A STUDY ON CREDIT RISK MANAGEMENT OF JOINT VENTURE COMMERCIAL BANKS

A Thesis

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RECOMMENDATION

This is to certify that the Thesis

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Entitled:

A Study on Credit Risk Management of Joint Venture Commercial Banks

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

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CAPITAL STRUCTURE & PROFITABILITY MANAGEMENT

OF NEPALESE COMMERCIAL BANKS

(With Reference to Everest Bank, Kumari Bank and Nepal Bangladesh Bank)

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

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Needless to says, to error is humans being. I am not exception from it. So, I am responsible for some deficiencies that may have remained in this work.

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DECLARATION

I, hereby, declare that the work reported in this thesis entitled “A Study on Credit Risk Management of Joint Venture Commercial Banks" submitted to Shanker Dev Campus Campus, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment for the Master’s Degree in Business Studies (M.B.S.) under the Supervision of Prakash Singh Pradhan, Shanker Dev Campus.

Date:………………………

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ABBREVIATIONS

A.D.	Anno Domini
ADB	Agricultural Development Bank
ATM	Automatic Trailer Machine
B.S.	Bikram Sambat (Abbreviation of Bikram Era)
CV:	Co-efficient of Variation
EBL	Everest Bank Limited
EPS	Earning Per Share
GDP	Gross Domestic Product
HBL	Himalayan Bank Limited
INGO:	International Non- Government Organization
Int. Inc.:	Interest Income
L&A:	Loan and Advance
LLP:	Loan Loss Provision
NABIL	Nabil Bank Limited
NBBL	Nepal Bangladesh Bank Limited
NBL	Nepal Bank Limited
NGO:	Non- Government Organization
NPA	Non Performing Assets
NPAT:	Net Profit after Tax

NPL:	Non-Performing Loan
NRB	Nepal Rastra Bank
P.E:	Probable Error
PL:	Performing Loan
RA:	Risky Assets
SBI	Nepal State Bank of India Limited
SCBNL	Standard Chartered Bank Nepal Limited
SD:	Standard Deviation
TA:	Total Assets
TD:	Total Deposit

CHAPTER - 1
INTRODUCTION

1.1 Background of the Study

Banking plays significant role in the economic development of a country. Bank is a resource for the economic development which maintains the self- confidence of various segments of society and extends credit to the people. So, commercial banks are those financial institutions mainly dealing with activities of the trade, commerce, industry and agriculture that seek regular financial and other helps from them for growing and flourishing, the objectives of commercial banks is to mobilized idle resources into the most profitable sector after collecting them from scattered sources commercial bank contributes significantly n the formation and mobilization of internal capital and development effort.

The concept of the banking has been developed from the ancient history with the effort of ancient goldsmiths who developed the practice of storing people's gold and valuables under such arrangement the depositors would leave their gold for safekeeping would get back their gold and valuable after paying a small amount as fee for safekeeping and serving.

The role of money in an economy is very important. Proper and well planned management of money directs, determines and enhances the health and productivity of total financial sector and the performance of financial sector affect the growth of economy. Hence, Money is the topic to manage and banks are the manager. The existence of a bank is for the change in every aspect of human being and its presence is for the upliftment of people. Banks are the back bone of the economy.

the history of the development of financial institutions in Nepal is not very long. Nepal bank Ltd. is the first commercial bank of Nepal, which was established in 1994 B.S. in non- government sector. The second commercial bank is Rastrya Banijya Bank Ltd., which was established in 2022 B.S. in 100% government ownership. But after studying to the origin of modern banking, we come to know that "Bank DE

RIALTO" which was established in 1587 A.D. is the first bank of the world in Venice, Italy.

Financial statements of a firm mainly include income statement balance sheet and cash flow statement they are the important sources of financial information regarding the firm's operations and its financial position. To analyze the financial performance strength and weakness and predicting reason of failure of the firm many types of tools and techniques are used.

The Nepalese economy has been passing through very difficult times over the last few years. New industries have not come up. Foreign act which used to take the form of out right grants has mostly turned into loans that that have to be repaid debt repayment is eating up an increasing position of the budget. The tourism sector has suffered serious blows. In such an adverse economic climate the banking sector has generally not only survived but have also been able to make reasonable operating profit.

Bank is a financial institution, which is established for depositing, withdrawing, borrowing and lending money. It is a intermediary accepting deposits and granting loans offers the widest menu of services of any financial institution (Rose, 2002:2).Bank is an Institution which deals with money and credit. It accepts deposit from the public and mobilizes the fund to productive sectors. It also provides remittance facility to transfer money from one place to another. Generally a bank accepts deposit from business institutions and individuals, which is mobilized into productive sectors mainly business and consumer lending. Bank is, therefore known as a dealer of money. As present context bank is not only confined to accepting deposits and disbursing loan. In addition to this, a bank may be engaged in different types of functions such as remittance, discounting bills etc. "Indeed, many financial institutions-including security dealers, brokerage firms, mutual funds, and insurance companies are trying to be as similar as possible to banks in the services they offers" (Rose, 2002:2). A modern bank performs such a variety of functions that it is difficult to give a precise and general definition of a bank.

"The banking sector is largely responsible for collecting household saving in terms of different types of deposit and regulating it in the society by lending in different sectors of economy. By lending their resources in small scale industries under intensive banking program has enabled the banks to share in the economic growth of the economy" (Sheathe, 1992:32).

In Nepalese financial system, financial institutions are categorized in four classes viz. A, B, C and D according to bank and financial institution act 2063 (BAFIA, 2063). These financial institutions are engaging to collecting deposit and granting loans and advance as well. Lending is a major function of banks. Loan is the sum lent to other for certain time period with the agreement to charge interest on principal. The interest is charged calculating certain percentage on the principal. When money belonging to one is advanced to another to be used for certain time period, it is called loan. The basic objective of loan advancement is to earn interest as the reward for lending the sum for specific period.

Commercial banks are organized institution providing loans for the needed. The loan advancement is the main function of commercial banks. Similarly, interest on loan has become their main source of income. Banks do deposit accepting and lending business. Lending is a risky business. Loans are provided to earn interest. However, sometimes, it may be difficult even for the repayment of principal. In this situation, interest barring becomes fair awaited business to be dealt. To get rid of such situation there should be proper loan management in banks.

In context of Nepal, the history of banking sector has a rather more slow evolution. Even now, the banking system is still an evolutionary phase. Nepal Bank Ltd. is the first modern bank of Nepal. It is taken as the milestone of modern banking of the country. It was established in 1937 A.D (30th Kartik, 1994

B.S.). To issue national currencies and promote financial organizations Nepal Rastra Bank was established in 1956 A.D (14th Baishakh, 2013) under NRB Act 1955 as the central bank of Nepal. Similarly, Rastriya Banijya Bank was established in 1965 A.D. as the second commercial bank of Nepal. The financial shapes of these two commercial banks have a tremendous impact on the economy. That is the reason why these banks still exist in spite of their bad positions.

For more than two decades, no more banks have been established in the country. After declaring free economy and privatization policy, Nepal government encouraged the foreign banks for joint venture in Nepal. As a result, Nepal Arab Bank Ltd. (NABIL) was established in 2041 B.S. This is the first modern bank with latest banking technology. Then a lot of commercial banks have been opened in the country. Now, there are altogether 31 commercial banks are operating in the country.

Overall national development of any country depends upon the economic development of that country and economic development largely depends upon the financial infrastructure of that country. Therefore, the primary goal of any nation including Nepal is rapid economic development to promote the welfare of the people and the nation as well. Nepal being one of the least developed countries has been trying to embark upon the path of the economic development by economic growth rate and developing all sectors of economy. Nepal started economic development very late, only from early fifties of the 19th century. The agriculture based economy, vast mountainous landforms, political instabilities, landlocked situation and poor resource mobilization, which have slowed down the pace of development.

Commercial banks are major financial institution, which occupy quite an important place in the framework of every economy. Commercial banks render numerous services to their customer in view of facilitating their economic and social life such as collection deposits from the public, grant loans to those investors who want to invest in the business, industry and other sectors, overdraft, guarantee services, letter of credit, discounting bills, promissory notes, selling of others share to general public, agency function task, limit of storage commodities etc.

Fund collection and mobilization is the major activity of a commercial bank. Fund management determines the effectiveness of a commercial bank. A bank is essentially an intermediary of short term, middle term and long term funds. He can carry out extensive lending operation only when he can effectively canalize the savings of the community (Weston and Brigham, 1997:125).

Current context of globalization, privatization, free market, economic liberalization etc have made the activities of banks and financial institutions more complex and challenging. Recent development in science and information technology has turned the whole world as a small village. A small mistake made by an organization affect in numerous sectors for the long run; to the organization, and nation. Therefore, organizations must be conscious and vigilant in their activities.

1.1.1 Introduction of Sample Banks

Everest Bank Ltd. (EBL)

Everest Bank Ltd. was registered under the company act 1964 in 19th November 1993 and started commenced banking transaction in 16th October 1994, the promoter of the bank decided to join hands with an Indian bank and entered into joint venture agreement in January 1997 AD with Punjab National Bank (PNB), which is one of the leading commercial bank of India, having over 100 years of successful banking experience and known for its strong system and procedure. A team of professionals are deputed by PNB under this arrangement. Now the bank has 38 branches including main branch in Nepal. Nepalese promoter holds 50% and rest held by General public.

The main purpose of EBL is to extend professional banking services to various sectors of the society in the Kingdom of Nepal and thereby contributing in the economic development of the country. It provides following facilities and services to their customers;

- Cumulative Deposit Scheme
- Unfix Fixed Deposit
- Required Deposit Plan
- *Telegraph Transfer (T.T)*
- Letter of Credit
- Drawing Arrangement

- SWIFT Transfer
- International Trade and Bank Guarantees
- Remittance
- Foreign Currency Deposits/ Lending
- Foreign Exchange
- Trade Finance
- 365 Days Banking
- Debit Card
- Merchant Banking
- ATM (Automated Teller Machine) etc

Everest Bank Ltd. is moving towards to the consumer finance and providing different types of loans like; Home Loan, Home Equity Loan, Education Loan, Professional Loan, and Vehicle Loan etc.

Nepal SBI Bank Limited

Nepal SBI Bank Ltd. (NSBL) is the first Nepal- Indo joint venture bank in the country. It is sponsored by three institutional promoters. They are State Bank of India, Karmachari Sanchaya Kosh (Employees Provident Fund) and Agricultural Development bank of Nepal (ADB/N). Nepal SBI Bank Limited became operational on the 8th July 1993.

The bank was registered on 2050/ 01/16 (28.04.1993) in the Department of Industry, Nepal Government (NG) under the Company Act 2021 and Commercial Bank Act 2031. The formal inauguration of Nepal SBI Bank Limited took place on 7th July 1993. It commenced its operations on 2050/03/24 (8th July, 1993). The equity composition of the Bank is as follows:

1. State Bank of India – 50%
2. Employee Provident Fund -15%
3. Agricultural Development Bank-5%
4. General Public-30%

The services provided by Nepal SBI Bank Limited include deposits, remittances, various types of loan facilities, letter of credit, bank guarantees, retail financing (house loans, vehicle loans and education loan), ATM facility, 365 days banking etc. (http://www.nsbl.com.np)

Nabil Bank Limited (Nepal Arab Bank Limited)

Nabil was incorporated in the year 1984. It commenced its operation on 12th July 1984 as the first joint venture bank in Nepal. It was listed in the Nepal Stock Exchange in the year 1986. (08/09/2042 B.S.). Dubai Bank Ltd. Dubai (Later acquired by Emirates Bank International Ltd. Dubai) was the first joint venture partner to Nabil currently, NB (International) Ltd., and Ireland is the foreign partner. Nabil Bank Limited had the official name Nepal Arab Bank Ltd. till 31st December 2001. The equity composition of Nabil is as follows:

1. NB (International) Ltd, Ireland – 50%
2. Nepal Industrial Development Corporation (NIDC)-10%
3. Rastriya Beema Sansthan -9.67%
4. Nepal Stock Exchange Limited-.33%
5. General Public-30%

NABIL Bank is the pioneer in introducing many innovative banking services and marketing concept in banking sector of Nepal. It operates its activities through 15 branches and 2 counters. It is the only bank having presence in the Tribhuvan International Airport. Some of the services provided by NABIL Bank Limited are accepting deposits, documentary credit, guarantees, collections, credit cards, Tele- banking, safe deposit, fund transfer etc. (http://www.nabilbank.com.np).

Although, there are many finance companies actively running in the country (approx. 79), there are 55 finance companies, which are listed in the securities board as on mid December, and only few companies whose shares are traded actively in stock markets. Only three finance companies have been selected as samples. They are following

1. National Finance Company Ltd.
2. Mahalaxmi Finance Company Ltd
3. Naryani Finance Company Ltd.

A short description of these sample finance companies portray below.

Standard Chartered Bank Nepal Limited

Standard Chartered Bank Nepal Limited, formerly known as Nepal Grind lays Bank Limited was incorporated in the year 1985 and has been in operation since 1987. On 31st July 2000, Standard Chartered Bank concluded the acquisition of ANZ Grindlays Bank form the Australia and New Zealand Banking Group Limited. With this acquisition, 50% shares of Nepal Grind lays Bank Ltd. (NGBL) previously owned by ANZ Grindlays are now owned by Standard Chartered (Grind lays Bank Ltd) leading to the name change of the Bank to Standard Chartered Bank Nepal Limited with effective from 16th July 2001. The equity composition of Standard Chartered Bank Nepal Ltd. is as follows:

1. Standard Chartered Grind lays Bank – 50%
2. Nepal Bank Limited - 33%
3. General Public - 17%

The Bank focuses mainly on corporate, consumer and commercial banking. It provides service for international firms, as well as embassies, aid agencies, airlines, hotels and government corporations.

The banking services range including full trade finance capabilities as well as working capital and medium term loan facilities, remittances, deposit services, credit card and ATM. For international firms, Standard Chartered Bank Nepal Limited has specialized in foreign trade, bonding, remittance services and foreign exchange. (http://www.standardchartered.com/np

Himalayan Bank Ltd

Himalayan Bank Ltd. is a join venture bank with Habib Bank Ltd. of Pakistan which was established in 18 June 1993 under the company act 1994. This is the first join venture bank holding with maximum share by Nepalese private sectors. Its ownership is composed of financial institutions of Nepal by 66.29%, Habib Bank Ltd. of Pakistan by 20% and general public of Nepal by 13.58%. Currently bank has Rs 1000 million of authorized Capital, Rs 600 million of issued and Rs 643 million of paid up capital. Currently it has 15 branches spread over 3 development region of the country. Still it has not any branch at mid western and far western development region.

Nepal Bangladesh Bank Ltd

Nepal Bangladesh Bank Ltd. was established in 5th June 1993 as a joint venture bank with I.F.I.C. bank ltd is one of the largest commercial bank of Bangladesh has a join venture exchange company in Oman and a joint venture in Pakistan. It has Rs 15 million authorized capital, Rs 1000 million issued and Rs 719.85 million paid up capital. Currently it has 17 branches spread over all 5 development regions of the country.

1.2Statement of the Problem

The success and failure of the commercial banks largely depends on the total credit risk management of the commercial banks. It is important to determine the factors affecting the default risk and its management. This study is assist to reveal how the joint venture banks of the Nepal manage the credit risk. Financial institutions are increasing regularly. Liquidity is at maximum level with the financial institutions. Hence, the banks and financial institutions are competing among themselves to advance credit to limited opportunity sectors. Due to the unhealthy competition among the banks, the recovery of bank credit is going towards negatives. Non-performing credit of the banks are increasing year by year. To control such type of state condition, the regulatory body of the banks and financial institutions, N.R.B. has renewed its directives of the credit loss provision. Since the objectives of the commercial banks are wealth maximization and achievement of organizational objectives contribute to the national economy. Especially the study is expected to reveal the following research questions.

- Is the credit risk management affected by the PESTL factors?
- Is their any necessity to amend the existing regulation?
- Is the proper investment policies and practices does assist to increase the credit risk?
- What are the main causes of highly increasing credit risk in commercial banking sectors?
- How the commercial banks are managing the credit risk?
- How to make optimal management of credit risk?

1.3 Objectives of the Study

The major objectives of the study are to evaluate the credit risk management of joint venture commercial banks. It tries to analyze the overall credit risk of sample banks. The specific objectives are as follows:

- To evaluate the SWOT in credit risk management of join venture banks.
- To reveal recovery status of the credit disbursement.
- To determine and analyze the credit risk of joint venture banks of Nepal.
- To suggest and recommend on the basis of major findings.

1.4 Significance of the Study

Research itself is very important because it aims to gain knowledge and to add the new literate in existing field. Thus, the research has its own imperative. Mainly, the study is important for the researcher to fulfill the academic requirement of master degree. On the other, the study is important for commercial banks, researchers, scholars, investors, government and many other parties. At last, it is expected that the study will add a drop of literate in the field of commercial banks and their capital structure.

1.5 Limitation of the Study

This study has been made for the partial fulfillment of the requirement for the Master's Degree in Business Studies (M.B.S.) but not a comprehensive study. The study has been conducted with certain limitations. The time is the one factor of limitations. Besides it, the scope of the study is limited within the bank. Some more limitations are follows:

- The study analyzes credit risk management of a particular bank.

- The whole study is based on primary and secondary data.

- Difficult to collect all required data, due to business secrecy.

- The study is fully based on the student's limited financial resources within a limited period.

- Variation of data in itself is also found when comparing with different sources.

- The study is not a final study of the subject.

1.6 Organization of the Study

The study has been organized into five chapters. The title of each of these chapters is as follows:

Introduction chapter comprises background of the study, focus of the study, statement of problem, objectives of the study, significance of the study and limitation of the study.

Review of literature chapter comprises conceptual review of the credit risk and review of the past thesis.

Research methodology deals with the method of investigation and includes research design, nature of the data, data collection procedure and tools used.

Data presentation and analysis of data deal with different statistical and the financial tools that used in the analysis of the data.

Last chapter includes the *summary*, *conclusion* of the study and *recommendation*.

CHAPTER-2

REVIEW OF LITERATURE

This chapter consists of two parts-Conceptual Framework and Review of Related Studies. In conceptual framework, review of what has been written in academic books is carried out while review of related studies is further divided into review of journals and review of master degree thesis.

This chapter is concerned with the review of relevant literatures available in the books, journals, articles, research reports, newspapers, magazines, policy documents which are published or unpublished. Every study is very much based on past knowledge, study and experiences. The past knowledge or the previous studies should not be ignored as it provides foundation to the present study. Various thesis works done in different aspects of working capital of different organization are also reviewed for the purpose of justifying the study.

2.1 Theoretical Review

The past decade has seen dramatic losses in the banking industry throughout the world. Firms that had been performing well suddenly announced large losses due to credit exposure that turned sour, interest rate positions taken or derivative exposures that may or may not have been assumed to hedge balance sheet risk. In response to this, commercial banks have almost universally embarked upon an upgrading of their risk management and control systems.

2.1.1 General Concept of Credit Risk Management

The credit risk is the potential financial loss resulting from the failure of customers to honor fully the terms of a loan or contract. On the other hand, the market risk includes balance sheet risk and trading risk such as potential risk to earning and capital resulting from changes in interest rate, liquidity conditions, impact of foreign exchange rate fluctuations etc. Meanwhile. Operating risk arise from the natural disasters, errors in processing and settlement of transactions safeguarding of assets, system failure, fraud and forgery.

Against the above backdrops, the main attributes of various risks that can be faced by a banker while evaluating a loan proposal may be expressed by the following functional relationship (Shrestha, 2007:15-22).

Credit Risk (CR) = *f* (BR, FR, Dr, CR, Fr)

Where,

f = function of

BR = Business\operation risk

FR = Financial risk

DR = Default/settlement risk

Fr = Fiduciary risk

It is not practically possible to assign a particular coefficient to each of the risk factors stated above as the degree of each varies from case to case.

2.1.2 Some Important Terms

In this section of the study, efforts have been made to clarify the meaning of some important terms that are frequently used. They are presented below:

1) Deposits: - Basically deposits mean the amount deposited in a current saving or fixed account of a bank or a financial institution. Deposit is the main sources of a fund that bank usually uses for the generation of profit. Therefore, the efficiency of the banks depends on its ability to attract deposits. Deposit being the borrowed amount from the depositors or from general public, it constitutes

the liability of bank. The deposits of a bank are affected by the various factors. They are as follows:

a) Types of customers.

b) Physical facilities of Bank.

c) Management accessibility of customers.

d) Interest rate paid on deposits.

e) Types and ranges of services offered by the Bank.

f) The prevailing economic condition of the country.

2) Loan and Advances: - This is the primary sources of income and most profitable assets of a bank. A bank is always willing to lend as more as possible since they constitute the larger part of revenue. But bank has to be more careful while providing loans and advances since they may not be realized at short period of time. Sometimes they may turn into bad debts. Fund borrowed from banks are much cheaper than borrowed from unorganized moneylenders. Loans and advances are provided against the personal security of the borrower or against the security of the immovable and moveable properties. Banks provide loans in various forms: overdraft, cash credit, direct loans and discounting bills of exchange. In addition to this, some portion of loan and advances and overdraft includes that amount which is given to the staff of the bank as house loan, vehicle loan, personal loan and other (Joshi, 2004:65).

3) Investment on Government Securities, Shares and Debentures: - Though a commercial bank can earn interest and dividend from the investment on government securities, shares and debentures, it is not the major portion of income. But it is treated as a secondary source of banking business.

4) Investment on Other Company's Shares and Debentures: - Commercial banks invest their excess funds to the shares and debentures of the other company. They generally do so when there is excess of funds than required and there is no alternative opportunity to make investment in the profitable sector. Now a day's commercial banks of Nepal have purchased shares and debenture of Regional Development Bank, NIDC and other Development Banks etc.

5) Other Uses of Funds: - Commercial banks must maintain the minimum balance with NRB i.e. 6 % for fixed deposits and 8 % for each of current and saving deposit account in local currency. Similarly 3 % cash balance of local cash balance of all local currency accounts must be maintained in the vault of the bank. Again a part of the funds should be used for bank balance in foreign bank and to purchase fixed assets like land, buildings, furniture, computers, stationery etc.

6) Off - Balance Sheet Activities: - Off-balance sheet activities cover the contingent liabilities. These activities are not recognized as assets and liabilities in balance sheet. They are LC, Guarantee, Commission, and Bills for collection etc. These activities are very important, as they are the good source of profit to the bank though they have risk (Joshi, 2004:67).

There is no single important part of sound management than the methods which bank used to manage risk. Banking business is very risky business, there are several types of risk prevailed in the banking industry, but three major area of risk are widely recognized. i.e., credit risk, market risk and operating risk.

2.1.3 Types of Risk Faced by Commercial Bank

i.) Credit Risk

The credit risk is the potential financial loss resulting from the failure of customers to honor fully the terms of a loan or contract. On the other hand, the market risk includes balance sheet risk and trading risk such as potential risk to earning and capital resulting from changes in interest rate, liquidity conditions, impact of foreign exchange rate fluctuations etc. Meanwhile. Operating risk arise from the natural disasters, errors in processing and settlement of transactions safeguarding of assets, system failure, fraud and forgery.

Against the above backdrops, the main attributes of various risks that can be faced by a banker while evaluating a loan proposal may be expressed by the following functional relationship (Shrestha: 2007: 15-22).

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Where,

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It is not practically possible to assign a particular coefficient to each of the risk factors stated above as the degree of each varies from case to case.

Business or Operational Risk

It is defined as the potential volatility of the performance of the unit concerned, caused by the very nature and type of business operations involved. The board elements of such risk can be classified as.

- Critical risk
- Operational risk
- Production risk
- Marketing and selling risk
- Labor risk

However, the most important component of this category is the macro system risk associated with the industry withself. The operational economic environment, in general and the fiscal and monetary policies of the government provide as additional dimension to the risk structure.

Financial Risk

This risk measures the relative stability of the unit in response to change in its own capital structure, i.e. debt-equity base or exogenous factors in terms of generation of profit. In other words, financial risk depicts whether or not the company would be in a position to generate sufficient profit, after paying debt interest, to finance satisfactory divided besides plugging back adequate quantum into the business.

Default or Settlement Risk

The term "Default" mean any failure to meet all or some terms of the lending agreement. Hence, this risk measures the probability of adherence of the borrower to the terms and conditions of the agreement, as it will ultimately be reflected in the repayment capability. This risk indicated the propensity and ability of the entrepreneur to pay back the bank loan.

Cost Base Risk

This risk indicated the degree of income or profit generated within a unit from a given cost structure. It is a fact as the business develops, cost incurred on various items also increases, and giving rise to incremental income. A developing concern would have incremental income, which shall be more than incremental cost or expenditure. A high value of non- performing assets may not lead to increase profit to the unit.

Fiduciary Risk

This risk refers to the eventuality of losses arise out of off balance sheet financial guarantee and other contingent liabilities (e.g. guarantee etc.) of associates substantial risk. Careful analysis is required at the time of credit appraisal.

ii.) Market Risk

Market risk is the risk incurred in the trading of assets and liabilities due to changes in interest rates, exchange rates, and other asset prices. So, Market risk is exposure to the uncertain market value of the firm's asset. Major factors affecting Market risk are:

- Liquidity Risk
- Interest Rate Risk
- Foreign Exchange Risk
- Operational Risk

a. Liquidity Risk

Anthony Saunders says" Liquidity risk arises whenever financial institutions' liability holders, such as depositors or insurance policyholders, demand immediate cash for their financial claims". When liability holders demand cash immediately - that is, put their financial claims back to the FI-the FI must either borrow additional funds or sell off assets to meet the demand for the withdrawal of funds. An institution is said to have liquidity if it can easily meet its liability holders' demand for cash either because it has cash on hand or can otherwise raise or borrow cash.

In banking sector, Liquidity risk is created when banks hold different types of assets and liabilities. Extreme illiquid assets in bank may result bankruptcy where as excess liquid asset may carry interest rate risk over the period of time. As it is fatal risk, prudent liquidity management is the primary function of banking sector. Liquidity management is also to make sure that expected shortfall amounts are funded at a reasonable cost, ensure excess fund are invested properly with reasonable returns and without carrying any interest rate risk to the bank.

b. Interest Rate Risk

Interest Rate Risk is the incurred by a financial institution when the maturities of its assets and liabilities are mismatched. Interest Rate Risk is probability of decline of earnings, due to the adverse movement of interest rates in various markets. The applicable interest earned on assets and liabilities and hence net interest margin is the function of market variables and it may get changed overnight or over a period of time according to the market situation. Changes in the interest rate can significantly alter net interest income depending on the mismatch of assets and liabilities held by the bank. Changes in interest rates also the market value of bank's equity.

c. Foreign Exchange Risk

Foreign Exchange Risk is the risk that exchange rate changes can affect the value of a bank's assets and liabilities denominated in foreign currencies. The bank is also exposed to foreign exchange risk, which arises from the maturity mismatching of foreign currency positions. In the foreign exchange business, bank also face the risk of default risk of the counter parities or settlement risk. While such type of risk crystallization will not cause principal loss, banks may have to undertake fresh transaction in the cash/spot market to replace the failed transactions. Thus, the bank may incur replacement cost, which depends upon the currency rate movements.

d. Operational Risk

Operational Risk is associated with problems of accurately processing, setting and taking or making delivery to trades in exchange for cash. It also arises in record keeping, processing system failures and compliance with various regulations. The Basel committee on Banking Supervision, Basel September (2000), defines the operational risk as "the risk of loss resulting from inadequate or failed interval processes, people and system or from external events."

Operational Risk arises from inadequate control systems operational problem and breaches in internal controls, fraud and unforeseen catastrophes leading to unexpected losses for bank. Many of the operational-risk-related functions such as regulatory compliance, finance management, frauds, IT, legal and insurance are carried out by the staff and thus human resources itself becomes a cause for operational risk.

2.1.4 Credit Risk Management

Financial environment is dynamic. In this dynamic financial environment fluctuation in interest rates, exchange rates and commodity and real estate prices are not something new. These fluctuations in economic and financial variables weaken the corporate strategies and performance of bank. Thus it's necessary that banks have a framework of risk management. Effective credit risk management allows a finance company to reduce risk and potential non-performing assets. Once finance companies understand their risks and their costs, they will be able to determine their most profitable business and thus price product according to the risks. Therefore, the finance companies must have an explicit credit risk strategy by organizational changes, risk measurement techniques and fresh credit processes and systems.

There are five areas that credit risk management should focus on.

a) Credit sanctioning and monitoring process.
b) Approach to collateral
c) Credit risks arise from new business opportunities.
d) Credit exposures relative to capital or total advances.
e) Concentration on correlated risk factors

2.1.4.1 Risk Management Framework

Froot & Scharfstein, "A Framework for Risk Management"(1994: 91-102), has suggested that the risk management framework rests on three pillars. They are summarized as follows:

a) Making Good Investment Decisions Creates Corporate Value

For traditional banks this means making good loans and investments and non tradition banks, it means this plus making good investment decisions regarding their nontraditional activities e.g., investment banking, mutual funds, insurance derivatives.

b) Generating Enough Cash Flow Internally is the Key to Making Good Investments

Companies that do not generate cash flow internally tend to cut investment more substantially than their competitors do. In banking, generating enough cash flow internally plays a critical role in maintaining a firm's capital adequacy. Adequate capital in turn is a prerequisite for expansion and making good investments. With respect to cost and control, finance companies with inadequate capital are subject to higher deposit insurance premiums greater regulatory scrutiny and possible takeover by outsiders.

c) Proper and Prudent Look at Major Market Indicators

Finance should look properly at major market indicator because adverse movements in external factors such as interest rates, and commodity prices can disrupt cash flow, a company's ability to invest can be jeopardized.

2.1.4.2 Credit Risk Management Technique

As the majority of the finance companies' assets are in the form of loan, as the lending function is simple and create the value of the companies. The main danger is the chance of the borrower not to pay the loan amount. So the proper and prudent management of the credit risk is very necessary.

Merton and Morten has suggested three techniques for the managing the credit risk in their article published in the Journal of Banking and Finance (Miller & Merton; 1995: 483-489).

A. Risk Based Pricing

It has been established that risk based pricing requires lenders to change the rate that compensates for the riskiness of the loan. The pricing procedure needs to be straightforward and not based solely on historical loan loss experience. In practice, loan pricing tends to flow the prime rate plus basis. Because the prime rate is not the lowest rate a bank charges, the credit worthiest customers can negotiate discounts from the prime rate. The discount prime rate is what banks use to attempt to complete with open market instruments such as commercial paper and corporate bonds.

B. Assets Restriction

Banks lenders and other creditors have a claim on the borrower's assets. As long as the market value of assets exceeds the value of liabilities, creditors are protected because proceeds from the sale of assets cover all the claims. Alternatively, as long as positive net worth exists, business firms are not going to turn over to creditor's assets that exceed the value of claims against them. Thus one way for lenders to protect themselves is to try to ensure that the value of assets always exceeds than value of claims. Restriction amount of debt a borrower takes on and restricting the variability of the value of assets are the basic ways of meeting this objectives. Restricting covenants in loan agreement and the strength of bank customer relationships are practical ways that lenders impose asset restrictions or attempt to establish borrower's incentives for compliance.

C. Monitoring

If lenders have a contractual right to monitor assets value continuously and to seize assets, then loan losses can be minimized either by auditing asset values and seizing assets before shortfalls exists or by requiring the posted value if collateral assets to equal or exceed the promised payments. For private loans, for which finance companies have considerable expertise in organization, monitoring with continuous surveillance is costly.

2.1.5 Regulation Relating to Loan Classification and Loan Loss Provisioning

Commercial Banks are heavily regulated than its non-bank competitors in the financial service industry. They are subject to follow the updated regulations issued by the regulation authority. As my topic is solely devotes to the credit risk review is just based on the recent regulation relating to the credit that are issued by the Nepal Rastra Bank, the regulating authority of Nepal.

As per directives issued by NRB dated 2058-5-29 loans and advances shall be classified into the following four categories

Performing Loan

According to Nepal Rastra Bank Directives good loans are considered as performing loan.

1. Pass Loan

Pass loan and advance whose principal amount are not past due and past due for a period up to one month shall be included in this category. Those are classified and defined as performing loans. Before, up to three months past due is taken as pass loan.

Non Performing Loan

According to Nepal Rastra Bank Directives sub standard, doubt and bad loans were considered as non performing loan.

2. **Sub Standard**

   All loans and advances that are past due for a period of three months to six months shall be included in this category. Those are classified as none performing loans.

3. **Doubtful**

   All loans and advances, which are past due for period of six month to one year, shall be included in this category. Those are classified as none performing loans.

4. **Loss**

   All loans and advances which are past due for a period of more than one year as well as advance which have at least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future has be included in this category. Those loans and advances are also classified and defined as none performing loans.

But NRB circulates a new circular on above classifications. It mentions only two types of loan i.e. Pass and Loss. All the installment dues and matured loans are Loss loan and remaining are considered as Pass loan.

Banks shall classify the loans every quarter and send the details for the same in the specified format within one month from the end of each quarter to the Nepal Rastra Bank.

Additional Arrangement in Respect of Loss Loan

- Even if the loan is not past due loans having any or all of the following discrepancies shall be classified as loss.
- No security at all or security that is not in accordance with the borrower's arrangement with bank.
- The borrower is absconding or cannot be found.
- Purchased or discounted bills are not realized within 90 days from the due date.
- The credit has not been used for the purchase originally intended.
- Owing to non recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation
- Loans provided to the borrowers included in the backlist and where the credit information bureau blacklist the borrower.

The Loan Loss Provision

On the basis of the outstanding loans and advances and bills purchase classified as per directives shall be provided as follows

Classification of loan	Loss provision
Pass	1 percent
Substandard	25 percent
Doubtful	50 percent
Loss	100 percent

Installments dues from one year is 100% provision of total principal balance of the loan. Further more recently the NRB circulates all the financial institution to maintain 100% loan loss provision for all the installment dues.

Policy on Accounting of Non-Banking Assets

Banks may in the case of non-utilization of loan, recover the outstanding principal and interest by the way of disposing the assets placed as collateral. Situation may arise requiring the banks to accept assets where the offer received for the assets put into auction is unsatisfactory. Under the section 13(1) of commercial banking Act, 2031 such self acquired assets are required to be disposed off with in 7 years. The bank management should be specific as to the valuation policy of assets. Since the assets are not for the purpose of own use and required to be disposed off within the specific time period valuation of such assets shall be equivalent to the outstanding amount of principal and interest such as the outstanding amounts become nil where the amount realize in disposition of the assets at a future date i.e. within seven years, varies the difference amount shall be adjusted to the profit and loss account. However, where in the year of acquisition of the assets, the total outstanding amount of principal and interest is more than the market value of such assets, the assets has to be valued at the market price and the difference amount of outstanding principal, interest and the market value of assets shall be charges off to the profit and loss account in the year of acquisition itself.(Regulation relating to loan classification and loan loss provisioning before 2058.5.29)

2.1.6. Capital Adequacy Ratio

Capital adequacy ratio (CAR) is the proportion of Capital Fund or Shareholders equity on the total risk weighted asset of a bank. In other words, it is the capital portion, which is used to finance the asset. The total risk weighted asset, on the other hand, includes both on & off balance sheet items, which has been rated with certain percentage of risk. The risk weight of assets ranges from zero for cash, balance at NRB and investment in government bonds to 100% for loans and advances. The higher risk weighted asset means lower will be the capital adequacy ratio as CAR is the ration between Capital fund and Risk Weighted Asset.

According to unified directive 2005, the capital fund includes two types of capital.

A. Primary Capital

Table -2.1

Primary Capital (Tyre One Capital).

1	**Issued Capital**
2	**Share Premium**
3	**Irredeemable Preference Share**
4	**General Reserve Fund**
5	**Retained Earning**
6	**Capital Redemption Reserve**
7	***Net Profit After Tax, Tax,& Bonus(Current Year)***
8	**Capital Adjustment Fund Other Free Reserve**
9	**Other Free Reserve**

(Source: Unified Directive of NRB, 2005)

B. Supplementary Capital

Supplementary Capital refers to all the reserves bank has made for specific purpose, such as loan loss, foreign exchange loss etc. The Supplementary Capital includes:

Table - 2.2

Supplementary Capital (Tyre Two Capital).

1	**General Loan Loss Provision (Good Loan)**
2	**Assets Revaluation Reserve**
3	**Hybrid Capital Instrument**
4	**Unsecured Subordinated Term Dept**
5	**Exchange Equalization Reserve**
6	**Additional Loan Loss Provision**
7	**Investment Adjustment Reserve**

(Source: Unified Directive of NRB, 2005)

C. Capital Fund

Capital Fund includes both the primary and supplementary capital. It can be stated in equation as below:

Capital Fund = Primary Capital + Supplementary Capital

Risk Weighted Assets includes both the on and off balance sheet assets. On balance sheet asset includes three types of risk-weighted asset (i.e. 0%, 20% and 100%). Zero percentage risk weighted assets include cash and bank balance, gold (tradable), investment in NRB and Government Bonds, loan against own bank's fixed deposit receipts, money at call, loan against government bonds, interest receivable on National Saving Bonds. 20% risk weighted asset includes balance with local and foreign banks, loan against other bank's fixed deposits receipts, money at call, loan against internationally rated bank's guarantee and other investment on internationally rated banks. 100% risk weighted assets includes investment on investment on shares and debenture, loans and advances, fixed assets, other investment, all other assets (excluding tax paid and accrued interest receivable).

Off balance sheet assets includes four types of types of risk-weighted asset (i.e. 0%, 20%, 50% and 100%). Bills collection has 0% risk. Letter of credit with maturity period less than 6 months and guarantee against counter guarantee of international rates foreign banks have 20% risk. 50% risk weighted asset includes letter of credit with maturity period more than 6 months, bid bond, underwriting and performance bond. 100% risk weighted items include advance payment guarantee, financial guarantee, other guarantee, irrevocable loan commitment, contingent liability income tax and acceptance and other contingent liability.

The Capital Adequacy ratio of a bank is calculated as below:

i. Capital Adequacy Ratio for Core Capital

$$\text{Capital Adequacy Ratio} = \frac{\text{Core Capital}}{\text{Total Risk Weighted assets}}$$

ii Capital Adequacy Ratio for Total Capital Fund

$$\text{Capital Adequacy Ratio} = \frac{\text{Capital Fund}}{\text{Total Risk Weighted assets}}$$

According to NRB directive 2005, the stator Capital Adequacy Ratio (CAR) for core capital is 6%, where as CAR for total capital fund is 12% for fiscal year 2007/08.

A finance company is a business organization that receives and holds deposits of fund from others, makes loans or extends credits and transfers fund by written order of deposits.

Finance company is a corporation, which accepts demand deposits subject to check and makes short-term loans to business enterprises, hire purchase, regardless of scope of its other retail banking services. A finance company is a dealer in money and substitute for money, such as cheque or bill of exchange. It also provides a variety of retail financial services.

Commercial bank Act 2031 B.S of Nepal has defined that," Commercial bank is a bank which exchanges money, deposits money, accepts deposits, grant loans and performs commercial banking functions and which is not a bank meant for co-operative, agriculture, industries or for such specific purposes."

According to J. H. Clemens, "Commercial bank should consider the national interest followed by borrower's interest and the interest of the bank itself before investing to the borrowers." To further his view, bank lending must be for such purpose of the borrowers that remain keeping with national policy and banks' overall investment policy. A bank's overall investment:

a) Should be basically of short term characters
b) Should be well spread
c) Should be repayable on demand
d) Must be profitable
e) Must be well in adequate security

Thus commercial banks have to consider policy of the government (I.e. Nepal Rastra Banks instructions), national and their own interest as well. Good investment policy ensure maximum amount of investment to all sectors with proper utilization.

M. Radha Swamy and S. V. Vasudevan in the book" A textbook of Banking (Law Practice and Theory of Banking) have described various aspects of lending. They had outlined principles of good lending. What constitutes good advances and a credit appraisal? Banks follow a cautious policy in the matter of lending and are generally governed by the well known general principals of sound lending as below.

1) Safety: The main business of banking consists of borrowing various types of deposits such as current, saving and fixed and discounting of bills. The safety of such funds should be ensured. If the banker has to ensure safe lending, then the three C's of the borrower are character, capacity and capital. Character of the borrower is important because that determines his willingness to repay the loan. His capital and capacity to run the loan depends on both his capacity to repay and willingness to repay.

2) Liquidity: As the bankers deposits are subject to the legal obligations of being repayable on demand and at short notice, he must ensure liquidity also while lending so in times of need. He will be able to convert the assets into cash quickly and can sell it without any loss.

3) Profitability: Commercial banks have obtained funds from shareholders and naturally if dividend is to be paid on such shares earning profits can only pay it. However, the banker will not give undue importance to this aspect because a particular customer may offer a higher rate of interest but an advance made to him result in a bad debt. Therefore, for the sake of profitability the other two principles, liquidity and safety cannot be scarified.

4) The purpose of the loan: Bankers should enquire the purpose for which the loan is taken. If an advance is given for productive purpose, in all profitability, it will be repaid. Thus safety is ensured. If an advance is made for speculative purpose, the banker may come to grief.

5) Diversification of Loans: The popular saying is "Do not put all the eggs in the same basket". A banker should try to diversify loans as far as possible, so that he may minimize the risk in lending. If the banker lends only to one industry or only two few big firms or concentrates in a certain geographical area, the risk is greater. He should diversify lending so that the failure of one industry or the few big borrowers may not affect him. Where lending is done only in one area, it may be affected by political upheaval or natural calamities.

What Constitutes a Good Bank Advance?

In order to make good advance, banker has to ensure the character of the borrower, nature of the proposition, security, and capacity of the borrower to utilize the credit, source of repayment and profitability of the advance.

1) The character of the Borrower: The banker should thoroughly enquire into the integrity and reliability of the borrower. The local manager already knows much of the information concerning the customer. The success of the loan very much depends on the truth of representation of the facts made by the customer and his capacity to run the scheme to a successful conclusion. This depends on his technical competence managerial skill and experience in particular industry or trade.

2) Collection of credit information: In case of new customer the banker has to collect credit information before deciding to make and advance to the customer. In foreign countries, there are specialized credit agencies that collect information relating to the status and financial standing of businessmen and sell the information to the bankers. Examples of such credit agencies are Seyd. & Co. in England and Dun & Bradstreet in U.S.A in India information is available from the credit Information Bureau functioning in the Reserve Bank of India, which provides such information. Such agencies contributes that information makes easy for loan decision.

3) Nature of the proposition: Banks prefer to advance of short periods, especially for working capital requirements. There are specialized institution to finance for the acquisition of fixed assets and new venture.

4) Security: Banker should rely more on the customer and his proposition. However, it is still risky to lend without security. He can fall back on the security when the customer and his proposition fail. According to George Rae, chairman of the (banker) book were covered by mentioning of adequate security. It is clear that in respect of such advances you would stand absolutely exempt from the risk of loss, but the moment you being to make expectation to the rule, by

granting advances to this client or that without security, you leave the solid ground of safety for the treacherous swamps of banking risks.

5) Capacity of the borrower to utilize the credit: The banker must reasonable, be sure about the capacity and integrity of the customer regarding utilization of credit for the purpose for which it is taken. The customer must have the marginal competence and hard working nature.

6) The amount: Bank should see that the amount of loan required is properly arrived at after taking into account all relevant expenses. Quite often the customer misses such items as taxes, overheads, legal expenses, and bank interest. If the amount stated is insufficient, the proposition will be affected by shortage of funds. If the bank is not in a position to lend the required amount, the customer will have to either go slow with his expansion or seek assistance from the other institutions. Sometimes, the proposition may be financed by more than one bank in consortium basis. In deciding the amount to be advanced banker always ensure that the stake of proprietor in the business is more than now own. If this is not ensured, the customer is likely to be reckless in the utilization of funds.

7) Sources of repayment: The banker should enquire the source from which repayment is promised. Where the request is for funds required as additional working capital, and the borrower promises to repay the advance out of profits over a period, the proposal requires careful consideration, and the banker after calling for full information should ascertain the rate at which the customer can reasonable hope to repay the advance. Before giving advance the banker should ensure that the repayment programmed has been properly drawn up and realistic. The sources from which repayment come must be clear. Banks mostly prefer self-liquidating advances.

8) Profitability of the advances: Interest on advances is the main sources of the banks revenue and the interest charged on advances depend in several factors such as prevailing bank rate, the rate of interest paid on deposits, and the risk involved in the particular advance and any other special consideration.

Steps Involved in the Appraisal of Credit Risks

Credit appraisal is an art, which every practical banker should master from out of experience can never be reduce to an absolute seen . In spite of several technical aids, such as ratio analysis of financial statements, cash flow and fund flow statements available to the modern banker, the ability to make a correct loan decision very much depends on the shrewd and critical judgment, common sense perspective intelligence and discriminating sense of the lending banker. However, the usual steps involved in the appraisals of credit risk are:-

1. Initial interview with the customer. In the initial interview the banker should ascertain the following:

a. The character , capacity and integrity of the borrower
b. The purpose for which the loan is being requested-whether productive or unproductive
c. Prospects of his proposal whether it will succeed or fail
d. Repayment capacity of the borrower including a consideration of the source of repayment.
e. The collateral that is being offered as security must be investigated as to the following.
   i) Whether it is easily marketable
   ii) Value of the security at present
   iii) Whether the value is likely to be stable or it is the security such that its value fluctuates considerably and
   iv) In case of default in payment, is it easily transferable?

Credit Investigation of the Customer

For credit investigation of the customer, the banker looks into:

i) Past history of the account
ii) Reports from other bankers and people in the same line of business in the case of new customer
iii) Search of document like memorandum of articles, registration papers, annual report available with the Registrar of joint stock companies
iv) A visit to customers place of business

v) Analysis of Balance sheet and profit and loss Account and funds flow analysis in the case of existing companies

vi) In the case if new companies or new projects of existing companies, there must be a critical appraisal of the projects which includes the following :

1. Examination of technical feasibility
2. Whether project is economically viable
3. The competence of the managerial personnel to successfully complete and run the project
4. Examination of the cash budget to ensure the repayment programmed.

M. Radshawmy in his book "Practical Banking" has explained the term credit appraisal. Credit Appraisal, the process of judging the soundness of credit proposal by carefully assessing the risks involved in extending credit to the proposal submitted by the borrowers. Appraisal involves basically two aspects: determination of the quantum of credit to be given and the safety of such credit .In the past the bankers were mostly guided by the security offered, the character of the borrower and their past experience, if any in relation to the borrower. Now the process of credit appraisal has become sophisticated involving a detailed study of business plans, analysis of balance sheets, profit and loss accounts, cash flow and fund flow-both past and projected. Ratio analysis techniques is used to analyses the balance sheet and profit and loss accounts.

Short-term loans are given essentially to meet the working capital gap, a part of which the borrower has to meet from out of long term sources. The bank manager ensures that the business plan submitted by the borrower is capable of achievement. The borrower submits the following statement during the loan application.

1) Operating statement showing the gross sales, cost of sales(with all the details), gross profit, operating profit after deducting interest, selling , general and administrative expenses, provision for taxes and interest and net profit after taxes.
2) Position regarding current assets and current liabilities. If the peak requirements of finance are on a date different from the balance sheet date, then information should also be given as on that date.
3) Computation of maximum permissible bank finance for working capital
4) Performa statement of stocks and receivables

5) Analysis of balance sheet with the help of analytical and comparative tools
6) Funds flow statement.

Business plans are based on the several assumptions such as government policy, market factors production constraints relating to power and raw material and changes in production techniques as a result of research and development. These assumptions must be subject to close scrutiny and if they are found to be not reasonable, the business plan must be revised. The manager should scrutinize the peak level balance sheet to determine the maximum credit limits. The peak level position and the credit limits should be revised if the peak level statement is found to be in excess of the norms. Projected year-end balance sheet should be studied to know how the financial position of the borrower would be after the completion of the business plan. Projected funds-flow statement should be studied so as to ensure that the long term sources are not only sufficient to meet the long term requirements, but also leave a balance to meet the working capital requirements.

Term Loans:

Term loans are medium and long term credits given for purchase of assets, like land, building and machinery and equipment. The amounts of terms loans are fixed primarily in relation to the total costs of the projects. Recently, there has been a phenomenal expansion in the demand for the term credit from the industry. In spite of the extension of several special financial institutional started to provide such credit, there is still a credit gap, which the commercial banks can fill because of the resources at their disposal. Banks in the past were cautious in extending term credit as they considered such credit non-liquid and risky. However, a substantial portion of the short term credit is "rolled over" by the commercial banks in this country. The overall financial position of the bank's deposits, it capital funds and the general level of its advances deposits ratio limit the quantum of term lending.

Aspects of Appraisal:

Appraisal of term-loans requires a dynamic approach, involving as it does among others, a projection of future trends of output and scales and estimates of costs return and flow of funds. There are four broad aspects of an appraisal technical feasibility, economic feasibility, financial or commercial feasibility and managerial competence. The scope of appraisal and the emphasis placed on each aspect would depend on the circumstances of each case.

The examination of technical feasibility consists of an assessment of the various requirements of the actual production process with a careful enquiry into the availability, accessibility and quality of the goods and services needed.

The testing of economic feasibility will be with reference to the earning capacity of the project. The appraisal of managerial competence is of importance because in a dynamic economic environment, the ability of an enterprise to forge a head of others depends upon the quality of its management. The repayment prospects of a loan thus vitally depend upon the competence and integrity of the management.

The most important aspect of the term loan appraisal is the financial aspect. The term lending institutions have to ensure that the projects to be handled by them meet the minimum financial criteria:

1) The estimated cost of the project is reasonable and complete and has a chance of materializing
2) The financial arrangement is comprehensive without leaving any gaps and ensures availability of cash as and when needed.
3) The estimates of earning and operating costs are as realistic as circumstances permit.
4) The borrower’s repaying capacity as judged form the project operations is demonstrable with a reasonable margin of safety.

The financial analysis considers the cost of the project, cost of production and profitability, performed financial statements, cash flow statement and income statements.

Ratio Analysis:

The banker has to apply ratio analysis to financial statements for three or four years to know the trends or patterns in financial structures and inter-relationship of facts. One of the important ratios is the debt-equity ratio. From the lender's point of view the financial structure should reveal a satisfactory balance of "owned funds" i.e. equity and borrower funds i.e. debt.

Inspection:

The pre-sanction and a follow-up of loan proposals in order to keep a watch on the progress of the projects are of considerable importance. There is an extension of financial appraisal and therefore form a part of the work of lending institution.

Loan Agreement:

On the basis of a thorough financial appraisal, the terms and conditions of the loan are settled. In drawing up their terms of loan, the principal consideration should be that it should ensure financial viability of the borrowing concern and as at the same time allowing a margin of safety to the lending institution. Most of the time lending institution charges a uniform rate of interest on all loans. But it is preferable to have variables rates of interest according to the degree of risk involved.

Security against Term Loan:

In the case of term loans, scientific financial assessment is of paramount importance. However in the absence of credit information bureaus, which can give information about the credit worthiness of the borrowers but the consideration of security assumes importance. In India, the security generally accepted by the term lending, institution loan proceeds and non-industrial assets as supplementary security. Assets can be valued on the basis of book value or current market value or replacement value. In valuing the assets it is better to combine one or more of the methods so that the resulting valuation safeguards of the interest of the lender and also works out to be equitable to the borrower. A proper valuation of security requires the assistance of legal experts.

Participation Arrangements:

Where the amount of loan is too large for a single lending institution, some form of participation arrangement so the part of different institution would be necessary. Such arrangement can also serve other purpose such as underwriting of shares, issuing guarantees etc.

According to S.P. Singh " The investment (credit)policies of banks are conditional, to great extent , by the national policy framework; every banker has apply his own judgment for arriving at a credit at a credit decision, keeping of course his bank's credit policy also in mind."

He further state" The field of investment is more challenging as it offers relatively greater scope to bankers for judgment and discretion in selecting their loan portfolio. But this higher degree of freedom in the field of credit management is also accompanied by greater risk, particularly during recent years; the credit function has become greater complex."

2.2. Review of Related Studies

Present section deals about concept or findings of earlier scholars on the concerned field of the study. It helps to develop the study as link in a chain of research that is developing and emerging the knowledge about the related field.

2.2.1. Review of Articles and Journals

The effort has been made in this present section to examine and review the some related articles published in different economic journals, Bulletins, magazines and newspapers.

Nepal Rastra Bank (NRB) has issued directives to all commercial banks and financial institutions ensuring transparency during loan disbursement as per provision. All commercial banks as well as all financial institution are now required to disclose the name of loan defaulters in every six months. Until now there was no such legal system of disclosing the loan defaulters' name. The new directives have also barred the financial institution from lending any amount to the blacklisted defaulter and their family members. The credit information bureau (CIB) can black list the firm, company or clear the debt within the stipulated period, as per day set criteria for blacklisting, the CIB would monitor those individuals and companies that have the principle loan of above Rs. one million. If the creditor falls to clear the amount within time, or is found mission the loan among other, the creditor can be blacklisted, ("Central bank tightens blacklisting procedure").

Due to slowdown in the world economy and deteriorating law and order situation of the country, many sectors of the economy are already sick. When any sector of economy catches cold, bank start sneezing. From this perspective, the banking industry as a whole is not robust. In case of investors having lower income, portfolio management may be limited to small saving income. But on the other hand, portfolio management means to invest funds in various schemes of mutual funds like deposits, shares and debentures for the investors with surplus income. Therefore portfolio management becomes very important both for an individual's as well as institutional investors. Large investors would like to select the best mix of investment assets. (Shrestha,” Portfolio management lays the vital role in individual as well as institutional”)

The current volume of the total banking deposits is over 1550-fold higher than what used to be some 38 years ago whereas the Gross Domestic Product (GDP) of the country during the same period, price increased just by 62-folds. Central bank static's shows that the total banking deposit in 1965 used to be just Rs. 129.8 million, but swelled to Rs. 202.13 billion by mid-Jan 2003. similarly, the total loan and advances of the entire banking system in 1960 stood at Rs. 107 million, which was over 82 percent of them total deposit. However, total loans and advances went up to Rs. 127 billion, comparing almost 63 percent of the total deposit, during the period. As a result both deposit and lending of the banking system witnessed increase of over 6-folds and 5 folds to Rs.21 billion respectively by 1990s. As a result of economic expansion and private sector development, the nineties witnessed a quantum jump in both deposit mobilization and lending. The deposit of banking system, by the end of 2002, touched Rs. 154.5 billion, which are 7-folds more than the deposit of the nineties. Loans and advances from the banking system touched Rs. 118 billion by June-end 2000 and the amount was double than what it used to be in 1985. (The Kathmandu Post (2003), "Central bank tightens blacklisting procedures")

In the past report titled 'loan loss provision rises Notably' published in the Kathmandu Post, the reporter has made an endeavor to highlight some facts and figures regarding loan loss provision of commercial banks. 'The banking sector is witnessing a huge surge in loan loss provisioning reserve lately. The increment is primarily a result of a directive issue by Nepal Rastra Bank (NRB) in 2001 that introduced stringent loan provisioning criteria for commercial banks. As per data recently released by the central bank, the total loan loss provision in the country's banking sector increased from amount Rs. 8.73 billion in mid-April 2001 to Rs. 13.18 billion in mid-April 2003. The increment is over 51 percent. As per the latest NRB figures, a remarkable surge has been seen in loan provision of Nepal Bank Ltd (NBL). Against the provision of Rs. 1.7 million in mid-April 2007, the loan provision amount surged to whopping Rs. 7.33 billion in a year"

The reporter further stated that apart from the two technically insolvent government-invested banks, loan provision of other joint venture private banks has also risen significantly and the notable increments seen in the loan loss provisioning amounts due to the eight-point prudential directives that the central bank issued in mid-July to all commercial banks.

The reporter concludes, "The directives laid down stringent guidelines relating to loan loss provisioning to ensure a good health of the overall banking system. The directive requires loans to be provisioned to the extent of cent percent if payment is defaulted for one year. Likewise, the directives require loans to be provisioned to the extent of 25 per cent if payment is defaulted for over three months and 50 per cent if the period of default extends beyond six months. The earlier directive required progressive provisioning of loans, but allowed maximum of three years, unlike the present system of just two year, for loans to be provisioned to the extent of cent percent'.

Binam Ghimire in his article titled "Credit sector reform and NRB" has tried to highlight the effects of change or amendment in NRB directives regarding loan classification and loan loss provisioning. "Although the circumstances leading to financial problem or crisis in many Nepali banks differ in many respects, what is common among most of the banks is the increased size of nonperforming assets (NPAs), to resolve the problem of the losses or likely losses of this nature facing the industry. NRB, as the central bank, has amended several old directives and issued many new circulars in the recent years." (Ghimire, 2005: 7-12).

As opinioned by him, since majority of the loans of most of the commercial banks of the country at present fall under substandard, doubtful and even loss categories, loan loss provisioning now compared to previous arrangement would be dramatically higher. The new classification and provisioning norms are much lent able as they help to strengthen banks financially. He added that we also must remember that the old system remained in force from 1991 to 2001, which was probably the most volatile decade of the business operation of the country. He has indicated that loan loss provisioning as a percentage of total credit of April 12, 2001 is 5.2% but as April 13, 2003, it has jumped to 18.39. If only private banks are considered, it is 2.12% of April 2001 where as it is 6.30% as of April 13, 2003. The total increment in LLP is Rs 11,328.11, million and the total increment in credit is only Rs 7976.70. He has also stated that tightening provisioning requirements on NPL is to ensure that banks remain liquid even during economic downturns.

In the conclusion he has mentioned that in the recent years NRB has worked for management and reform of the credit of the financial institution more seriously and NRB has adopted reforms aimed not just at dealing with problems but also at strengthening banking supervision to reduce the likelihood of future crisis, "All prudential directives of NRB in connection of credit sector reform have been made revised after April 2001. To adapt to such changes there can be some difficulties and for a better and harmonized reform NRB should continue to be supportive, proactive and also participative to take opinions of bankers for a change in regulation/policy taking place in the future."

In the article by Dependra B Chhetri, titled "Non Performing Assets: A need for Rationalization", the writer has attempted to provide connation of the term NPA and its potential sources, implication of NPA in financial sector in the South East Asian region. He has also given possible measures to contain NPA. "Loan and advance of financial intuitions are meant to be serviced either part of principal of the interest of the amount borrowed in stipulated time as agreed by the parties at the time of Loan settlement. Since the date becomes past dues, the loan becomes non-performing asset. The book of the account with lending institution should be effectively operative by means of real transaction affected on the part of the debtor in order to remain loan performing."

As stated by the writer, the definition of NPA differs from country to country. In some of the developing countries of Asia Pacific Economic Cooperation (APEC) forum, a loan is classified as non-performing only after it has been arrear for at least 6 months. Similarly, it is after three months, in India. Loans thus defaulted are classified into different categories having their differing implication on the asset management of financial institution. He also stated that NPAs are classified according to international practice into 3 categories namely substandard, Doubtful and Loss depending upon the temporal position of loan default. "Thus the degree of NPA assets depends solely on the length of time the asset has been in the form of non-obliged by the loaner. The more time it has elapsed the worse condition of asset is being perceived and such assets are treated accordingly. "As per Chhetri's view, failure of business for which loan was used, defective and below standard credit appraisal system credit program sponsored by Government, slowdown in economy/recession, diversion of fund is some of the factors leading to accumulation of NPAs.

He said that there is serious implication of NPAs, on financial institutions. He further added that the liability of credit institution does not limit to the amount declared as NPA but extends to extra amount that required for provisioning depends upon the level of NPAs and their quality. As per his view, rising level of NPAs create a psyche of worse environment especially in the financial sector. He mentioned that by reviving the activities of the financial institution like waiving interest, rescheduling the loan, writing off the loan, appointing private recovery agent, taking help of tribunals and law of land, etc, NPAs can be reduced.

Finally he concluded that financial institutions are beset with the burden of mounting level of NPAs in developing countries. "Such assets do bar of income flow of the financial institution while claiming additional resources in the form of provisioning thereby hindering gain investment. Rising level of NPAs cannot be taken as stimulus but the vigilance demanded to solve the problem like this, eventually will generate vigor to gear up the banking and financial activities in more active way contributing to energizing growth." (Chettri, 2007: 15 - 20).

According to Pradhand and Yadav (2002), saving is income not consumed. It is one the important and perhaps the chief sources of Investment. In developing countries about 45% of the incremental saving is invested domestically, while in developed countries about 75% of the incremental saving in invested domestically. This suggests that capital is more mobile in developing countries than in developed countries. Saving are of great significance in a country's development. while saving results in high economic growth rate, rapid development leads in turn high savings. Nepal's saving rate is lower as to other developing countries, however, even to achieve 5 to 6 percent economic growth rate, more than 25 percent annual Investment of GDP is considered necessary. As the country's current domestic saving are about 14% the economic resources are short by nearly 11% in proportion of the GDP.

The situation is such that huge portion of Investment has still to be made with external resources. The amount of saving of a typical household in Nepal is small because of the people have limited opportunities for Investment. They prefer to spend saving on commodities rather than on financial assets. This restricts the process of financial intermediation, which might otherwise bring benefits such as reduction of Investment risk and increase in liquidity. When capital is highly mobile international, saving from aboard can also finance the investment needed at home. When capital is not mobile internationally, saving form abroad will limit Investment at home.

Wherever there is Investment there must be capital formation .The development of an economy requires expansion of productive activities, which in turn is the result of the capital formation, which is the capital stock of country. The change in the capital stock of the country is known as Investment. Therefore Capital formation is closely related to investment. Investment generally takes two forms:

1. Financial Investment and
2. Physical Investment

Physical Investment related to real Investment in the economy or industry, which is known as capital formation. Capital formation shows the change in gross fixed assets of production units of manufacturing industries.

Capital formation refers to the creation of physical productive facilities such as building tools, equipment and roads. The process of adding to the amount of stock of the real assets produces growth in the economy. It means increasing a country's stock of real capital. It implies additions to the exiting supply of capital goods in a country. It represents an additional of new capital stock to exiting stock after deducting depreciation, damage and other physical deterioration of the existing capital stock. Economic progress in country depends upon its rate of capital formation. Hence, a key factor in the development of an economy is the mobilization of domestic resources. In the process of capital formation, the capacity to save by certain classes of people and institution becomes quit important. These people have varied asset-preferences, which change from time to time. The need of entrepreneurs who actually use saving for productive purpose also varies over time. (Pradhan and Yadav, 2002: 9 & 10).

In an article published written by Atma Shrestha in Business Age entitled “Entrepreneur –Friendly Credit Policy” has reviewed the present credit policy with main focus of the credit decision being based on the collateral. He argues that only collateral should not be considered as the basis of the credit decision. (Shrestha, 2004: 11).

Access to finance is vital element for entrepreneurship development in the country. Without it one cannot think of starting business of any sort. It’s mainly due to this reason; most of the students after completing their single mindedly look for employment opportunity. No other option, no matter how lucrative and attractive it would be enters into their mind. It has created huge pressure in the labor market. In the absence of entrepreneurial activities in the country, employment opportunity will be very limited and even qualified and competent people do not get job. The established notion of the

Nepalese bankers that money lent to the wealthy people based on collateral is safe. But is not actually a safe assumption in the face of greater difficulty in loan recovery from these people. Also, this particular segment of market is already over-banked. With the worsening business performance of the Nepalese corporate sector mostly due to the poor management compounded by other factors sluggish economic conditions and political instability, banks must now explore newer market segment for their sustained growth and success. Under this backdrop, Nepalese commercial banks must change their policy and must understand that even the people living in the low and middle level of economic pyramid can potentially be lucrative market. They can ignore them only at their peril, especially at the time when the competition in the market consisting of people at upper level of economic pyramid is very intense and had already saturated. In this context, potential entrepreneurs armed with skills, knowledge and readiness to take plunge in the business world can form a formidable market opportunity for the Nepalese banking industry –only if it can come out of the cocoon of traditional collateral-driven lending approach.

At the time when Nepalese banking industry is confronting with the increasing NPA, it might seem unwise and untimely to suggest that commercial banks extend loan to the potential entrepreneurs without collateral. It is not that they must ignore the collateral altogether while making credit decision. Collateral may be one of the important elements of the credit decisions. But this should not be a pre-condition for any credit decision. Lesson should be learned from the past experience of this credit policy that collateral alone does not ensure quality of credit decision. The fluctuation and stagnancy in the real estate business has further reinforced this view. More important, Nepalese bankers themselves must have to have entrepreneurship spirit which means, they should not hesitate to take educated risk by giving more weight to the entrepreneurship dimension of the credit proposals while making credit decision. The ability of lending is identifying and investing a distinct competitive advantage in the crowded market. However it's essential that any government rules and regulations that inhibit the promotion of entrepreneurship in the country must be abolished.

Entrepreneurship development is one of the important conditions for the economic growth of a country. There must be the sprout of entrepreneurship activities in the country for rapid economic growth and progress. However it does not happen automatically. We must create necessary condition and environment where people with skills, knowledge and hunger to make money by starting their own business can get easy access to capital.

The ordinance relating to banks and financial institutions has been promulgated that has been brought into existence effective February 4, 2004. The Banks and Financial Institutions Ordinance, 2004 has replaced the existing Agricultural Bank Act, 2024, Commercial Bank Act, Development Bank Act, and Nepal Industrial Development Corporation Act and Finance Companies Acts and have bought all such institutions under the preview of a single Act. Though this ordinance came as an achievement in the financial sector reform program, its being a, matter of debate among the various finance experts that the ordinance having six months existence time should be enacted? At this time since there is no parliament in the country and the parliament is authorized to enact permanent law. It is obvious that the financial sector must go through uncertainty in the future. The ordinance, popularly called as Umbrella Act.

In an article "Comments on Umbrella Ordinance 2004" Tirtha Upadhya, president of ICAN has clearly described the ordinance along with his views. The ordinance is comprehensive and prescribes in detail the provision for licensing, incorporation, governance and merger and dissolution procedure for banks and financial institutions (FIs). This is a significant improvement over the existing Acts but apprehension is expressed about the discretionary power that the ordinance has vested on Nepal Rastra Bank(NRB).(Upadhaya, 2004: 6-17)

2.3.2 Review of Related Thesis

Chhetri (2006) on "**A study on financial Analysis of NIBL"** has found out that the analysis of the banks shows that the deposit have bee increasing gradually during the study period i.e. (2001/02-2005/06). However the rate of increase was comparatively low in the year 2002/03 than in the year 2004/05. Total loans and advances have been also increasing. The total investment of the bank has been increasing over the years, which is mainly due to bank strategy of safe lending and also a as a result of increase in customer deposits and limited opportunities for prudent lending. As the loan and advances from the bank is increasing provision for loan loss has also been increasing. The bank has been holding adequate provision for losses over the years and the general loan loss provision was 4% in average of the total risk assets.

In her study she has recommended that the bank should focus more on non – risky lending opportunities such as mortgages, housing loans and personal loans. It should carefully examine safety of principal as well as sources of repayment, capital structure, requirement and credit worthiness of a borrower for providing credits. In other words, credit manager should evaluate credit risk by considering well-known five C's of credit viz character, capacity, capital, collateral and conditions.
The financial analysis of NIBL has been analyzed and interpreted in this thesis. Analysis on terms of loan and advances is simply presented with comparison with the previous year data only. On the loans and advances part, it has only simple comparison been done. Whether the loan classifications and provisioning of loans, investment in priority and deprived sector loan investment regulation of NRB's directives has been followed or not has not been explained.

The review of above relevant literature has contributed to enhance fundamental understanding and knowledge, which is required to make this study meaningful and purposive. There has been lots of article published related to investment policy published related to investment policy, loan and advances of commercial banks. There are various researches conducted on investment analysis and policy of commercial banks, Impact and Implementation of NRB guidelines in commercial banks but there are a few research conducted on lending aspect of commercial banks. There was a thesis done by Lila Prasad Ojha on "Lending Practices:

Maharjan (2007) on the topic **'A study on non-performing loans and loan loss provisioning of commercial banks'** revealed that SCBNL had risk averse attitude o the management or they have policy of investing low in the risky assets i.e. loans and advances as compared to NBL AND NABIL because the loans and advance to total asset ratio of NBL, NABIL & SCBNL during the study period was appeared to be 52.3%. 47.0% and 29.34% respectively. The SCBNL has higher proportion of the investment in risk free or nominally risky asset like treasury bills, National Saving bonds etc.

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

However the better activity ratio of SCBNL has proved this bank the best in managing the lending portfolio according to the demand of profit-oriented business. The high volume of lending activities and high volume of productive sector loan of Nabil has put this bank in the top position in absolute term.

Adhikari (2008) on the topic **'A study on non-performing assets of Nabil and SCBL'** In the same way, proportion loan loss provision of NBL was found to be significantly higher (i.e. 40.17%) as compared to other two commercial banks. The proportion of NABIL and SCBNL was found to be 5.69% and 4.49%.

The average ratio of provision held to non-performing loan of NBL, NABIL & SCBNL was found to be 80.03%, 57.85% and 122.32% respectively shows that the SCBNL has maintained adequate level of provision against non-performing loan where as NABIL was found to be comparatively lower. The NBL was found to be an average position.

Dhakal (2009) on the topic **'A study Credit Management of Commercial Banks in Nepal"** the loans and advances to total deposit ratio of NBL, NABIL and SCBNL during the study period was found to be 57.63%, 56.35% and 35.94% respectively. It indicates that SCBNL has the most consistent and variability during the study period where as the NBL has the higher consistent and variability as comparison to other two banks. NABIL has the moderate level of consistent and variability.

Karki (2009) Conducted a study "**Lending Practices and Procurers of Nepal Bangladesh Bank Limited**" has outlined his major findings as follows. Not concentrating only in big cities and large groups he has suggested NB Bank to expand branches in rural areas. Banks should invest in productive sector, develop the concept of micro financing and group financing Make should maintain the balance in its loan portfolio and current requirement of the customers. Banks should give preferences to the short term lending. Banks should provide the consortium loan for those for those projects under government guarantee and security thereby uplifting the economic condition of the country.

Shrestha (2010) in his thesis on "Risk management of commercial bank in Nepal; A comparative study between KBL and MBL" has outlined major finding as follows:

"The major risk in KBL and MBL is associated with credit decision as the proportion of credit risk on total risk is high. Based on the response of structured questionnaire, it has been found that proportion of credit risk on total risk is more than 60%. The same conclusion is shown by financial statement analysis. The average loans and advances to total assets ratio of KBL and MBL is 65.19% and 68.14% respectively. Similarly, the mobilization of deposit in credit (i.e. credit deposit ratio) also suggests that major portion of deposit ratio is invested on loan and advances. The average credit deposit ratio on KBL and MBL is 86.38% and 81.12% of total income in KBL and MBL respectively.

The credit practice of MBL shows that MBL is also granting loan without collateral which is poor sign of credit practice. 100% of provision is to be made for this sort of loan which reduces the bank's profit. This sort of practice is not found in case of KBL. Similarly, credit concentration on single sector of KBL and MBL shows that both banks have very high amounts of concentration in single portfolio. In manufacturing sector, KBL and MBL have 25% and 35% of total loan exposure which is sign of “Putting all eggs in one basket”. There is positive correlation between loan loss provision and loan and advances in both banks. This indicates that there is a change in LLP of both banks where there is loan and advances. Likewise LLP and non-performing loan of KBL are positively correlated where as correlation coefficient of MBL is found negative due to higher amount of loan against personal guarantee and unsecured lending. The organizational structure of KBL is found more stringent and advanced than that of MBL. In KBL, Assets Liability Management Committee (ALMCO) has mainly concerned with all types of risk management including credit risk. In MBL, credit committee which includes the member of board of directors and management is the main body for managing credit risk.”

CHAPTER-3

RESEARCH METHODOLOGY

3.1 Introduction

Research methodology is systematic way to solve the research problem. In other words, research methodology describes the methods and process applied in the entire aspect of the study. Research methodology refers to the various sequential steps (along with a rational of each step) to be adopted by a researcher in studying a problem with certain objectives in view (Kothari, 1994:9). Thus the overall approach to the research is presented in this chapter. This chapter consists of research design, sample size and selection process. Data collection procedure and data processing techniques and tools.

Research methodology is the main body of the study; it is the way to solve about research problem systematically. Therefore, research methodology is the research method on techniques to use through the entire study. In other words, research methodology is the process of arriving at the solution of problem through planned and systematic dealing with collection, analysis and interpretation of the fact and figures.

3.2 Research Design

A research design is the specification of methods and procedures for acquiring the information needed. It is the overall operational pattern of framework for the project that stipulates what information is to be collected, from which sources and by what procedures (Poul, 1997:34). Thus a research design is a plan for the collection an analysis of data. For research there exits different types of research design like; Historical research, Descriptive research, Case study research, Field study research, Analytical research, True experimental research and so on. Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance.

The study is evaluative and analytical type of study regarding the credit risk management. The research design used in the study is descriptive and evaluative. The data relative to topics are collected through financial statement of the finance and other available sources. The data for five years had been collected and various financial and statistical tools had been used to resolve the objectives.

3.3 Nature and Sources of Data

The data used in this study are secondary in nature. Published annual reports of the concerned banks are taken as basic source of data. The data relating to financial performance are directly obtained from the concerned banks. Similarly, related books, magazines, journals, articles, reports, bulletins, data from Nepal Stock Exchange and Nepal Rastra Bank, Central Bureau of statistics, related website from internet etc. as well as other supplementary data and various economic surveys are also used. Previous related studies to the subject are also counted as source of information.

3.4 Population and Sample

The term "population" of universe for research means the universe of research study in which the research is based" (Pant, 2000:75). At present there are 31 commercial banks operating in Nepal and most of their stocks are traded actively in the stock market. All 31 commercial banks are the population of this study. Among them Standard Chartered Bank Nepal Limited is chosen as sample for the present study on the basis of good financial performance.

3.5 Data Collection Procedures

The annual reports of respective finance companies were collected from their respective offices and also by post on request. NRB reports were collected from Research department of NRB. The numerical data collected from different sources were used in whole numbers for the convenience of the study. The internet also proved to be a very good source of data. Various sites were used for the collection of data.

3.6 Data Processing and Presentation

The information and data obtained from the different sources are in row form. From that information, direct presentation is not possible. So it is necessary to process data and converts it into required form. After then only, the data are presented for this study. This process is called data processing. For the study, only required data are taken form the secondary source and presented likewise, in some case graphical presentation is also made. For presentation, different tables are used. Likewise, in some case graphical presentation is also made. The calculations that are related to this study are done with the help of scientific calculator as well as computer software program.

Data Analysis Tools

For the achievement of the study various financial and statistical tools can be applied. The analysis of data will be done according to the pattern of available data. The descriptions of financial as well as statistical tools are as follows:

Financial Tools

The financial tools are used to find the financial strength, weakness, opportunity and threats of a firm. An analysis of financial statements helps to take managerial and financial decisions. In this study, various financial tools will be employed for the sake of analysis. The basic tool for financial analysis will be ratio analysis. Beside it, risk index techniques also will be adopted.

Ratio analysis has been accepted as the most dominant financial tools to analyze and interpret the financial statements. The relationship between two figures expressed mathematically is known as financial ratio. It is the systematic use of ratio to interpret the financial statement so that the strength and weakness of the firms as well as its historical performance and current financial conditions can be determined. Thus ratio is defined as "the indicated quotient of two mathematically expresses ions, and the relationship between two or more things."(Web star's New Collegiate: 1975:95)

Alexander Wall has considered as the pioneer of ratio analysis. He presented after serious thinking, a detailed system of ratio analysis I 1990. He explained that the work of interpretation can be made easier by establishing quantitative relationship between the facts given in the financial statements.

Ratio analysis has various uses such as it is useful in financial position which helps the banks and other financial institutions in lending and making investment decisions; for forecasting purpose and making plans; for locating weak spot in business and also in comparison of performance with the contemporary firms or department. In spite of uses, there are some limitations, which rusticates it uses. If data are incorrect, it present false result; there is no common standard of comparison; it is only one method of analysis. But despite that its significance is much accepted in analyzing the financial performance of any firm. A large no. of ratio can be generated from the components of profit and loss account and balance sheet. For this study, ratios are categorized into the following major headings.

A. Activity Ratio

Activity ratio or utilization ratio is employed to measure the efficiency of the bank managers for utilize its resources. Hence the ratios are called efficiency ratio, assets utilization ratio or turnover ratio.

This ratio indicates the efficiency, sped and rapidly with which assets have been used or converted in to sales. The greater the ratio is the more efficient the utilization of resources. Various ratios are examined under this ratio. Some of them which are useful for this study have been shown below.

1. Credit and Advances to Total Deposit Ratio

Commercial banks utilize the outsider's funds for profit generation purpose. Credit and advances to total deposit ratio shows whether the banks are successful to utilize the outsider's fund for the profit generate purpose on the credit and advances or not.

Generally a high ratio reflects higher efficiency outsider funds and vice-versa. The ratio can be calculated by using the following formula.

$$\text{Credit and Advance to Total Deposit Ratio} = \frac{\text{Credit and advances}}{\text{Total deposit}}$$

2. Credit and Advance to Fixed Deposit Ratio

Fixed deposits are the long term interest bearing obligations. Credit and advances are the major sources of the investment to generate the income by the commercial banks. The ratio measures how many times the amount is used in credit and advances in comparison of fixed deposit for the income generating purpose. A high ratio indicates idle cash balance meaning is not being utilized properly.

To calculate this ratio, the following formula should be used.

$$\text{Credit and Advance to Fixed Deposit Ratio} = \frac{\text{Credit and advances}}{\text{Fixed deposit}}$$

3. Credit and Advance to Total Assets Ratio

Credit and advances of any commercial banks represents the major portion in the volume of total assets. High degree of this ratio indicates the good performance of the bank in mobilizing its fund by way of lending function. This ratio is computed by dividing credit and advances by total working fund i.e. total assets, credit and advances consists of loans, cash credit & overdraft, bills discount & purchase. Its measures the ability in mobilization total assets into credit and advances for generating income. A higher ratio is considered is an adequate symbol for effective utilization of total assets of banks to credit and advances which creates opportunities to earn more and more. This ratio can be calculated by using the following formula.

$$\text{Credit and Advance to Total Assets Ratio} = \frac{\text{Credit and advances}}{\text{Total assets}}$$

4. Performing Assets to Total Assets Ratio

It tells the percent of performing assets to total assets. It is useful to know the fact that whether the good credit is increasing or not. We can generate more earning by increasing good credit and can reduced bad and inferior credit. It teaches us to invest on the sources of the good credit. This ratio can be calculated by using the following formula.

$$\text{Performing Assets to Total Assets Ratio} = \frac{\text{Performing assets}}{\text{Total assets}}$$

B. Profitability Ratio

Profitability ratio indicated the degree of the success in achieving desired profit. Profit is the difference between revenue and expenses over a certain period of time. Profit is ultimate output of the company and its existence is not justified if it fails to make sufficient profit. So profits are essential for every firm to survive and to grow a long period of time. Profitability ratios are the indicators degree of managerial success for achieving firm's overall efficiency of the business. The following ratios are calculating under the profitability ratio.

1. Return on Total Assets Ratio

Return on total assets explains the contribution of assets to generating net profit. This ratio indicates the efficiency of the assets mobilization. In other word, ROA is an overall profitability which measure earning power and overall efficiency of the organization. Higher ratio indicates higher efficiency in utilizing of assets of the firm and vice versa. This ratio can be calculated as follows.

$$\text{Return on Total Assets Ratio} = \frac{\text{Net profit after tax}}{\text{Total assets}}$$

2. Return on Equity

The equity capital of the bank is its owned capital. The prime objective of any bank is wealth maximization i.e. to earn high profit by maximizing return on its equity capital. This ratio shows how efficiently the banks have utilized shareholder's funds to raise the profit. The higher ratio represents the higher efficiency of the bank in utilizing long term funds of shareholders. It can be calculated as follows.

$$\text{Return on Equity} = \frac{\text{Net profit after tax}}{\text{Shareholder's equity}}$$

3.7.2 Statistical Tools

1. Risk Index

Basically credit risk management is reviewed by two approaches**.** First approach is micro approach which is generally out by bank employee, internal auditor who can collect all and every related information to credit management. Another approach is macro approach. This approach is faster but less accurate way of estimating risk and loss exposure of banks according to Joseph F. Siney, in his book, commercial bank and financial management**.**

Risk index is based on macro approach to review and appraised the credit management process. It measure the bank risk exposure related to credit based on the financial information. This index is widely used and practiced in the banks for review and appraisal. It was first propounded by Hannen Hanwack, 1998. It has been applied by Liang and Savage in 1990, Sinkey and Nash, 1993. Risk index can be computed by using following formula.

$$\text{Risk Index} = \frac{\text{E (ROA)} + \text{CAP}}{\text{S.D. (ROA)}}$$

Where,

E (ROA) = Expected return on assets

C.A.P. = Inverse of equity multiplier

S.D. (ROA) = Standard deviation of R.O.A.

Lower the risk index implies riskier bank where as higher implies safe bank. The resultant figure as per group average, or above or below the average shows that the strength and weakness of the bank's credit and administrative policies and practices.

2. Profitability of Book Value Insolvency

This figure is calculated by using the value of risk index. Profitability of book value insolvency can be expressed as half square of risk index i.e. $0.5(R.I.)^2$. The resulting figure shows the thickness of the book value cushion a bank has available to absorb accounting losses. In both cases, risk index and profitability of book value insolvency, a bank with the high expected R.O.A. shows a strong capital position and stable earning, has a relatively high of risk index and a small change of exhausting its book value equity.

Profitability of Book Value Insolvency = $0.5(R.I.)^2$

Where,

R.I. = Risk Index

3. Coefficient of Correlation

Correlation can be defined as a degree of linear relationship existing between two or more variables. Correlation can be categories in three types. There are simple, partial and multiple correlations. It may be positive, negative and zero. Correlation can be classified as linear and non-linear.

Coefficient of correlation is an important measure to describe how one variable explains another. It is the simplest of ascertaining the correlation between two variables. It is not influences by the size of the extreme items. Karl Pearson coefficient of correlation is usually denoted by ‘r’.

$$R = \frac{N\phi XY - \phi X\phi Y}{\sqrt{[\{N\ \ X^2 - (\ \ x)^2\}\ \{N\ \ Y^2 - (\ \ Y)^2\}]}}$$

Where,

N = number of observations of X and Y

ϕXY = Sum of the product of the observations in series X and Y

ϕX = Sum of the observation in series X

ϕY = Sum of the observation in series Y

ϕX^2 = Sum of the square of the observation in series X

ϕY^2 = Sum of the square of the observations in series Y

4. Probable Error

Probable error of the correlation coefficient is denoted by P.E. which is the measure of testing the reliability of the calculated value of correlation coefficient. It can be defined as P.E. = $\bullet 0.6745(1-r^2)'/\sqrt{N}$. With the help of the P.E. it is possible to determine the reliability of the value of coefficient. Decisions rules for significant tests are:

a) If $r\Phi$P.E., the value of ‘r’ is not significant no matter how high the value of ‘r’ is, i.e. there is no evidence of correlation between the variables.

b) If $r\Psi$P.E., the value of ‘r’ is significant

c) If ‘r’ does not satisfy either of the above two conditions the relation is inconclusive

$$P.E. = \frac{\bullet 0.6745\ (1-r^2)'}{\sqrt{N}}$$

5. Regression Analysis

Regression analysis is used as a tool of determining the strength of relationship between two variables. Thus, it is a statistical value of one variable when the value of other variables is known. The unknown variables which have to be predicted is called dependent variable and the known variable is called independent variable (Shrestha and Silwal, 2057, 249-250). The general form of simple regression line is:

$$Y = a \Gamma bx$$

Where,

Y = dependent variable

X = independent variable

a = intercept of y on x

b = slope of the regression line

In this study, simple regression analysis has been used to study that influences of P.L.L to R.O.A. as well as R.O.E. Therefore P.L.L. is the dependent variable while R.O.A. and R.O.E. are concerned as independent variables.

6. Test of Hypothesis

The test of hypothesis is a process of testing population on the basis of the sample drawn from the population. The computed value of statistics may differ from the hypothetical value of the parameters due to sampling fluctuation. If the differences are small, we consider that has arisen due to sampling fluctuation. Hence the difference is considered to be insignificant and the hypothesis is rejected. (Shrestha and Manandhar, Valley Publishers, P. 6-11)

Another type to measure the statistical analysis is signuificance of the slope of the line has been calculated. For this purpose, null hypothesis will be formulates, as the slope of the line is zero. This can be formulated as follows:

$$S_y = \sqrt{\frac{(Y)^2 - a \quad (Y) - b \quad (XY)}{N - 2}}$$

Where,

S_y indicates the standard error of the 'y' value

The S_y value results are again put in calculating the standard error of estimate of the slope of the line. That is;

$$S_b = \frac{Sy}{\sqrt{(X - \quad X/N)^2}}$$

The resultant figure is put in the following formula and compared it with the tabulated value which determine statistically significant of the slope of the line. That is,

$$Tb = \frac{b - 0}{S_b}$$

Where,

Tb indicates the calculated t-value

CHAPTER 4

PRESENTATION AND ANALYSIS OF DATA

Data presentation is the interpretation of the study. Data analysis summarizes the collected data and its interpretation presents the major findings of the study. Analysis is not complete without interpretation and interpretation cannot proceed without analysis. In this course of analysis, data gathered from various sources have been inserted in the tabular form and shown in diagram form. The data have been analyzed by using financial and statistical tools. The results of the computation have also been summarized in appropriated tables. This chapter includes presentation of data and analysis of that data to reach at a conclusion.

4.1. Presentation and Analysis of Secondary Data

4.1.1. Financial Statement Analysis

The concept of financial statement analysis has been already discussed in previous chapter. Here we study and analyze the data by using financial tools.

Table 4.1.1. (A)

Analysis of Credit and Advance to Total Deposit Ratio

Fiscal Year	SCBNL	NABIL	HBL	EBL	SBI	NBBL
2003/04	30.37	57.68	51.53	73.31	68.43	68.44
2004/05	30.29	58.01	58.70	72.97	71.46	67.53
2005/06	42.12	72.57	54.2	78.23	71.80	67.07
2006/07	38.75	66.80	59.50	73.44	69.32	49.64
2007/08	42.61	66.60	59.22	77.44	82.66	46.97
2008/09	46.12	66.94	61.23	78.56	88.33	50.15
2009/10	38.14	73.87	71.49	71.68	54.23	67.08

Total	268.4	462.87	415.88	525.63	506.13	416.88
Average	38.34	66.07	59.41	75.09	72.30	59.55
S.D.	5.63	5.86	5.84	2.65	10.14	9.26
C.V.	14.68	8.86	9.83	3.54	14.02	15.56

Source: Appendix 2

From the above table the average ratio of credit and advances to total deposit of SCBNL is 38.34%. The fluctuation in the ratio is not too high. The lowest ratio is 30.29% and the highest ratio is 46.12% in fiscal year 2004/05 and 2008/09 respectively. Standard deviation and coefficient of variation of SCBNL are 5.63 and 14.68 percent respectively. The consistency of the bank is 85.32%.

The average ratio of NABIL is 66.07%. There is medium level of fluctuation of bank's credit and advance to total deposits. Under the study period the lowest ratio is 57.68% and the higher ratio is 73.87% in fiscal year 2003/04 and 2009/10 respectively. Similarly, the standard deviation and coefficient of variation of NABIL are 5.86 and 8.86 percent respectively which is not high. The consistency of the bank is 91.14%.

The average ratio of HBL is 59.41%. In fiscal year 2003/04, the lowest ratio of HBL is 51.53% and fiscal year 2009/10 the highest ratio of the bank is 71.49% respectively. Standard deviation and coefficient of variation of HBL are 5.84 and 9.83 percent respectively. The consistency of the bank is 90.17%.

The average ratio of EBL is 75.09%. Fluctuation in the ratio is low. The lowest and the highest ratio are 71.68% and 78.56% in fiscal year 2009/10 and 2008/09 respectively. Standard deviation and coefficient of variation are 2.65 and 3.54% respectively. The consistency of the bank is 96.46%.

The average ratio of credit and advances to total deposit of SBI is 72.30%. Fluctuation in the ratio is not high except in fiscal 2009/10. The lowest and the highest ratio are 54.23 and 88.33% in fiscal year 2009/10 and 2008/09 respectively. Standard deviation and coefficient

of variation of these ratios are 10.14 and 14.02 percent respectively. The consistency of the bank is 85.98%.

The average ratio is NBBL is 59.55%. Fluctuation of the ratio is high. Under the study period, the lowest ratio and the highest ratio are 46.97 and 68.44% in fiscal year 2007/08 and 2003/04 respectively. Standard deviation and coefficient of variation of the ratios are 9.26 and 15.56% respectively. The consistency of the bank is 84.44%.

From the above table, it is clear that the combined average ratio is 61.79%. Total deposits are the main sources of the bank to provide credit and advances and 61.795 of total deposit goes as credit and advances to customer. Therefore it seems that the banks are heavily depends on credit and advances to make profit from their investment. Similarly above table shows that as the deposit increases, the credit and advances also increase and vice versa. So, it indicates that there is strong relationship between total deposit and total credit and advances.

Table 4.1.1. (B)

Analysis of Credit and Advances to Fixed Deposit Ratio

Fiscal Year	SCBNL	NABIL	HBL	EBL	SBI	NBBL
2003/04	292.25	344.40	338.38	175.60	133.73	144.04
2004/05	448.88	354.39	274.31	203.04	153.46	177.38
2005/06	575.07	509.19	220.26	232.08	152.08	188.75
2006/07	418.31	374.69	248.22	238.94	124.71	225.32
2007/08	328.63	286.03	216.97	250.28	171.47	279.40
2008/09	415.57	252.42	303.52	292.21	176.72	467.69
2009/10	192.63	331.97	388.79	338.79	183.75	237.77
Total	2671.34	2453.09	1990.45	1730.94	1095.92	1720.35
Average	381.62	350.44	284.35	247.28	156.56	245.76
S.D.	114.00	75.54	58.86	50.42	20.47	99.38
C.V.	29.87	21.55	20.70	20.39	13.08	40.44

Source: Appendix 3

Above table shows that the average ratio of credit and advances to fixed deposit of SCBNL is 381.62%. The fluctuation in the ratio is too high. Highest ratio is 575.07% in fiscal year 2005/06 and the lowest ratio is 192.63% in fiscal year 2009/10. So the standard deviation and the coefficient of variation are 114.00 and 29.87% respectively. The consistency of the bank is 70.13%.

Similarly, according to this table the average ratio of credit and advances to fixed deposit of NABIL is 350.44%. The fluctuation in the ratio is high which means that the lower ratio to higher ratio is vast difference. So the lowest ratio and the highest ratio are 252.42 in fiscal year 2008/09 and 509.19 in fiscal year 2005/06 respectively. S.D. and C.V. of the bank is 75.54 and 21.55 respectively. Consistency of the bank is 78.45%.

The average ratio of HBL is 284.35%. There is the medium level of fluctuation of bank's credit and advances to fixed deposit. Under the study period the lowest ratio is 216.97% and the highest ratio is 388.79% in the fiscal year 2007/08 and 2009/10 respectively. S.D. and C.V. of the bank is 58.86 and 20.70% respectively. The consistency of the bank is 79.30%.

The average ratio of credit and advances to fixed deposit of EBL is 247.28%. The fluctuation in the ratio is not too high. Highest ratio and lowest ratio are 175.60 and 338.79% in fiscal year 2003/04 and 2009/10 respectively. S.D. and C.V. of the bank is 50.42 and 20.39% respectively. The consistency of the bank is 79.61%.

The average ratio of SBI is 156.56%. The lowest ratio is 124.71 in fiscal year 2006/07 and the highest ratio is 183.75% in fiscal year 2009/10 respectively. The S.D. and C.V. of the bank is 99.38 and 40.445 respectively. So the consistency of the bank is 86.92%.

The average ratio of NBBL is 245.76%. Fluctuations in the ratios are high. The highest ratio and the lowest ratio are 467.69 and 144.04% in the fiscal year 2008/09 and 2003/04 respectively. S.D. and C.V. of the bank is 99.38 and 40.44% respectively. The bank's consistency is 59.56%.

From the above table, it is clear that the combined average ratio of credit and advances to fixed deposit of J.V.B.s are 277.67%. As we know that the ratio is measures how many times the amount is used in credit and advances in comparison of fixed deposits for the income generating purpose.

Table 4.1.1. (C)

Analysis of Credit and Advances to Total Assets Ratio

Fiscal Year	SCBNL	NABIL	HBL	EBL	SBI.	NBBL
2003/04	27.24	46.83	44.82	60.95	59.00	60.81
2004/05	27.11	48.91	50.21	61.23	60.95	60.66
2005/06	37.38	61.60	46.59	66.99	60.07	57.62
2006/07	34.68	57.87	51.54	63.51	58.51	55.17
2007/08	36.73	57.04	51.85	65.71	68.05	60.77
2008/09	41.15	57.54	53.90	69.38	70.48	58.12
2009/10	33.70	62.89	63.05	64.70	48.94	56.04
Total	237.99	392.68	361.96	452.47	426.00	409.19
Average	34.00	56.10	51.71	64.64	60.86	58.46
S.D.	4.84	5.61	5.46	2.45	6.50	2.18
C.V.	14.12	10.00	10.58	3.79	10.68	3.73

Source: Appendix 4

From the above table, we can conclude that the SCBNL has generally steady trends under the study period. The average ratio is 34.00% which exhibits that the bank has utilizing the minimum capacity of total assets in the form of credit and advances. The higher ratio in the fiscal year 2008/09 is 41.15% and the lowest ratio is 27.11% in the fiscal year 2004/05. Fluctuation in the ratio is little which is supported by standard deviation i.e. 4.84 and C.V. i.e.14.12%.

NABIL is an increasing trend except in 3rd and 4th year of the study period. The ratio in highest in fiscal year 2005/06 i.e. 61.60% and lowest in 2003/04 i.e. 46.83%. The average ratio as credit and advances to total assets of the bank is 56.10%. Standard deviation and coefficient of variation are 5.61 and 10.00% respectively which means that the bank has to utilize the capacity for its assets to gain income. Consistency in utilization of assets in the form of credit and advances is satisfactory.

HBL has the steady trends of ratio except the 7th year of the study period. The highest ratio is 63.05% and the lowest ratio is 44.82% in fiscal year 2009/10 and 2003/04 respectively. The average ratio is 51.71% which shows that the bank has utilized its total assets properly in the form of credit and advances. The standard deviation and the coefficient of variation of HBL are 5.46 and 10.58% respectively which indicates that the consistency in the utilization of assets in the form of credit by HBL is good.

EBL has mixed trend of the ratios under the study period. The highest ratio is 69.38 and the lowest ratio is 60.95 in fiscal year 2008/09 and 2003/04 respectively and the fluctuation rate is also little. The average ratio is 64.64 which indicate that the bank has the capability to utilize its total assets in the form of credit and advances. The standard deviation and the coefficient of variation are 2.45 and 3.79% respectively. It shows that the bank has fully used its assets at satisfaction level.

It is clear from the above table that SBI has generally mixed trend under the study period. It also shows that the ratios are little fluctuated except in the fiscal year 2009/10. So the highest ratio and lowest ratio are 70.48 and 48.94% in the fiscal year 2008/09 and 2009/10 respectively. The S.D. and C.V. of these ratios are 6.50 and 10.68% respectively, it shows that the bank has uses its assets properly.

NBBL has decreasing trend in the 1st four fiscal year and then after from increase to decrease trend which means that the bank has not able to utilize its total assets properly. The highest ratio in fiscal year 2003/04 i.e. 60.815 and the lowest ratio is in fiscal year 2006/07 i.e. 55.17%. The average ratio under the study period is 58.46% which shows that the bank has utilized its total assets as credit and advances is little high which can create high difficulty for the bank. Fluctuation in the ratio is medium and the S.D. and C.V. of the ratio are 2.18 and 3.73% respectively.

The combined average ratio of credit and advances to total assets of J.V.B.s are 54.30%. Similarly, standard deviation and the coefficient of variation are 4.51% and 8.83% respectively. It shows that in an average the joint venture banks have utilized their total assets as credit and advances around 54%. It will be the good investment for bank if there is not any default situation emerge. Combined consistency level is around 91.17%.

Table 4.1.1. (D)

Analysis of Performing Assets to Total Assets Ratio

Fiscal Year	SCBNL	NABIL	HBL	EBL	SBI	NBBL
2003/04	27.51	46.27	40.30	61.33	57.75	58.29
2004/05	27.25	49.34	45.75	62.35	61.45	60.34
2005/06	37.62	62.85	43.12	65.90	60.88	55.90
2006/07	34.97	58.65	48.14	62.70	59.34	58.66
2007/08	37.04	57.70	49.98	65.18	69.10	76.13
2008/09	41.50	58.16	54.46	68.91	71.32	68.84
2009/10	33.98	63.31	63.50	65.96	45.96	63.72
Total	239.87	396.28	345.25	452.33	425.80	441.88
Average	34.17	56.61	49.32	64.62	60.83	63.13
S.D.	4.88	5.99	7.19	2.44	7.67	6.61
C.V.	14.14	10.58	14.58	3.78	12.61	10.46

Source: Appendix 4

The above table shows that the performing assets to total assets ratio of N.S.C.B.L. is little fluctuated. Highest ratio is 41.50 in fiscal year 2008/09 and the lowest ratio is 27.25 in fiscal year 2004/05 respectively. The average ratio is 34.17%. Standard deviation and coefficient of variation of the bank are 4.88 and 14.14% respectively.

Performing assets to total assets ratio of NABIL is mixed trend under the study period. Highest ratio is 63.31 in fiscal year 2009/10 and the lowest ratio is 57.70 in fiscal year 2007/08 respectively. Highest ratio indicates higher efficiency of proper utilization and vice versa. Average ratio, standard deviation and coefficient of variation of the bank are 56.61%, 5.99% and 10.58% respectively.

HBL's performing assets to total assets ratio has volatile trend in the study period. It means that the bank's performing assets are little fluctuated. The average ratio is 49.32%. Standard deviation and C.V. of the bank are 7.19 and 14.58% respectively.

Performing assets to total assets ratio of EBL is too low fluctuated under the study period i.e. 61.33, 62.35, 65.90, 62.70, 65.18, 68.91 and 65.96% in fiscal year 2003/04, 2004/05, 2005/06, 2006/07, 2008/09 and 2009/10 in their respective year. This means that the bank has properly utilized his total assets as performing assets. So, the average ratio is 64.62%. Standard deviation and C.V. of the bank are 2.44 and 3.78% respectively.

SBI performing assets to total assets ratio has volatile trend in the study period i.e. 57.75, 61.45, 60.88, 59.34, 69.10, 71.32 and 45.96% in their respective year. The average ratio is 60.83%. The standard deviation and C.V. of the bank are 7.67 and 12.61% respectively.

Performing assets to total assets ratio of NBBL is also in volatile trend i.e. 58.29, 60.34, 55.90, 58.66, 76.13, 68.84 and 63.72 in their respective year. The average ratio is 63.13% which indicates that non-performing assets are almost 37%. Consistency in the ratio is high as it is almost 90%.

The combined average ratio also shows that the performing assets ratio is 54.80% only in the seven years research period. All banks should be increase in their performing assets for prosperity of the bank.

Table 4.1.1. (E)

Trend Analysis of Combined Ratios

Particulars/F.Y.	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Trend values of combined credit and advances to total deposit ratio (%)	0.5939	0.6019	0.6099	0.6179	0.6259	0.6339	0.6419
Trend values of combined credit and advances to fixed deposit ratio (%)	2.6054	2.6636	2.7218	2.7800	2.8382	2.8964	2.9546
Trend values of combined credit and advances to total assets ratio (%)	0.5100	0.5209	0.5318	0.5427	0.5536	0.5645	0.5754
Trend values of combined performing assets to total assets ratio (%)	0.4985	0.5150	0.5315	0.5480	0.5645	0.5810	0.5975

Sources: Appendix 6

Above table shows that the trend values of combined credit and advances to total deposit are increasing every year. The figure also shows that the trend value is 0.5939, 0.6019, 0.6099, 0.6179, 0.6259, 0.6339 and 0.6419 in fiscal year 2003/04, 2004/05, 2005/06, 2007/08, 2008/09 and 2009/10 respectively under the research period. The trend value of combined credit and advances to fixed deposit ratio is in increasing trend i.e. 2.6054, 2.6636, 2.7218, 2.7800, 2.8382, 2.8964 and 2.9546 in the fiscal year 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09 and 2009/10 respectively. Similarly the trend value of combined credit and advances to total assets are also being increase in every seven year research period. Likewise the trend value of combined performing assets to total assets is increasing trend under the 7th year's research period.

In overall trend value indicates that in the research period of time the amount of credit and advances are increasing faster than total assets and deposits.

4.1.2. Company wise Analysis

As per directives issued by N.R.B. loan and advances should be categories into performing loan and non-performing loan. Non-performing loan also must be categories into substandard, doubtful and losses. For these loans provision should be maintained which must be 25, 50 and 100% respectively.

Table 4.1.2. (A1)

Loan and loss provision of SCBNL

(Figure in million Rs.)

Fiscal Year	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Performing loan	5752	6442	8195	9010	10593	13835	13790
Non-performing loan	248	252	226	196	197	129	91
Total provision	304	284	278	271	288	245	201

Sources: Annual Report of SCBNL

As per above table of loan loss provision of SCBNL, its performing loan is increasing trend and non-performing loan is in decreasing trend. So the difference between performing loan and non-performing loan is very high which shows that the bank is maintaining good loan and its credit risk position is also maintained.

Table 4.1.2. (A2)

Return Analysis of SCBNL

Fiscal Year	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
R.O.A.	2.47	2.27	2.46	2.56	2.42	2.46	2.53
R.O.E.	41.05	35.96	33.88	37.57	32.70	32.85	33.58
P.L.L.	5.07	4.14	3.30	2.94	2.67	1.75	1.45

As per above table of return analysis, it shows that there is no negative effect of loan loss provision on R.O.A. and R.O.E. Trend of return on equity and return on assets is stable R.O.E. is slightly fluctuated than R.O.A. but it has not decreased as bank has to maintain the loan loss provision.

NABIL: 8 employees said that there is NRB related problems whereas 2employees said 'no'. The reason is same as said by the SCBNLthat is frequent changes in rules, regulations; provisions and directives are the main causes of problem.

- SCBNL: 7 out of 10 employees of SCBNL said that there is credit related problem in the bank and the rest employees said that there is no credit related problem in the bank. No payment of credit in time by customer slow in the legal process, increasing amount of non-performing credit are the main causes of the credit related problems.

  NABIL: Under the employees of NABIL, no. of 9 employees are said that there is credit policy related problem in the bank and no. of 1 employee said there is no any credit policy related problem in the bank. The causes of problem for these banks are also the same as faced by the SCBNL

- SCBNL: 80% (8 out of 10) employees know the interest rate of the credit of the bank, 20% (2 out of 10) employees do not know the interest rate of credit of the bank. Most of the employees who work in the credit department said they were up to dated with the interest rate of bank.

  NABIL: 60% (6 out of 10) employees know the interest rate of credit of the bank, 40% (4 out of 10) employees do not know the interest rate of credit of the bank. There could be seen booklet of the interest rate structure of credit on the table of most employees in the credit management. So, the employees used to the same while consulting with the customers.

- 9 out of 10 employees of the both bank said that there is necessary to change in the process of recovering loan. Lengthy and weak legal process of recovery is the main causes of the problem. And rest respondent said that there is no needed to changes in the process of recovering loan.
- All respondents of both banks are agreed about that their bank is obeying the 'NRB rules and directives' sincerely.
- SCBNL: 9 employees out of 10 say that they are satisfied with the incentive in the bank whereas 2 employees say that they are dissatisfied with the incentive provided by the bank. They are satisfied as they compare their incentives with the high incentives paying ban
- NABIL: 8 employees out of 10 say that are satisfied with the incentive in the bank whereas 2 employees are dissatisfied with the incentive provided by the bank. Newly appointed employees are more satisfied than the old one.
- Both of the bank's all sample employees answered that they will not shift to the other bank because of the present bank has been provided all facilities to the employees.
- SCBNL: 8 employees are satisfied with the bank promotion policy. The remaining 2 employees out of 10 are dissatisfied with the bank promotion policies. Main reason of dissatisfaction is nepotism, favoritism, open recruiting policy etc.
- NABIL: 70% employees are satisfied with the bank promotion policy and the rest 30% employees are not satisfied due to the same reason of SCBNL

4.3. Major Findings

a. In the case of EBL, risk index is high and probability of book value insolvency is les than one percent. Relatively, its risk index is higher among other J.V.B.s except SCBNL and probability of book value insolvency should be lower than other J.V.B.s except NABIL and SCBNL which is good sign for the bank for its future. Banks non –performing to net loan for seven years is just 1.27 % which is the tremendous performance by the bank as a view point of credit risk management as. Correlation coefficient regarding to P.L.L. with R.O.A. and R.O.E. indicates that there is negative correlation between them but the result is small and considered it as insignificant. Regression coefficient of loan loss provision with R.O.A. and R.O.E

.is negative for both and bank's t-value is not significant at 5 % level of significance.

b. Nepal SBI Bank Limited data shows that risk index of the bank is moderate or comparatively low and the probability of book value insolvency is less than one percent. Banks non-performing loan to net loan for seven years period is 6.08 % (combined) which is not too high and at maintaining level and also the non-performing loan to gross loan ratio is in decreasing trend. There is negative correlation between P.L.L. and R.O.A. and positive correlation between P.L.L. and R.O.E. Again by analyzing from statistical aspect, there is insignificant relationship between independent variable P.L.L. and dependent variable R.O.A. and R.O.E. though regression coefficient of P.L.L. is positive for R.O.E. and negative for R.O.A. Its t-value is not significant at 5 % level of significance.

c. The data pertaining to NBBL shows that it has very lower risk index than other J.V.B.s and probability of book value insolvency is much more than one percent. Banks non-performing loan to net loan for seven years period is 33.94 % (combined) which is high and an increasing trend which can be generated dangerous situation to the bank. Correlation coefficient regarding P.L.L. with R.O.A. and R.O.E. indicates that there is positive relationship between them but the result is not too sufficient that's why it is considered as insignificant. Regression coefficient of P.L.L. is positive but the value is not significant at 5 % level of significance.

d. Risk index and probability of the book value insolvency of SCBNL indicates that the bank has very risk index and its probability of book value insolvency is less than one percent. This indicates that a bank has a higher current expected R.O.A., strong capital position and stable earning. And its current position exhibits that it has a high level of cushion to absorb accounting losses. Banks non-performing loan to net loan for seven years period is 2.37 %(combined), which is little high but it is in decreasing trend. It is the good sign for the bank. Again by analyzing from statistical aspect, there is insignificant relationship between independent variable P.L.L. and dependent variable R.O.A. and R.O.E. though regression coefficient of P.L.L is negative for R.O.A. and positive for R.O.E. its t-value is not significant at 5% level of significance. It shows that the slope of the line is statistically insignificant at 5% level. Most of the credit customers of the bank are fully satisfied with the bank.

e. In the case of NABIL, it has the lower risk index than SCBNL, in other word it shows the better performance of the bank and its current position shows that it has a high level of cushion available to absorb accounting loss. Banks non-performing loan to net loan for seven years period is just 2.11% (combined) which is very good situation for the bank and also it is in decreasing trend. Correlation coefficient regarding P.L.L. with R.O.E. is negative relationship between them but the result is small and considered it as insignificant. Under the statistical aspect, there is insignificant relationship between independent variable P.L.L. and dependent variable R.O.A. and R.O.E. though regression coefficient of P.L.L. is positive for R.O.A. and negative for R.O.E. So, its t-value is not significant at 5 % level of significance.

f. Higher risk index and book value insolvency of HBL indicates that the bank has low risk i.e. 6.35% (combined). In other word, it shows that the better performance of the bank and its current position shows it has high level of cushion available to absorb accounting loss. Bank's correlation coefficient regarding P.L.L. with R.O.A. and R.O.E. indicates that there is negative relationship between P.L.L. and R.O.A. as well as P.L.L. and R.O.E. but the result are too small for both and consider it as insignificant. Regression coefficient of loan loss provision is negative for both and bank's t-value is not significant at 5 % level of significance.

g. The trend of combined credit ratios of the commercial banks are increasing. With the increase in the ratio of credit, the non-performing assets have also increased it means that performing assets of the commercial banks have increasing regularly.

h. Most of the credit customers of the J.V.B.s of Nepal are satisfied with their respective banks. Few customers are suggested the bank should decrease its interest rate. As they complain the bank has decreased the deposit interest rate heavily but the credit interest rate has not lowered so much. Therefore they go under difficulty to pay the interest amount in time. Some of the credit customer of J.V.B. said that they have not got full cooperation from the bank's officer. This complains mainly for bank management who do not extend time period of reimbursement of credit when they demanded even when they have provided all the required explanation and documents. They said because of political conditions of our country, they are suffering from the economic crises but the bank does not understand their problems.

i. In the term of activity, all the J.V.B.s is able to satisfy the demand of various depositors, creditors and shareholders as well as government. All the banks are provided modern facilities to its customers and have used modern technology. Therefore they can attract good customers. It can be taken as strength of the J.V.B. In other hand, overdue creditors of all commercial banks have increased. It has damaged the income of bank. Banks have not open their branches all over the country especially in mid-western and far-western. Only Nepal Bangladesh Bank and Everest Bank have one–one branches and other J.V.B.s have not any branch at far and mid-western region. Because of this, banks are unable to grabs the opportunity from all over the Nepal.

j. 68.97% credit customers have accepted that the bank officers used to visit their project site or analyzed their project in depth. Similarly, 17.24% customers denied that the bank officers visit or analyze their project site before granting the loan and 13.79% customers were not given any clear response for the research question.

k. 58.62% credit customers knew all information about the bank policies and 41.38% were little unknown with the bank policies.

l. 46.55% of the customers from the sample taken in this topic were satisfied with the bank's interest rate whereas rest of the customers was not satisfied with that interest rate. 41.38% credit customers were not satisfied with the interest rate of the J.V.B.'s. It exhibits that the bank must think about this situation.

m. 75.86% credit customers were accepted that bank which gave them the credit expiration notice for their credit amount. 10.34% customers clearly denied and 13.80% customers were still confused while giving their opinion.

n. 68.97% credit customers said that the co-operation followed by the bank officers to them are quite appreciable, 17.24% customers said that co-operation given by the bank officers are not reached at that level where it has to be and 13.79% customers were not given their clear response on the bank officer's co-operation.

o. Exactly 89.66% credit customers said that they used to taken credit from the bank on that project where they clearly specified at the time of taking loan, 1.72% customers denied using the credit amount taking from the bank used on the same project where they specified and 8.62% customers were confused while giving the answer for the same question.

p. 81.04% credit customers were satisfied with their bank in the view point of there overall performance, 12.07% customers were dissatisfied with their bank at some circumstances and 6.89% were unable to give the clear answer for the same question.

q. 79.31% customers were on the favor of taking loan from same bank again and again in the future too, 8.62% customers denied to taking loan again from the same bank and said that the process taken by the bank at the time of granting loan is little irritating and 12.07% customers can not make the proper decision either they take a loan again or not.

r. 51.72% customers were in the favor of service charge with their related bank, 41.38% customers were not in favor of bank's service charges and 6.90% customers can not make the proper decision.

s. 8.62% credit customers were not in the favor of continuing the relationship with their bank in future and like to switch off the bank if they got another bank which gives them more facilities, 87.93% customers were in favor of continuing their relation with the same bank in future too and the rest 3.45% were unable to make give proper decision.

CHAPTER-5

SUMMARY, CONCLUSION AND RECOMMENDATION

This is the concluding chapter of this study. This chapter is divided into three sections: Summary, Conclusions and Recommendations. In this chapter summary of the study is provided in brief. It has been a concern from the first chapter to the end. Findings of calculations, which have been drawn using different tools and technique based on the data provided by the concerned companies, are concerned here in conclusions section. In the last section of this chapter some recommendations have been given, which are useful to stakeholders and to concerned companies as well. They can use these recommendations to take some corrective actions to draw decisions.

5.1. Summary

Financial institution includes banks, finance companies, co-operative organizations and insurance companies. All of them do contribute something to the economy of the country. Financial institutions play a vital role in the proper functioning of an economy. Among them, banking sector plays an important role in the economic development of the country. Commercial banks are one of the vital aspects of this sector, which deals in the process of channel zing the available resources in the needed sectors. It is the intermediary between the deficit and surpluses of financial resource.

This study "A Study on Credit Risk Management of Joint Venture Commercial Banks" is primarily prepared for the partial fulfillment of the requirement of the master of business studies (MBS). This study is mainly based on secondary and primary data provided by concern companies, security board of Nepal (SEBON) and respondents. The main objective of the study is to assets the credit risk management of sample bank. However due to the time and resource constraints all types of analysis are not conducted and information are gathered from the period of 2005/06 to 2009/10.

The collected information is presented analyzed and conclusion is drawn from the study.

Chapter One is concerned with the introduction of the whole study. It explained about the concentration of the study objectives and organization of the study which provides guideline for entire study.

Chapter Two is for the review as well as the review of related previous studies is conducted.

Chapter Three specifies the guidelines, tools and research design to achieve the objectives of the study.

In Chapter Four, the analysis of data, some statistical and financial tools are used. In this study Correlation Coefficient between figures as well probable error are considered as the main statistical tools in this study.

In chapter Five, main findings are concluded as the conclusion of the study. Based on the analysis and conclusion of the study some recommendations are made in this chapter.

For the detail analysis of commercial banks in Nepal, in this study. The joint venture bank's data are collected through primary and secondary sources and different data analysis tools have been used. The hypothesis tests are done and various limitations are found out. For the analysis of data, mainly this focuses on loan loss provision, ratio analysis and their relation with the return on assets and return on equity. On an average of seven years of research period, credit and advances to total deposit ratio of Standard Chartered Bank Nepal Limited. Nabil Bank Limited, Himalayan Bank Limited, Everest

Bank Limited, Nepal SBI Bank Limited and Nepal Bangladesh Bank Limited are 38.34, 66.07, 59.41, 75.09, 72.30 and 59.55 percent respectively. Likewise SCBNL, NABIL, HBL, EBL, SBI and NBBL have the average ratio of credit and advances to fixed deposit under the seven years research periods are 381.62, 350.44, 284.35, 247.28, 156.56 and 245.76 percent respectively. At the same time the average credit and advances to total assets ratio for the seven years research period of SCBNL, NABIL, HBL, EBL, and SBI and NBBL is 34.00, 56.10, 51.71, 64.64, 60.86 and 58.46 percent respectively. Similarly, the average performing assets to total assets ratio for the seven years research period of SCBNL, NABIL, HBL, EBL, SBI and NBBL 34.17, 56.61, 49.32, 64.62, 60.83 and 63.13 percent respectively. Also 64.29% of total deposits of joint venture banks (as combined) are utilized in credit and advances for the year 2009/10 and combined performing assets to total assets for 2003/04 to 2009/10 are 0.4985, 0.5150, 0.5315, 0.5480, 0.5645, 0.5810 and 0.5975 percent respectively. This indicates that the performing assets are increasing regularly in the seven years research period. As the non- performing credit has been decreases year by year, banks are generating lower credit risk which is good sign for any banks.

5.2. Conclusion

i. The entire joint venture banks have utilized most of funds in the form of credit and advances therefore it is the major part of utilizing deposits for income generating purpose.

ii. The banks have deposit born can provide many to its customers as credit and advances. For that, banks are attracting deposits to the needy areas to make profit for themselves.

iii. Provisions for credit and losses have been increasing year by year for all joint venture banks. Due to economic condition in the country, credit takes are not getting good return from their investment. Because of this situation, credit customers do not return money of the bank in the stipulated time period. Therefore, due to the risk of default credit has increases. That's why the bank should increase its provision for credit loss.

iv. All the joint venture banks have insufficiently liquidity. It shows that banks haven't got proper investment sector to utilize their liquid money. Now, in the context of Nepal, many banks and other financial institutions are functioning to collect deposit and invest money somewhere. Therefore monetarization have been increased since liberalization policy taken by the government. Heavy remittances have also helped to increase the amount of deposits of the banks.

v. Due to political instability and crises, economic sectors have been damaged. Most of the projects have been withdrawn due to security problems. Therefore, banks have maximum liquidity due to lack of safety investment sectors.

5.3. Recommendation

i. Bank should be sensitive to adverse movements in external factors such as interest rates, exchange rate and commodity prices as it has direct disruption on cash trends of the bank.

ii. Some customers are unsatisfied with the service charges and interest of credit; therefore banks should decrease of their service charges and interest charges. Especially NB Bank should decrease the above charges.

iii. Bank should strictly band the policy of nepotism and favoritism. On the basis of capability and efficiency, employee's recruitment, placement and promotion should be executed.

iv. Economic liberalization policy adopted by the government of Nepal has created an environment of strict competition even in the banking sectors. In this context, all the commercial banks are suggested to formulate and implement some sound and effective financial and non-financial strategies to minimize their operational expenses to meet required level of profitability. N.R.B. has formulated various kinds of rules, regulation and directives. Every bank must follow these rules, regulation and directives and central bank must examine timely whether the banks follow these rules.

v. Cash and bank balance of all joint venture banks are high. Unused cash and bank balance do not provide return to the bank. Therefore some percentage of cash and bank should be invested somewhere in profitable sectors. There must be a god investment decision which increases the cooperate value of the firm. It should be carried out by effective identify, organized and manage, discrete and diverse segmenting order to serve particular status of customers more effectively.

vi. Good liquidity position is very necessary for commercial banks as it should be enough to meet the depositor's obligations as well as for good investment and for expansion.

vii. Banks are one of the most reputed organizations of our country. So, bank should fulfill some social obligations by extending their resources to rural areas and promoting the development of poor and disadvantaged group. In order to do so, they should open their branches in the remote areas with the objective of providing cheaper charge banking services.

viii. Every bank is operated on city areas of the country. They have not reached in rural areas for providing banking services. So, the banks should be reached in these rural areas and to collect their deposits as well as to follow the loans for developing these areas.

ix. Bank should avoid extending credit merely based on oral information presented at the credit interview. Historical financial and trade records as well as realistic cash flow projections should be obtained for purpose arrangement of the proposal. Banks also should regularly follow the credit customers to confirm that whether the customers have utilized their credit for the same purpose for the same committed at the time of taking credit from the bank.

x. In this research, joint venture banks were taken for the study. Joint venture banks definitely have international relation. Therefore, these banks should make negotiation with the international banks to increase its transactions in the internal area.

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