HBL is 0.7167 that means positive correlation between two variables. The value of ' $r^2$ ' is 0.5126, which indicates 51.36% of variation between deposit and investment. Here, ' $r$ ' > 6P.Er, which means there is significant relationship between dependent and independent variables.

From this analysis, it can be concluded that the coefficient of correlation of NABIL is lower than that of HBL. In case of NABIL, the relationship between deposit and investment is highly insignificant and has lower percentage of dependency. The relationship in case of HBL is significant and gives higher percentage of dependency.

### **1.9.3 Coefficient of correlation between deposit and net profit**

The Coefficient of correlation between deposit and net profit measures the degree of relationship deposit and net profit. In this study, deposit is taken as independent variable (x) and net profit is taken as dependent variable (y). The main intention of calculating 'r' between them is to confirm whether deposits are significantly used as net profit or not. Table 42 shows the value of 'r', P.Er and 6P.Er between total deposits and net profit of NABIL and HBL.

**Table 42**

### **Coefficient of correlation between deposit and net profit**

| <b>Evaluation Criteria</b> |          |                      |             |              |                |
|----------------------------|----------|----------------------|-------------|--------------|----------------|
| <b>Banks</b>               | <b>r</b> | <b>r<sup>2</sup></b> | <b>P.Er</b> | <b>6P.Er</b> | <b>Remarks</b> |
| NABIL                      | 0.5637   | 0.3178               | 0.1756      | 1.0536       | $r < 6P.Er$    |
| HBL                        | 0.8695   | 0.7566               | 0.062       | 0.3178       | $r > 6P.Er$    |

**Source: Appendix 24 – C**

In Table 42, the 'r' of NABIL is 0.5637, which indicates a positive relationship between deposits and net profit. The coefficient of determinants is 0.3178, which shows 31.78% of the variation of net profit has been explained by the deposit. Here,  $r < 6P.Er$ . This states that there exists an significant relationship between two variables.

The coefficient of correlation of HBL is 0.8635 which denotes a positive relationship between dependent and independent variables. The coefficient of determinants of HBL is 0.7560This indicates that 75.60% of the variation of the dependent variable has been explained by the independent variable. Here,  $r > 6 P.Er$ , which means there is significant relationship between total deposit and net profit.

From this analysis, it can be concluded that correlation coefficient of NABIL is lower than HBL. The value or 'r<sup>2</sup>' in case of NABIL shows lower percentage of dependency and in case HBL, It shows higher percentage of dependency. NABIL shows significant relationship and HBL shows significant between total deposit and net profit.

## **2. Major findings of the study**

The prior chapters have discussed and discovered the facts for the various parts of the study. Analytical part, which is the heart of

the study, makes an analysis of various aspects of the investment policy of NABIL and HBL by using some of financial and statistical tools. The most vital task is to enlist finding issues and give suggestions for further improvement. This would be meaningful to the top management of the bank to initiate action and achieve the desire result. The main objectives of the study are to point errors and mistakes, to correct them and to give directions for further growth and improvement.

The main findings of the study are derived on the basis of financial data analysis of NABIL and HBL are presented below:

### **2.1 Findings from liquidity ratios analysis**

The current assets of NABIL and HBL have exceeded current liabilities in average. The average ratios of NABIL and HBL are 1.0729:1 and 1.0506:1 respectively during the study period. The coefficient of variation (C.V.) between the ratios of NABIL and HBL are 1.57 and 1.09, which means the current ratios during the study period are more uniform. Both current liabilities and C.V of NABIL is higher than HBL. In general, the current ratio analysis shows that both banks are able to meet their short-term obligations. However, NABIL has higher ability than HBL.

The cash & bank balance to total deposits ratio of NABIL is decreasing. However, HBL has fluctuating trend. The mean ratios of NABIL and HBL are 5.76% and 7.69% respectively. Considering the inflationary pressure in the economy, NRB has prescribed CRR of 5%. In the F.Y 2006/07 CRR of NABIL has 5.99% whereas HBL has 5.85% which gives positive impact. This ratio indicates that HBL's solvency position is higher than NABIL.



Similarly, C.V of HBL is lower i.e. 16.28% showing more stability than NABIL which is 29.49%. So, NABIL should increase its liquidity position as it maintains any unexpected demand of the depositors. The cash & bank balance to current assets ratio shows the bank ability to meet the demand of cash. The average ratio of NABIL i.e. 5.00% is lower than HBL which has 7.04%. The C.V of NABIL and HBL are 28.00% and 16.04% respectively. It indicates the HBL has better position in maintaining its cash and bank balance to meet its daily requirement than NABIL to make the payments on customers' deposits withdrawal. On the basis of C.V the ratio of HBL is less variable than NABIL.

The investment on government securities to current assets ratio of NABIL is decreasing whereas HBL has the fluctuating ratio. The mean ratio of NABIL is 20.84 % which is greater than the ratio of HBL which has 17.73%. The C.V of NABIL and HBL are 26.22% and 19.37% respectively, which clears that the ratio of NABIL is more variable than HBL. According to the NRB directives, there is no restriction for the commercial banks to invest in the government securities. Hence, investment in government securities of both banks can be regarded as healthy.

## **2.2 Findings from assets management ratio analysis**

Loan & advances to total deposit ratio of NABIL and HBL are 62.23% and 55.09% respectively. Higher ratio implies the better utilization of total deposits. The C.V of NABIL is almost twice of HBL. Thus, the ratio of NABIL is less uniform. Loan and advances is the banks' most risky asset. High level of risk is not desirable for commercial banks as the default in loans can increase the loan loss provision and hence decrease the profit.

The investment to total deposit ratios of NABIL has decreased from F.Y 2002/03 to F.Y 2004/05 and has increased in F.Y 2006/07 to 38.22%. The ratio of HBL is in fluctuating trend during the study period. The mean ratio of investment to total deposit of NABIL is 41.02% which is lower than that of HBL which has the mean ratio of 41.51%. The C.V of NABIL and HBL are 19.36% and 19.97%, which shows that the ratios are less consistent and more variable. The figures suggest that the bank has mobilized about one-third in average of its total deposits in government securities and shares and debentures.

The mean ratio of loan and advances to total working fund of NABIL is 52.16% and the C.V between is 12.98, which shows that the ratios are consistent over the study period. Similarly, the ratio of HBL is 48.92% and the C.V is 5.55. This shows that NABIL has higher risks and eventually yields higher return than HBL as loan and advances is the most risky and most productive assets of the bank.

Investment on government securities to total working fund ratio shows the proportion of risk free assets of bank. Investment on government securities is the risk free investment for the commercial banks. The ratio of NABIL is in decreasing trend since the investment on Government securities is decreasing. However, the mean ratio of NABIL is 17.39% which is higher than that of HBL i.e. 15.76 %. The ratio of HBL is in fluctuating trend during the study period. The C.V of NABIL and HBL are 25.13% and 19.77% respectively. Analysis shows that the both banks have mobilized about less than one fifth of fund on risk free sector.

NABIL has been investing larger amount of money on shares and debentures since F.Y 2004/05 than HBL. The mean ratio between investment on shares & debentures and working fund of NABIL (0.64%) is greater than of (0.14%). The C.V of NABIL (128.89) is comparatively higher than HBL (29.02). It means the distribution of NABIL is more variable. So, HBL has invested very less percentage of total working fund into shares and debentures of other companies than NABIL.

Performing loan loss provision indicates the success of banks in utilizing their assets for the generation of profit. Performing loan loss provision of NABIL and HBL are 96.69% and 91.87%. Hence, NABIL has higher ratio than HBL. It indicates that NABIL has proper utilization of assets on good loans than HBL. The C.V of NABIL and HBL are 2.39 and 2.89 respectively.

Higher non performing loan loss provision ratio indicates worse management of assets. NABIL and HBL both have decreasing trend in the ratio which shows good utilization of their loan and proper management of assets. Analysis indicates that NABIL (3.33%) has lower ratio then HBL (8.12 %) in average, showing better utilization of loan than HBL. The C.V of NABIL and HBL are 68.88 and 33.16 respectively. It means the ratio of NABIL is more variable.

Loan loss provision ratio illustrates the amount of provision a bank has to create for its loan and advance. Higher loan loss provision ratio is beneficial to the bank. Analysis indicates that the mean ratio of NABIL is higher than that of HBL. The mean ratios are 1.5234 and 0.9189 respectively. The C.V of NABIL (44.07) is

higher than HBL (24.21 ). However, both banks have shown increasing ratio, which is better.

### **2.3 Findings from profitability ratios analysis**

Return on loan and advance indicates the earning on mobilized fund based on loan advances. Loan and advances are highest yielding assets of the bank with highest risks. The average ratio of NABIL and HBL are 4.45% and 2.50% respectively. Thus, it shows that NABIL has efficiently employed its resources in terms of loan and advances than HBL in average. Although, the loan and advances of HBL is increasing than NABIL, the return on loan and advance ratio is lower than NABIL due to the Net profit. From analysis, it is found that C.V of NABIL and HBL are 15.48 and 15.96. That means the ratios of both banks are variable.

Return on working fund or return on assets measures the overall profitability of all working funds. Total working fund of HBL is increasing than NABIL. But return on total working fund ratio of HBL is lower than NABIL in average because of lower HBL's Net profit. The mean ROA of NABIL and HBL are 2.34% and 1.22%. The C.V of NABIL (22.74) is higher than that of HBL (16.65).

Return on equity indicates the efficiency of utilization of owners' fund by banks. According to the analysis, mean ROE of NABIL (30.19%) is higher than that of HBL (24.92 %). The ratio of NABIL indicates that they are more uniform than ratio of HBL during the study period as C.V of NABIL and HBL are 10.83 and 24.90.

Total interest earned to total asset ratio measures the earning capacity ratio of the bank through assets. The average ratio of NABIL and HBL are 6.17 % and 5.54 % respectively. C.V of NABIL is more consistent than HBL as C.V of NABIL is 4.82 and that of HBL is 11.47 .

Total interest to total working fund ratio measures the percentage of interest earned over total working fund. Total working fund includes all asset of on balance sheet items. Total interest to total working fund of NABIL and HBL are 6.09 % and 5.45% respectively whereas C.V of NABIL and HBL are 6.07 and 11.01 respectively. Thus, NABIL has shown better performance than in terms of interest earning on its total working fund.

#### **2.4 Findings from the risk and ratios analysis**

Credit risk ratio indicates the possibility that loan will not be repaid. The credit risk ratio of both NABIL and HBL has the fluctuating trend. The mean credit risk ratio during the study period of NABIL and HBL are 52.93 % and 49.64 %. The C.V of NABIL is variable with 13.39 and the C.V of HBL seems to be consistent with 5.91.

Capital risk ratio of the NABIL is in fluctuating trend while that of HBL is increasing. The mean ratio of capital risk ratio of HBL is 3.8 % with C.V 20.9. The mean ratio of HBL is 3.27% having 12.52 C.V. According to the analysis, the mean ratio of NABIL is higher than that of HBL. Its ratios are more variable than HBL.

#### **2.5 Findings from growth ratio analysis**

The analysis of growth ratios of total deposits shows that total deposit of NABIL is fluctuating with the average growth of 7.70% during the seven years study period. Meanwhile, the total deposit of HBL is increasing each year with the average growth rate of 9.85 %.

The analysis of growth ratio loan and advances indicates that loan and advance of NABIL is fluctuating between Rs 8324. million and 15903 million. However, analysis shows that loan and advance is increasing since F.Y 2002/03. It has average growth rate of 12.20 %. While the loan and advance of HBL is in increasing trend with average growth rate of 12.14 %.

The analysis of growth of total investment reveals that total investments of both banks are in fluctuating trend. The average growth of total investment of NABIL and HBL are 6.65 % and 25.73%.

The analysis of growth of total net profit indicates that net profit of NABIL is increasing since F.Y 2002/03. Its average rate is 16.42 %. While HBL has fluctuation of net profit between Rs.277 million and Rs492 million during the study period. It has average growth rate of 12.04 %.

## **2.6 Findings from capital adequacy ratio**

Both NABIL and HBL are increasing total capital fund over the study period to reach the target given by NRB. The capital fund of bank is largely depending upon share capital. The reserve funds and profit of the bank also plays the vital role in the

formation of the capital. NABIL got success to meet the CAE prescribed by NRB. HBL was successful in maintaining the required total capital for the fiscal years 2001/02, 2002/03, 2004/05 and 2006/2007 by 2.56%, 0.93%, 0.01%, 0.01% and 0.11% respectively but it was not able to maintain in the fiscal year 2003/04 and 2005/2006 by 0.35% and 0.74%. Even though the core capital of the bank was good enough, it was the supplementary capital, which made bank suffer from the low capital adequacy ratio. The decrease in the loan loss provision was the main reason behind the decrease of supplementary capital.

## **2.7 Findings from common size analysis**

Common size analysis is the comparative study of balance sheet and income statement of the bank. Total assets, total liabilities and interest earned are considered as common base for this comparative analysis. According to common size balance sheet analysis, share capital of NABIL covers 2.8 %, 2.8%, 3.0%, 2.9 %, 2.9%, 2.9%, 2.2% and 1.8% of total liabilities respectively from F.Y 2000/01 to F.Y 2006/07. While HBL covers 1.6%, 1.9%, 1.8%, 2.2%, 2.3%, 2.6% and 2.4%. Similarly, deposit of NABIL occupies 89.1 %, 88 %, 81.2 %, 84.3 %, 84.9 %, 86.6% and 85.6% respectively from total liabilities whereas HBL has 93.5 %, 90.1%, 89.9%, 88.1%, 89.1%, 89.9% and 89.6% during study period.

NABIL has Cash & Bank Balance 4.6 %, 6 %, 6.9 %, 5.8 %, 3.3 %, 2.8 % and 5.1 % of total assets and HBL has 7.6%, 6.1%, 8.5%, 8.1%, 7.2%, 5.8% and 5.2 % during the study period. Money at call and Short notice of NABIL covers 2.9%, during F.Y 2000/01 and 2.1% during F.Y 2006/07. Money at call and Short notice of HBL are 21.5 % and 5.1%

during F.Y 2000/01 and F.Y 2006/07 respectively. Likewise, investment of NABIL shares 43.4 % during F.Y2000/01 and 32.8% during F.Y 2006/07 from total assets where as that of HBL are 21.1 % and 35.3%. As loan, advances and bills purchased shares the largest amount of total assets, it covers 43.5%,42.2%,46.8%,48.9%,61.6%,57.95% and 57.1% of NABIL's total assets from F.Y 2000/01 to 2006/07 respectively. Loan and advances of HBL from F.Y 2000/01 to F.Y 2006/07 are 45.2%, 43.1%, 42.8%, 48.5%, 44.6%, 49.7% and 50.7 % respectively.

According to the common size balance sheet analysis, interest income of bank is taken as hundred percentages. Net interest incomes of NABIL during F.Y 2000/01 to F.Y 2006/07 are 54.4%, 58.8%, 68.9%, 71.8%, 77.2%, 72.7% and 65.1%. It clearly indicates that income of NABIL has increased significantly till F.Y 2004/05 while it has slightly decreased in F.Y 2006/07. Analysis shows that Net profit of NABIL has increased form F.Y 2001/02 to F.Y 2004/05. During F.Y 2002/03, it has increased almost reach twice i.e. from 24.2% to 40.9%. NABIL has the highest percentage of net profit during F.Y 2004/05 and the lowest during F.Y 2000/01 over total interest income.

Net interests of HBL from the analysis of common size income statement from F.Y 2000/01 to F.Y 2006/07 are 44.6%,49.7%, 53.9%, 60.5%, 61.1%, 30.1% and 56.8%. Net profits of HBL during the seven years study period are 20.9 %,20.5%, 17.7%, 21.1%, 21.3%,28.1% and 27.7% of total interest earned. The analysis indicates that HBL has the highest net profit during F.Y 2005/06 and the lowest during F.Y 2002/03. HBL has fluctuation trend on net profit. According to



the common size income statement, net profit percentage of NABIL is excessively higher than that of HBL.

## **2.8 Findings from trend analysis**

From the trend analysis of total deposit, loan and advances, investment and net profit of NABIL and HBL, it is cleared that they are in increasing trend. The trend of total deposit, loan and advances and total investment of HBL are higher than that of NABIL. They are rising rapidly with higher slope. Whereas the trend of net profit is higher than HBL. Hence, NABIL and HBL both banks are able to increase the profitability of the banks as their fund collection and utilization are increasing. Banks are adopting the proper policy to increase the profit of the organization. So, the investment policy of the banks in terms of optimum utilization of their resource to generate optimum return is good.

## **2.9 Findings from the correlation coefficient analysis**

The correlation coefficient between total deposits and loan and advance shows that the correlation 'r' between deposits and loan & advances of NABIL is 0.5463 and probable error multiplied by six is found to be 0.6936 Similarly, correlation of coefficient between deposits and loan & advances of HBL is 0.9802 and six times P.Er is 0.0366 Since  $r > 6P.Er$  of both banks, it is significant and there is correlation between total deposit and loan advance in NABIL & HBL correlation(r) is positive and near to 1. So, there is positive correlation between

total deposits and loan & advances during the study period. It means the increase or decrease of total deposit of the bank highly affects the loan & advances.

The correlation coefficient between total deposit and total investment shows that the correlation coefficient ( $r$ ) between total deposits and total investment of NABIL and HBL are 0.4861 and 0.7167 respectively. Probable errors multiplied by six are found to be 1.1679 and 0.744 since  $r < 6P.Er$  of NABIL, there is not significant relationship between deposit and investment. However,  $r > 6P.Er$  of HBL, it has significant relationship. Correlations of both banks are positive.

The correlation coefficient ( $r$ ) between deposit and net profit of NABIL is .0.5637 and probable error multiplied by six found to be 1.0536 since  $r < P.Er$ , it is insignificant and there is no correlation between total deposit and net profit in NABIL. Similarly, the correlation coefficient between deposit and net profit of HBL is 0.8695 and six times probable error is 0.3720 Since  $r > 6 P.Er$ , there is significant relationship between deposit and bet profit. However, both banks have positive correlation coefficient.

## **CHAPTER-V**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

This chapter is concerned with the major conclusions and recommendation on the basis of the major findings of the study derived from the analysis of Investment policy of NABIL and HBL.

#### **1. Summary**

Economic development depends upon capital formation and its proper utilization. Financial institutions collect scattered savings of the country and invest them into the most desirable and high yielding sectors of the economy to fuel the process of economic development. Commercial banks are major financial institutions, which occupy an important place in the framework of every economy because they provide capital for the development of industry, trade and business and other resource banks play a vital role in the economic development of the country. They render various services to their customers which automatically facilitate their economic and their social life. Every bank formulates an investment policy statement in order to define the objectives of bank's liquidity management and investment portfolio.

Investment refers to the conversion of money into claims on money and use of fund for productive assets. It includes the savings of resources for future benefits. In terms of banking investment, it means purchasing stock, bonds, shares, treasury bills, etc. The features of investment decisions are profit, risk,

speculation and wealth. Good investment policy ensures maximum amount of investment amount of investment to all sectors with proper utilization.

Investment management of a bank is guided by the investment policy adapted by the bank. The investment policy of bank helps the investment operation of the bank to be efficient and profitable by minimizing the risk. A healthy development of any bank depends upon its investment policy. A sound investment policy of a bank is such that its fund are distributed on different types of assets with good profitability on the one hand and provides maximum safety and security to the depositors and banks other the other hand. There are five principles of sound lending policy i.e., liquidity. Profitability, safety and security, stability and diversification.

Investment policy provides guidelines to handle their investment operation smoothly ensuring maximum return with minimum exposure towards risk. Main investment of the bank is lending its collected fund in different sector of economy. Lending affects the bank's profitability and liquidity, so it is one of the crucial decisions for the commercial banks. The major source of income of a bank is interest income from loans and investments. Loan and advances provided by commercial banks are the major statements for Nepalese commercial banks. so, commercial banks have to follow their policies to utilize their funds.

In current scenario there is a very high competition in banking sector in Nepal but investment alternatives are decreasing due to political instability, insurgency, etc. so banks have to face many problems to survive in this type of environment. Every bank is following sound investment policy for a purposeful, safe and profitable investment. Development of trade, industry and business is the main ground of banks to conduct its activities and fulfil its profit making objectives. The sound investment policy helps all the banks to make profitable investment which in turn also helps to develop the economic condition of the country.

The basic objective of this study is to evaluate the investment policy adopted by NABIL and HBL and to suggest measures to improve the investment policy of the banks. The study is mainly based on secondary data from F.Y.2000/2001 to 2006/2007. The data had been obtained from the annual reports and financial statements, various published reports and past period master's degree thesis related to this topic. Various financial and statistical tools are applied in this study to analyze and interpret the data and information. Under financial analysis, liquidity ratio, asset management ratio, profitability ratio, risk ratio, growth rate and common size analysis have been used. Under statistical analysis, trend analysis and coefficient of correlation analysis have been used.

## **2. Conclusions**

The conclusions of the major findings of the research have been discussed below.

1. The study shows that current ratio of both NABIL and HBL is consistent, but still below the standard. NABIL has higher ability than that of HBL on the basis of current ratio and investment on government securities to total deposit ratio. This study shows that HBL has better position in maintaining cash reserve ratio and cash and bank balance to current asset ratio than NABIL.
2. The asset management of NABIL is better than that of HBL. The loan and advances to total deposit ratio, loan and advances to working fund ratio, investment on government securities to total working fund ratio and investment on shares on debentures to total working fund ratio of NABIL are higher than that of HBL. Loan loss provisions of NABIL is good enough as compared to that of HBL.
3. The profitability ratio of NABIL is somewhat better than that of HBL. Return on loan and advances ratio, return on total working fund ratio, return on equity, total interest earned to total asset ratio and total interest earned to total asset ratio and total interest earned to working fund of NABIL is higher than that of HBL. Thus, it indicates NABIL is more efficient in function of a bank in terms of profit than HBL.
4. Both credit risk and capital risk of NABIL is higher in the comparison of HBL. The credit and capital ratio of NABIL is

more variable than the ratio of HBL over the research period. It shows NABIL has less consistency of the degree of risk than HBL.

5. The deposits of NABIL have been increasing since F. Y. 2003/2004 whereas HBL has increasing since F.Y. 2000/2001. Loan and advances of both banks have been increasing. Total investment of NABIL has shown fluctuation whereas HBL has shown increment. Net profits both banks have been increasing since last few years. Due to the increase in Deposits, investment in loan & advances and other sectors. Due to the increase in deposits, investment in loan and advances and other sectors have also been increasing every year. At the same time, net profit of the bank is also increasing. While comparing two banks, it is cleared from the study that growth rate of HBL is better than the growth rate of NABIL.
6. NABIL was successful in achieving the CAR prescribed by NRB over the 5- years study period. while HBL was failed to achieve this target during F.Y. 203/2004 and F.Y. 2005/2006. However, both banks were successful in achieving core capital adequacy ratio. Hence, total capital of both banks is increasing each year.
7. According to the common size balance sheet percentage of capital and liabilities such as share capital, reserves and surplus, bills payable, and undistributed dividend and percentage of assets of NABIL are higher than HBL are higher than NABIL. According to the common size income statement, the percentage of assets of HBL are higher than NABIL. According to the common size income statement, the percentage of net profit of

NABIL is quite higher than that of HBL. It indicates that NABIL has been successful to adopt the appropriate investment policy which increases the profitability of the bank.

8. Both NABIL and HBL have positive trend in total deposit, loan and advance, investment and net profit. However, slope of trend lines of HBL is higher than that of NABIL with respect to total deposit, loan and advance and total investment whereas slope of trend line with respect to net profit of NABIL is higher than that of HBL. The banks have also been able to increase their profitability. Therefore it can be concluded that the banks have been adopting a good investment policy.
9. Since, correlation coefficient ( $r$ ) between total deposits and loan and advances are positive, nearer to 1 and  $r > 6p.Er$  of both banks, it is significant and there is positive correlation between total deposits and loan and loan and advance in NABIL and HBL. It means the increase or decrease of total deposit of the bank highly affects the loan and advances.
10. The correlation coefficient between total deposit and total investment of NABIL and HBL are 0.5463 and 0.9869 respectively. Hence, total deposit and total investment of both banks are positive correlated. Since  $r < 6p.Er$  of NABIL, there is not significant relationship between deposit and investment. However,  $r > 6p.Er$  of HBL, it has significant relationship.
11. The correlation coefficient ( $r$ ) between deposit and net profit of NABIL and HBL are positive. Therefore, both banks have positive correlation coefficient between deposit and net profit. Since  $r < 6p.Er$  of NABIL, it is insignificant and there is no correlation between total deposit and net profit. However



$r > 6p$ . Er of HBL, it is significant relationship between deposit and net profit.

### **3. Recommendation**

On the basis of analysis, findings and gaps of the study, following recommendation can be advanced to overcome weakness, inefficiency and to revitalize and improve present fund mobilization and investment policy of NABIL and HBL.

1. According to the study, the current ratio of NABIL and HBL are below standard i.e. 2:1. The liquidity position affects external and internal factors such as prevalent investment situations, central bank requirements, the growth position of the financial market, lending policies, management capabilities, strategic planning and fund flow situation. The bank should maintain enough liquidity assets to pay short-term obligations. Hence, both banks should increase the current assets or try to lower the current liabilities to improve its liquidity position.
2. The cash reserve ratio (CRR) of NABIL is decreasing and is below the standard rate in F.Y.2006/07 as NRB has prescribed CRR of 5% Hence, NABIL should increase cash and bank balance or try to decrease total deposit.
3. Investment on Govt. securities of NABIL is decreasing . Govt. securities are risk free investments. Hence, NABIL is recommended to increase the investment in govt. Securities, which helps to utilize funds into income generating assets as well as minimizes risk. The investment on 0% risky assets such as Treasury bills reduces total risk weighted assets.

4. The position of assets management ratio of NABIL is better than HBL. However, NABIL should try to maintain consistency of asset management ratio since it is less consistent than HBL.
5. Deposit money must be utilized as loan and advances to get success in competitive banking environment. The largest item of the bank in assets side is loan and advances. It has been found that the average loan and advances to total deposit ratio of NABIL is higher than HBL. It means HBL has not properly used their existing deposit as loan and advances. So, HBL is recommended to follow liberal lending policy and invest more percentage amount of total deposit in loan and advances. Liberal lending policy helps a bank to make the efficient utilization of its deposits.
6. The non performing loan to total loan and advances ratio of HBL is higher than standard level . It should be less than 5% to be graded as internationally 'A' grade commercial bank. Therefore, the management of banks should give attention to manage the NPA within the satisfactory level.
7. Bank can gain more profit if it can reduce its NPA as non performing loan decrease net profit of the bank. According to the finding form the study, HBL has larger amount of nonperforming loan than NABIL. Thus, net profit of HBL is also lower than NABIL. Therefore, HBL should have its due attention to work out a suitable mechanism through which the default loans can be realized.
8. Regarding NPA, HBL should focus on the collection of expired loans and advances to reduce the loan loss ratio. The

policy of HBL should ensure rapid identification of delinquent loans, immediate contact with the borrowers and continual follow up until a loan is recovered. The recovery of loan is the most challenging job to a bank. Therefore, the bank must be very careful in formulating a sound credit collection policy.

9. Profit is very important for the survival and stability of any organization. The average ratio of return on loan and advances, return on total working fund, return on equity and total interest earned to total asset of HBL are lower than that of NABIL. This may be due to the focus of HBL on low return areas. HBL should look for other areas of investment with higher return so that it can earn return sufficient enough for its survival, stability and long term sustainability.
10. Credit risk of both banks is higher. It measures the possibility that loan will go into default. Loan default in commercial bank is the result of various factors such as lack of the necessary skills for the project appraisal, political influences, improper collateral evaluation, irregular supervision and lack of entrepreneurial attitude. The proper inspection of the documents presented is the must for preventing any critical conditions in the future. Political backing is highly prevailing in each and every sectors of Nepalese investment. Commercial bank=s should always keep a distance from these influences.
11. Immediate increase of the capital in very short term can be difficult for any commercial banks. Issuing new share, bonus share or right share and issuing debentures takes a long time, as the prior approval of NRB has to be obtained. Therefore, to maintain the adequate capital, the only option left with the

bank is to manage the assets to reduce and increasing the investment in Government securities can help to maintain the adequate capital.

12. The existing unstable political situation directly affects economic sectors such as hotel and tourism, manufacturing and trading sector. So banks should create new investing sector to mobilize deposit.
13. Both the banks have invested nominal percentage of its funds in shares and debentures of other companies. They are recommended to invest more in shares and debentures of financial and non financial companies across different sectors to encourage overall economic development of the country.
14. NRB has directed the banks to extend a certain percentage of loan and advances to the deprived sector. Both the banks are recommended to adhere of the directives issued by NBR and invest more in these sectors. NBR should also speed up its supervision and monitoring in this regard.

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