

**A STUDY OF CREDIT MANAGEMENT OF  
SHANGRI-LA DEVELOPMENT BANK LIMITED**

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# ***RECOMMENDATION***

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## ABBREVIATIONS AND ACRONYM

AGM	:	Annual General Meeting
BFI	:	Bank and Financial Institutions
CAM	:	Credit Approval Memorandum
CEO	:	Chief Executive Officer
CIB	:	Credit Information Bureau
CPG	:	Credit Policy Guideline
CPM	:	Credit Portfolio Management
CRR	:	Cash Reserve Ratio
DV	:	Distress Value
FDR	:	Fixed Deposit Receipt
Fig.	:	Figure
FI	:	Financial Institutions
FMV	:	Fair Market Value
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
Govt.	:	Government
HBL	:	Himalayan Bank Limited
ICAN	:	Institute of Chartered Accountants of Nepal
IFRS	:	International Financial Reporting Standards
IMF	:	International Monetary Fund
ISA	:	International Standards on Auditing
JV	:	Joint Venture

Ltd.	:	Limited
NABIL	:	Nabil Bank Ltd.
NBL	:	Nepal Bank Limited
NIBL	:	Nepal Investment Bank Ltd.
NPL	:	Non Performing Loan
NRB	:	Nepal Rastra Bank
PG	:	Personal Guarantee
RCC	:	Reinforced Cement Concrete
ROA	:	Return on Asset
ROE	:	Return on Equity
ROI	:	Return on Investment
SAARC	:	South Asian Association for Regional Corporation
SCBNL	:	Standard Chartered Bank Nepal Limited
SDBL	:	Shangri-la Development Bank Ltd.
SEBON	:	Security Exchange Board of Nepal
SLR	:	Statutory Liquidity Ratio
VDC	:	Village Development Committee

# **CHAPTER I**

## **INTRODUCTION**

### **1.1 General Background**

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

Economy was further hit by the fall in share market and which has not been able to recover yet. Share market has not been able to gain the confidence of the investors and hence the share market is still down like real estate of the economy. Liquidity crisis in financial sector as well as bearish trend in stock market and still not showing

any sign of gearing up made the confidence of the investors low, resulting in the decrease in aggregate demand (AD) thus the economic growth of the world economies was hampered. That is the only reason that the GDP of the world expanded only by 3.2% in 2008 and 0.8% in 2009. World economy has started to gain pace with different measures taken by the government of developed economy like capital injection and other monetary measures taken by central banks of developed economies. However, due to apathy of government our economy did not show as sign of recovery. With the almost three years of dormant state of the financial sector which faced high liquidity crunch, failure of finance like Nepal Share Markets and Finance and shut down of development bank like Gurkha Development Bank, at present banking sector has high liquidity than three year back where the banking sector faced the problem of liquidity crunch. This problem of liquidity crunch raised the lending interest rate of bank and finance which almost became double and raise to more than 18% in finance and more than 15% in bank. Though the liquidity crunch has ceased yet the lending rate of bank and finance and not gone down like expected because mainly of high deposit cost tied up in Fixed Deposit at the time of liquidity crunch and another reason is credit deposit ratio put by the NRB. Even though the rate in deposit has come down, Bank and Finance are reluctant to decrease the rate.

### **1.1.1 Concept of Banking**

Bank can be defined as an institution, which collects deposits from natural or legal persons and channel then to needy investors or entrepreneurs in the form of loans and advances. They provide security to the money of the depositors and help them earn interest on the other wise idle money of the depositors and help them earn interest on the other wise idle money that would have stayed in their home. In loans and advances they provide to investors and entrepreneurs they will charge slightly higher rate of interest and earn profit. Actually the difference in rate of interest they take on loans and advances and rate of interest they pay on deposit is call spread of interest and that is what determines the profit of the bank. Higher the spread of interest higher will be the profit. A question may arise how will the banks be able to return the money to the depositors when they present cheques as they have lend the same to the investors and entrepreneurs? The thing is that they will not lend the whole amount to the investors but will keep certain part with them. At present, NRB has restricted Bank not to lend more than 80% of the deposit they have collected plus capital they

have invested. Hence they will be return money to the depositors when they present cheques, moreover all the depositors will not need or ask for the whole amount they have deposited in the bank. However, in some instances when the credit of the bank goes bank and there is higher Non Performing Loans (NPL) then they will not be able to return the deposit of the depositors when they ask for and hence the general public loss the faith in the bank and all the depositor will ask to return their deposit and this situation is termed as bank run.

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

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

#### **1.1.1.1 Origin**

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

There are few other words like "Back" in Germany and "Banke" in French that are also believed to the origin of the word bank. No matter whether the word Bank has been derived from any of the word that are mentioned above, but all these word means the same thing, joint stock companies that collect deposits and provide loan to the general public. The first bank Casa de san Giorgio in Genoa was established in 1148 A.D. Bank of Vanice was established in 1147 A.D. In 1401 Bank of Barcelona

was established in Barcelona. Morden bank started to take rapid speed from 17<sup>th</sup> century. In 1609, the Bank of Amsterdam was established. Likewise in 1610 A.D. Bank of Humburg was established in Germany. The first central bank was established in 1844 A.D. as “The Bank of England”.

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

### **Definitions**

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

“A bank is an institution which collects money from those who have in spare or who are saving it out of their income and lends this out to those who require it.”- G.S. Crowther

A bank and financial institution is a business organization that receives and holds deposits of fund from others makes loans or extends credits and transfers funds by written order of depositors.

Bank and financial institution is a corporation, which accepts demand deposits subject to check and makes short-term loans to business enterprises, regardless of the scope of its other services.

Commercial bank Act 2031 B.S. of Nepal has defined that “A commercial bank is one which exchanges money, deposits money, accepts deposits, grants loans and performs commercial banking functions and which is not a bank mean for cooperative, agriculture, industries for such specific purpose.” However, the Bank and Financial Institutions Ordinance, 2060 has merged the five banking Acts including the commercial bank Act, 2031, which defines the bank with respect to their transactions. Later on the Ordinance has been replaced by Bank and Financial Institutions Act 2063. This Act is trying to categorize the banking institutions in two ways based on their transactions one as bank and other as financial institutions. According to this Act, “Bank is the institution which performs its transactions under the section 47 of this Act.” This Act has laid emphasis on the functions of commercial bank while defining it. Commercial banks provide short-term debts necessary for trade and commerce. They take deposits from the public and grant loans in different forms. They purchase and discount bills of exchange, promissory notes and exchange foreign

currency. They discharge various functions on the behalf of their customers, provided that they are paid for their services. The act has categorized bank and financial institutions into 4 classes on the requirement of paid up capital required for obtaining license to operate financial transactions. At present 4 classes and their paid up capital requirement is illustrated in the table below.

**Table 1.1**  
**Classes of Financial Institutions and their Capital Requirement**

Class	National Level	Regional Level*	4 – 10 District*	1 – 10 District*
A	200 Crores			
B	64 Crores		30 Crores# 20 Crores	30 Crores# 10 Crores
C	30 Crores# 20 Crores			30 Crores# 10 Crores
D**	10 Crores	6 Crores***	2 Crores##	1 Crores

*Notes:*  
 \* Outside Kathmandu Valley and such Institutions needs their area of lending limited to the approved districts only.  
 # Applicable to those institutions involved in Leasing transactions.  
 \*\* Institutions having mirco finance transaction.  
 ## Institutions limited to 5 districts of rural area  
 \*\*\* Operating within a development region.

*Source: Directives of Nepal Rastra Bank.*

### 1.1.1.2 Development of Banking Sector in Nepal

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

### **1.1.1.3 History of Banking in Nepal**

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

#### **First Phase of Nepalese Banking**

The first phase of the Banking in Nepal can be traced back the date when a merchant named Shankhadhar had started "New Year – Nepal Sambat" after freeing all the people of Kathmandu Valley from their debts. This shows that there was existence of money lender at that time and some form of banking did exist at that time as well. Further King Jayasthiti Malla had given the responsibility to a caste of society called "Tankadhari" which was responsible for transactions of money in the society.

However a distinct starting of the organized financial institution in Nepal started after the establishment of "Tejarath Adda" in 1933 B.S. The purpose of Tejarath Adda was to provide loans to Government officials and provide loan against the security of Gold and Silver to general public. Still at that time it would not accept deposit from the general public.

#### **Second Phase of Nepalese Banking**

The replacement of "Tejarath Adda" by Nepal Bank Limited on 30<sup>th</sup>Kartik 1994 B.S. marked the second phase of Nepalese banking. Nepal Bank Limited was established with an authorized capital of Rs. 10 million. Sadar Muluki Khana of the than His Majesty's Government brought into circulation of 5, 10 and 100 rupees notes. In the beginning Nepal Bank Limited was given the role of central bank with modern banking facilities and with the pace of time it was felt that a separate Central Bank is necessary.

Nepal Rastra Bank was established in 14<sup>th</sup>Baisakh 2013 B.S under NRB Act 2012 which has been replaced now by NRB Act 2058 to match the current need of the modern banking. The central bank of Nepal issued notes on 7<sup>th</sup>Falgun 2016 B.S. for the first time. Prime objective of that time was to replace prevalent Indian currency in Nepal, stop dual monetary system and to apply monetarism in all part of Nepal. Further its objective at the time of establishment was to provide issuance of note, to bring Nepalese currency in use, to manage monetary system well, to encourage national industry by mobilizing the capital for the development of nation and too develop banking system in Nepal. Its objectives have changed over time and at present is main objective is regulating banks and financial institutions prevalent in

Nepalese economy, maintenance of positive balance of payment and maintaining exchange rate through NRB Act 2058.

After the establishment of Nepal Bank Limited and Nepal Rastra Bank another bank was established in 2022 under Baniijya Bank Act 2021 called Rastriya Baniijya Bank. Rastriya Baniijya Bank was established according to the recommendation of NRB. Rastriya Baniijya Bank went into along with Nepal Bank Limited due to high Non Performing Assets. After they went into trouble NRB started restructuring program and they are now slowly recovering.

Yet another bank was established in initiation of government for promoting agriculture sector of the economy. Agriculture Development Bank was established on 7<sup>th</sup> Magh 2024 for financing in Agriculture sector of the economy.

### **Third Phase of Nepalese Banking**

After the establishment of Agriculture Development Bank, there was gap of around 2 decades for further opening of the banks in Nepal. In 2040 a Joint Venture Bank Nepal Arab Bank Limited (NABIL) was established under the Commercial Bank Act 2031 and Companies Act 2021 which marked the starting the 3<sup>rd</sup> Phase of Banking in Nepal. After NABIL bank, came Nepal Investment Bank Limited (the then Nepal Indosuez Bank) and Standard Chartered Bank (the Grindlays Bank Limited) in 2042 and 2043 respectively. Soon many other joint venture banks were established after that like Himalayan Bank Limited (JV of Habib Bank of Pakistan), Nepal SBI Bank Limited (JV of SBI India), Nepal Bangladesh Bank Limited (JV of International Finance Investment and Commerce, Bangladesh), Everest Bank Limited (JV of Punjab National Bank, India), Bank of Kathmandu (JV of Syan Bank of Thailand), Nepal Credit and Commerce (former bank of Ceylon, JV of Srilankan and Nepalese investors). So third phase of Nepalese banking saw the foreign investment in Nepal grow in banking sector. Along with it grew the other local banks like Lumbini Bank Limited, Machhapuchhre Bank Limited as regional based banks and Laxmi Bank Limited, Siddhartha Bank, Kumari Bank etc in Kathmandu.

### **Fourth Phase**

After the establishment of democracy in early 90s in Nepal and liberalization of Banking Sector, banks were able to determine the rate of interest on the basis of demand supply and further to started the concept of regional banking and

development banking which marked encouraging progress and massive expansion of various types of banks and thus marked the 4<sup>th</sup> Phase of Nepalese Banking. With the promulgation of NRB Act 2058 (Amendment 2063) and Bank and Financial Institutions Act 2063 that categorized the banks into various categories as per the capital requirement and forms of transactions possible to be done by them, many financial institutions sprouted, at national as well as regional level. The range of financial inclusiveness has widened, environment for capital mobilization eased, and opportunities in the banking sector extended with the expansion of the financial sector.

### **Current Scenario**

At present there are 32 Commercial Banks, 88 Development Banks and 70 Finance companies at the end of Fiscal Year 2068/69. Along with Banks and Financial Institutions, there are 24 of Microfinance Development Banks, NRB licensed Cooperative and 36 NRB Licensed NGOs which are given limited right for banking transactions. There has been decline in number of finance companies due to the merge of finance companies with commercial banks or developments banks and 1 increment of commercial bank is due the upgrading of Sanima Development Bank to commercial bank. Table below shows the growth in number of banks and financial institutions over the year.

**Table 1.2**  
**Banks and Financial Institutions in Nepal**

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

*Source: Nepal Rastra Bank (Banking and Financial Statistics), Mid-July 2011.*

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

With the bubble growth of real estate and the lending of banks and financial institutions in the that sector had made the time hard for banks and financial institutions as the central bank put the caps through circular in real estate sector and the same time the slowdown of global economy and decline in remittance. Further the central bank fixed the CD Ratio and increased Cash Reserve of financial institutions. However, with time the banking sector is recovering but at the same time there is rise in NPL of the banks and financial institutions which is the result of rampant lending in real estate during the bubble growth of real estate.

### **Banking in Pokhara**

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

#### **1.1.5 About Shangri-La Development Bank Ltd.**

Shangri-La Development Bank Limited is B class licensed financial institution authorized by Nepal Rastra Bank. It is Pokhara based and have its head office in New Road Pokhara. It came into operations from 9<sup>th</sup> Bhadra 2064 and has been operating in profit since then. It was started by individuals from various sectors with the goal to provide banking services to general public with the cutting edge technology and hence it has slogan of Bank for Every Body. It was established as 39<sup>th</sup> development bank of the nation; however, it has come into forefront in many indicators like Deposit

Mobilization, No. of Customers, lending and in respect of number of other measuring indicators.

## **Network**

Shangri-La Development bank has at present 13 branches and three micro finance outlets. Since it is a regional development bank, it has been approved to operate in only 10 districts and so far it has covered 7 districts of the 10 approved districts. Bank has 7 branches in the Pokhara Valley and other 6 are located in Dulegaunda, Narayangaht, Hetauda, Butwal, Amarapuri and Baglung.

In terms of its performance, it has been able to win the heart of around 50 thousands customers and collected deposit of 2.57 Billions, made a lending of 2.12 Billions with an operating profit of around 78.5 million as of Ashad End 2069 as per the unaudited report published by the bank. Large customer base and good service has made the bank outstand among the banks in the region and one of the most loved banks by the citizen of Pokhara Valley. It has been able to keep up the slogan that it has hold and provide the service at par of the commercial banks.

## **1.1.6 Services and Products of Shangri-la Development Bank Ltd.**

### **1.1.6.1 Deposit Products**

In the past the bank had been popular by the slogan of prepaid interest. It was due to a fixed deposit product named Shangri-La Prepaid Fixed Deposit. It was such a product that in which the depositor were paid interest at the time of deposit in term of cash or equivalent FD receipt. However, of lately bank's management has discouraged that product due to higher cost tied up with it. After Shangri-La Prepaid, came Shangri-La Lakh Yojana where depositors were able to make deposit at the multiple of 65 thousands and receive 1 lakhs or its multiple at the end of 5 years.

Various deposit products and services are as following.

- Shangri-La Bal Bhabisya.
- Shangri-La Suva Laxmi.
- Shangri-La Special Saving.
- Shangri-La Gurkha Saving.
- Shangri-La Jestha Nagarik Saving.

### **1.1.6.2 Other Services**

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

- Shangri-La i Banking.
- SMS Banking.
- Locker Services.
- ATM.
- Remittance.
- ABBS, 365 banking, fee collection.

### **1.1.6.3 Loan and Advances Products**

Shangri-La not only makes lending and charge interest to the customer but also provides lots of different services to facilitate that the customer will make right use of the borrowed sum and make good business out of it. In other word it can be said that it will work as a financial consultant of the customer and provide advises on the use of loan and advances wisely along with the support in right decision making.

Here are the loans and advances product of the bank. Bank only provides loan and advances against the security of land and building, however its micro finance unit provide loan against group guarantee. The loan provided against the group guarantee will be less than 90 thousand to an individual. With the collateral security and feasible project Bank can make lending up to 8 crores at present as its capital is 32 crores only. The bank has offered number of loan and advances products which has been listed below.

- Overdraft and Working Capital Loan.
- Term Loan.
- Housing Loan.
- Auto Loan / Hire Purchase Loan.
- Education Loan.
- Personal overdraft Loan and personal loan.
- Share Loan.
- Gold and Silver.
- Deprived Sector / Micro Finance.
- Foreign Employment Loan.

## **1.2 Statement of Problem**

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

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

This study would mostly be focusing on the importance of credit management and various factors that needs to be considered in the meantime it will answer the following questions.

- What sort of credit policy (Generally called CPG - Credit Policy Guidelines) does banking industry and in Shangri-La Development Bank in particularly have?

- How a project is appraised and risk are addressed before providing credit facilities in banking industry and in Shangri-La Development Bank in particular case?
- How does Nepal Rastra Bank control credit risk in banking industry and how far has Shangri-La development Bank complied with those directives of NRB?

### **1.3 Objectives of the Study**

Setting of objective of the study is important to give proper direction of the study and reach a fruitful conclusion. Credit Management has a sole objective of studying the credit policy, credit risk management and default management of the banking industry and Shangri-la Development Bank in particular. This helps to plan and manage credit portfolio of the bank and help the organization to better equip them in mitigating the risk if not eliminated.

The objectives of the study paper can be further enumerated in following points:

- To study different aspect covered by credit policy in order to manage credit of the banking industry and Shangri-la Development Bank in particular case.
- To study how a project is appraised and risks are mitigated before a credit facilities are sanctioned in Shangri-la Development Bank.
- To study how Nepal Rastra Bank regulate banks and its provision for control of credit risk.

### **1.4 Significance of the Study**

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

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

Few of the instances of bank failure also can be seen in case of Nepalese banking history. High NPL of two major Govt. Banks Nepal Bank Limited and Rastriya Banajya Bank Ltd, these banks' management was taken by Nepal Rastra Bank and foreign management was provided for the effective management of the bank. Further Management of NCC Bank and Nepal Bangladesh Bank was also taken by Nepal Rastra Bank, not only that Nepal Development Bank was liquidated and Nepal Share Markets and Finance Limited and Gurkha Development Bank has been declared as problematic financial institutions. These banks and finance face problem due to its bad credit and the reason behind was not following proper corporate governance while making lending decision to the customers.

Nepal Rastra Bank has felt that the number of financial institutions has grown to large scale and it has to be slash down, hence it has adopted a policy of merging banks and financial institutions. With this step of NRB number of banks and finance has merged and there are other banks and finance which are in the process of merging.

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

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

### **1.5 Limitations of the Study**

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

- Since real exposure to the credit files was not possible and it difficult to make actual analysis of the risk.
- Due to limited time a comprehensive study of all the factors was not possible using different tools and techniques.
- Since the credit appraisal was very confidential, the real process and its nature was not exactly disclosed by the banks management.
- Due to slight difference between different products it was hard to know exact portfolio and the system to manage the portfolio.
- Since the process of credit administration and other data of the credit like name of borrower, rate and limit sanctioned to borrower, collateral offered by the borrower are highly confidential, these data disclosed by the management of the has been strictly kept confidential and the name of the borrower has been disguised to hide the actual name of the borrower.

- In case of group of borrower they have been called Group A, Group B, Group C, Group D and Group E to hide the real name of group of borrower in the group and the company under study have been named ABC Company to hide the real name of the company to which the bank had provided lending.
- The quality of study depended upon the data provided by the bank and its management.

## **1.6 Organization of the Study**

This research has been organized in three chapters as below:

### **Chapter I: Introduction:**

The first chapter deals with introduction. This includes background, statement of problem, objectives of the study, significance of the study, limitation of the study and organization of the study.

### **Chapter II: Review of Literature**

This chapter consists of conceptual review and review of related studies.

### **Chapter III: Research Methodology**

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

### **Chapter- IV: Presentation and Analysis of Data**

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

### **Chapter -V: Summary, Conclusion and Recommendation**

The third chapter includes summary, conclusion and recommendation for improvement.

## **CHAPTER II**

### **REVIEW OF LITERATURE**

#### **2.1 Conceptual Framework**

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

##### **2.1.1 Credit Management**

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

the end. All these process are outlined and defined in the credit policy guidelines, generally called CPG.

### **2.1.2 Credit Policy Guidelines**

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

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

### **2.1.3 Credit Risk**

Financial activities are necessary for the economic development of the country and banking in this context is the heart of financial system. Optimal investment decision plays a vital role in each and every organization. But especially for the banks and other financial institutions, sound knowledge of investment is the must, because this is more concern with mobilization of funds in different sectors in view of return. As the banks and financial institutions, they must mobilize (i.e., investment in different sectors) their collections (deposits) and other funds towards the profitable, secured

and marketable sectors so that they will be in profit. As we know without risk there is no return hence credit of the banks and financial institutions has risk associated with it and the risk will be of different categorized. As the risk can't be totally eliminated, hence an effort is made to mitigate it. For this purpose these banks and financial institutions should gather the sufficient information about the prospective borrowing firm (client). The information collected include a financial background, nature of business as well as its ability to pay the loan back or basically check the five c of credit i.e. and the probable risk associated with it. Following are the risk associated with credit.

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

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

## **2.2 Financial Analysis**

Ratio analysis is the process of determining and interpreting numerical relationship based on financial statements. A ratio is a statistical yardstick that provides a measure

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

Webster's new collegiate dictionary defines a ratio as "The indicated quotient of two mathematical expressions and as the relationship between or more things." In financial analysis a ratio is used as benchmark for evaluating the financial position and performance of a firm ("Websites, New Collegiate Dictionary" 8th Edition Supering Field Mass).

### **2.2.1 Standard of Comparison**

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

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

### **2.2.2 Types of Ratios**

Several ratios calculated from the accounting data can be grouped into various classes according to financial activity or function to be evaluated. Long-term creditors or the other are more interested in the long-term solvency and profitability of the firm and short term lender will see the current assets and the cash flow if the firm can meet their obligation when the loan will mature in the near future. Similarly owners

concentrate more on the firm's profitability and financial condition. Management is interested in evaluating every aspect of firm's performance. They have to protect the interests of all parties and see that the firm generate enough profit and maximize wealth of the firm and have adequate cash flow so that it will be able to meet the dues when they fall dues. In view of the requirement of various ratios they may classify into following groups.

#### **2.2.2.1 Credit Practices Ratio**

##### **i. Total Loan to Total Deposit Ratio**

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

##### **ii. Loan and Advances to Total Assets Ratio**

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

##### **iii. Loan and Advances to Current Assets**

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

##### **iv. Interest Income to Loan and Advances**

Interest income to loan and advances is one of the major indicator of how well the bank and financial institution is operating its loan and advances. It

indicates the return on the lending provided by the bank hence the higher ratio is indicator of good performance of bank. In other word it is average yield on loans and advances of the bank or percentage of return on the loans and advances of the bank.

**v. Loan Loss Provision to Total Loan and Advances Ratio**

It describes the quality of assets that a bank is holding. NRB has directed the banks to classify its loan and advances into five the category viz. pass, restructured, standard, doubtful and bad. As per the directive issued by the central bank, the banks and financial institution has to provide a provision of 1%, 12.5% 25%, 50% and 100% respectively in the mentioned categories of loan and advances. NRB has classified the pass and restructured loan as performing loans and other three substandard, doubtful and bad types of loans non-performing loans. The provision made against the pass and restructured loan is called the general loan loss provision and provision made against the substandard, doubtful and bad loan is called specific loan loss provision. The provision for loan loss reflects the increasing probability of non-performing loan. Increase in loan loss provision decreases in profit result to decrease in dividends. The low ratio indicates the good quality of assets in total volume of loans and advances. High ratio indicates more risky assets in total volume of loan and advances.

**vi. Non-performing Loan to Total Loan and Advances Ratio**

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

**2.2.2.2 Credit Efficiency Ratio**

**i. Interest Expenses to Total Deposit Ratio**

This ratio measures the percentage of total interest paid against total deposit. A high ratio indicates higher interest expenses on total deposit. Banks are

dependent upon its ability to generate cheaper fund. The cheaper fund has more probability of generating loans and advances and vice versa.

**ii. Total Loan to Liabilities Ratio**

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

**iii. Interest Expenses to Total Expenses Ratio**

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

**iv. Interest Income to Total Income Ratio**

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

**v. Interest from Loan and Advances to Total Interest Income Ratio**

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

other bank and finance. Commercial bank will not get interest on the deposit they make in another commercial bank.

**vi. Interest Suspense to Total Interest Income from Loan and Advances Ratio**

Interest suspense means the interest due but not collected. As per NRB directives when booking interest income from loan and advances the banks and financial institutions needs to follow cash flow basis i.e. interest that is receivable but not received can't be account as income rather an interest suspense account of equivalent amount has to be created. The increase in the interest suspense decreases the profit of the company. This ratio, interest suspense to total interest income from loan & advances, measures the composition of due but uncollected interest in the total interest income from loans & advances. The high degree of this ratio indicates the low interest turnover and low degree of this ratio indicates high interest turnover. This ratio also helps to analyze the capacity of the bank in collecting the repayments of the loan and advances. However, when measuring this ratio one has to take into account of overdue interest, as certain portion of the interest will only accrue but will not be due at the time of preparing balance sheet. The portion of interest that has accrue but has not been due should be taken as the acceptable level of interest suspense but the interest suspense on overdue interest means the recovery of the interest is not good of that bank and financial institutions.

## **2.3 Factors Affecting Credit Policy**

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

### **2.3.1 Industry Environment**

Viability of the project is determined by the prospect of growth of industry in which the project falls, for example during the period of insurgency lending to the hotel and resort would not be good decision as the hotels and resorts were not running on profit

rather they were in loss. Hence study of the industry would be very crucial further even if the industry is growing and overall business is good yet the position of the firm would be very important as whether the firm can sustain the competition of its competitors. Viability of the industry is major point to note prior to make a lending decision hence it will be incorporated in the credit policy of the bank.

### **2.3.2 Financial Condition**

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

### **2.3.3 Management Quality**

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

### **2.3.4 Technical Strength**

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

### **2.3.5 Security Realization**

It determines the control over various securities obtained by bank to secure the loan provided. A security should be neither too big nor too small, very large collateral will be hard to sell when the credit goes default and too small will not cover the loan amount extended to the borrower. When the case becomes too big to fail like the loan

extended to Hotel Fulbari Resort by Rastriya Banijay Bank than when the loan becomes non performing than it will not only effect the profitability of the bank but will some time make the bank to collapse. Present value of the properties mortgaged with the bank need to be assessed and its future value when the credit matures need to be taken account of in the credit policy. Weakness in security threatens the bank's second way out and when the security provided by the borrower is weak and does not cover the loan amount than the borrower will be reluctant to repay the loan and credit will go default.

### **2.3.6 Credit History and Past Performance**

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

## **2.4 Review of Related Studies**

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

Nepal Rastra Bank has issued directives to banks and financial institutions ensuring transparency during loan disbursement and report of such to be submitted in a monthly and quarterly basis. Further Banks and Financial Institutions have to report of loan greater than 2.5 million to Credit Information Bureau (CIB) within 15 days from the time of lending. Not only that after the ending of each quarter banks and

financial Institutions have to send report to CIB as well about the performance of each party. NRB directives have also barred the banks and financial institutions from lending to the blacklisted defaulter and his family members. Not only that if a lending is made to the black listed party then the Central Bank would be able to fine the concern banks and financial equivalent to the amount of lending made to the black listed party. The Credit Information Bureau (CIB) will blacklist the firm, company and individuals on the request of the banks and financial institutions when a firm, company and individual defaults the loan and does not assist the bank in recovery of the loan that was sanctioned to them. Not only that the Central Bank will fine Banks and Financial Institutions if they do not black list the defaulter who needs to be black listed. Further it is mandatory to obtain credit information regarding the customer prior to lending from CIB when banks have to make lending of more than 1 million. Not only that if the customer has loan transactions with one or more of the banks and financial institutions then prior to lending credit information has to be obtained from such banks and financial institutions (Nepal Rastra Bank, 2012).

In the post report titled "NRB tells banks to assess risk" published in the Kathmandu Post, the reporter is trying to show one of the control measure applied by the Central Bank. NRB has asked commercial banks to prepare their Internal Capital Adequacy Assessment Process (ICAAP) policy and submit it the regulator by the end of second quarter of fiscal year 2069-70. ICAAP is the bank's internal assessment of capital that is considered adequate to cover all material risks to which it is exposed to. Commercial banks of Nepal have to comply with BASEL II accord which considers the credit risk, market risk and operation risk and asks banks to maintain a minimum capital adequacy ratio of 10% to cushion the risks (The Kathmandu Post, 2012),.

Credit management and management of it risk have come a long way and modern portfolio management is lot more different than the traditional one. The volume of business has grown into tremendous volume and complex problems has arisen overtime and hence to cope with the new problems and meet the challenges new set of tools and different strategies has been adopted for the management of credit portfolio. In essence, a bank's credit culture was a series of written and unwritten rules about which types of customers, industries and credit profiles were acceptable. This culture ultimately dictated the structure and composition of the bank's total portfolio. The credit culture will vary upon the bank being commercial, development or it is a finance company. Not only that it will be depending on the locations as well, as

different parts of the country have different specialty. However, a real credit culture of the bank is followed by only very few of the banks of Nepal. Still large number of banks and financial institution of Nepal will make lending on the basis of the collateral and does not follow a strict credit culture like a home loan to be provided to the individual where the loanee himself/herself would be residing in the house mortgaged for the loan, but such practice is not followed.

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

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

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

Protection measures against portfolio losses focused on loan loss reserves based on moving-average formulas. Concentration risk was to be avoided, but there were always those special customers for whom exceptions could be made. If the formulas were correct, then overall expected losses in the portfolio would be covered by reserves. But those formulas and expectations were not always so accommodative. As a result, certain concentrations would invariably lead to extraordinary, or unexpected, losses that were charged to income in the year of their incurrence.

Portfolio management looks at the impact of loans individually, collectively, and comparatively. Modern portfolio management techniques have supplemented these unwritten rules with portfolio analysis and policies that establish limits on exposure by country, by obligor, by industry, and so on. These limits are derived from a specific focus on the technical aspects of this asset class, a segmentation of the credit

product and an analysis of the effect of combining credits into portfolios. Credit portfolios can now be evaluated on the basis of fundamental as well as quantitative portfolio analysis.

### **Functionally, Credit is now segmented into four Parts**

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

approval manages expected loss and allocates capital to desirable transactions. CPM, as separate from credit approval, optimizes the use of capital through alterations to the portfolio's profile.

### **Alternative Structure for Credit Portfolio Management (CPM)**

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

The state of CPM along this development curve often dictates whether it is located inside the wall (subject to the possibility of receiving non public information) or outside the wall (not subject to non public information and freer to adjust positions).

Functions of Credit Portfolio Management CPM achieve two principle goals:

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

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

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

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

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

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

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

The ratio of loans and advances and investment to deposits ratio has measured the proportion of total deposits that is used to increase the income of the banks irrespective of the portfolios of its application. Nabil has deployed the highest

proportion of its total deposits in earning activities and this ratio is significantly above the ratio of other two banks. The combine ratio is highly deviated from the mean ratio of Nabil and SCBNL. This is the indicative of that in fund mobilizing activities Nabil is significantly better than SCBNL.

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

On the basis of the findings and conclusions he has recommended for the banks as the liquidity position of all these three banks is found to be high.

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

SCBNL is recommended to give extra priority sector loan. The increasing provision on loan loss and high volume of non-performing assets in Nabil and HBL certainly attracts the high attraction of any person interested with these banks. The high volume

of HBL non-performing assets may have caused due to the failure of industrial and agricultural sector. Nabil's increased non-performing assets may have caused due to the accumulated bad debts that is kept behind the curtain to show the efficiency of management.

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

**Subi Joshi (2003)** “ Financial Analysis of NIBL” has found out that the analysis of the banks shows that the deposit have been increasing gradually during the study period i.e.; (2053/54 – 2057/58). However the rate of increase was comparatively low in the year 1997/98 than in the year 2000/01. Total loans and advances have been also increasing. The total investment of bank has been increasing slowly over the years, which is mainly due to bank strategy of safe lending as a result there is increase in customer deposits to higher volume as there are limited opportunities for prudent lending.

The bank has been holding adequate provision for losses over the years and 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 principle as well as sources of repayment, capital structure, requirement and credit worthiness of a borrower for providing credits. In other words, credit manager should evaluate credit risk by considering well-known 5C's of credit viz. character, Capacity, capital, collateral and conditions.

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

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

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

In the same way, proportion of loan 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% respectively. The average ratio of provision held to non-performing loan of NBL, Nabil and SCBNL was found to be 80.03%, 57.85% and 122.32% respectively shows that the SCBNL has maintained adequate level of provision against non-performing loan whereas Nabil was found to be comparatively lower. The NBL was found to be an average position.

**Reetu Shrestha (2007)** "Non Performing Asset Management of Nepal Bank Ltd." study is concerned to examine the effect of NPL in profit of the bank and how adversely its effects the banks performance. As the study show the adverse effects the banks performance. As the study show the adverse effect of NPA in profit of the

bank, it is focusing on how NPA are dealt and how credit management system is developed in order to avoid NPA in the future.

**Manju Kunwar (2009)** "Credit Management A Comparative Study of Himalayan Bank Ltd and NABIL Bank Ltd." study is concerned to examine and study the practice of credit management in Himalayan Bank Ltd. and NABIL Bank Ltd. This study is trying to compare credit management in commercial bank and especially between Himalayan Bank Ltd and NABIL Bank Ltd.

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

The study recommends that the actual loan disbursement is less than targeted loan disbursement hence a new standard needs to be set for meeting target and also decrease the variance over loan disbursement and repayment of loans and advances. There is shortage of skill in the human resource of the bank hence a targeted training needs to be provided to the staff of the bank to meet the match between actual loan disbursement and repayment. The researcher also points that if the bank has to compete and come forward it needs to diversify its loans and make disbursement of loan in other sectors like transportation and other sectors. It is good news that the loan repayment is increasing but it should be increased with the pattern of loan disbursement and the bank needs to be caution that the loan repayment not exceed loan disbursement of the bank. One of the ironical point noted by the researcher is that

though the bank was targeting for development of agriculture and people in the rural area where large number of people are depending on agriculture there is non presence of the bank and it has not been able to provide service to the agricultural people living in the rural area, hence it is recommended to extend the service in the rural area .

**Dil Bahadur Baral (2011)** "Loan Management of Commercial Bank, A Case Study of Kumari Bank Limited" study is concern with how credits of commercial banks are managed. It makes the study of loan management of Kumari Bank Limited with the help of structured questions, statically and financial tools like trend analysis, correlation coefficient, profitability ratio, liquidity ratio and capital adequacy. The study can be summarized in the following way, it says that still Nepalese banks lacks proper and consistent credit policy. It states that most of the commercial banks are in profit but few are in loss as well. This is due to instability in loan management of Banks.

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

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

## **2.5 Research Gap**

The purpose of this research is to development some expertise in one's area, to see what new contribution can be made and to receive some ideas, knowledge and suggestions in relation to credit management of Shangri-la Development Bank Ltd. Previous studies cannot be ignored because they provide the foundation to the present study and guide the research to the new level without repetition of work. In other words, there has to be continuity in research and one research should help the other so that what has already need not be repeated. This continuity in research is ensured by linking the present study with the past research studies. After the study of past research work and NRB directives it is found that number of work has been done in regards to the study of Nonperforming Assets of commercial Bank, their compliance to the directive issued by NRB, risk management of credit of commercial bank with the study of two or more commercial banks' comparative study. Lots of work has been done in the study of credit risk management of commercial banks' and to that with the specific banks taken into consideration. A very little work was found on credit management of bank and financial institution. Further a very little work has been done in the field of Development banks and Finance and credit management of development banks has not been done hence, to fulfill this gap, this research is selected. To complete this research work, many books, journals, articles, various published and unpublished dissertation, websites of NRB, website of Nepal Research and search engine like Google are followed as guideline to make the research easier and smooth. In this regard, here the researcher is going to analyze the different procedure of credit management of Shangri-la Development Bank Ltd.

Our main research problem is to study and analyze what sort of credit policy the bank follow, how a project is appraised prior to lending and how does the central bank controls the credit risk of the bank. To achieve this main objective, various financial and statistical tools are used. Similarly, trend analysis of investment, NPL and profit are reviewed to make this research a complete one. Therefore, this study is useful to the concern bank as well as different persons, such as shareholders, investors, policy makers, stockbrokers, state of government etc.

## **CHAPTER III**

### **RESEARCH METHODOLOGY**

#### **3.1 Research Design**

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

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

#### **3.2 Sources of Data**

Data is the facts or statistic collected together for reference or analysis and without data a research would remain incomplete or a research would not be possible. There are two types of data and they are as follows.

##### **3.2.1 Primary Data**

A first hand data collected by the researcher for the first time for his or her research is called a primary data. For the purpose of research primary data were collected by:

- Interview with the staff of the bank.
- Observation.

### **3.2.2 Secondary Data**

It is the published data which has been used by first person or other. Only primary data only can't fulfill the requirement of the research work. So, adoption of secondary data is also suitable to accomplish the objectives of study. The following procedures were adopted for obtaining secondary data.

- Library.
- Publications of unaudited reports in the newspaper.
- Books and Journals/ Magazines.
- Booklets, and
- Internet and websites etc.
- Annual report presented in the AGM.

The output of the research work depends upon accuracy of the applied data. So, the researcher tried to collect up to data and accurate data as far as possible.

### **3.3 Data Collection Procedure**

For the collection of primary data a set of questionnaire will be prepared and provided to the employee and customer of the bank and study of credit files shall be done for data collection and processing. For the collection of secondary data a reliable source like website of Nepal Rastra Bank, Annual Report published by the banks, unaudited reports published in the newspapers and journals shall be used.

#### **3.3.1 Populations and Sampling**

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

Here the total number of development bank shall constitute the population of data and the bank under study constitutes the sample for. Among the banks and financial institutions, Shangri-la Development Bank Ltd. has been taken as sample for the

study. Similarly, financial statement of 5 years from 2006/07 to 2011/12 has been taken for the study.

### **3.4 Tools and Techniques Used for Data Analysis**

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

#### **3.4.1 Descriptive Techniques**

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

#### **3.4.2 Financial Tools**

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

#### **Ratio Analysis**

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

##### **i. Nonperforming Loan (NPL) to Total Loans and Advances**

Nonperforming loans and advances to total loans and advances give us an idea about what percentage of total loan is not performing well or is in default. This

ratio is good indicator of how well the portfolio has been maintained by the bank.

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

#### ii. Provision to Non performing loan (NPL)

This ratio shows if the non performing loans and advances are adequately provisioned or not. This ratio is greater than 100% is considered good and that the NPL is adequately provisioned but if it goes below 100% than it is not adequately provision hence the bank may be at risk.

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

#### iii. Capital Adequacy

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

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

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

#### iv. CD Ratio

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

$$\text{CD Ratio} = \frac{\text{Total Deposit} + \text{Capital} + \text{Reserve}}{\text{Loans and Advances}} \times 100\%$$

#### v. Average Yield on Loans and Advances

Average yield on loans and advances is an indicator of return on the loans and advances and it also show the price made on loan and advance by the bank.

$$\text{Avg. Yield on Loans and Advances} = \frac{\text{Interest Income}}{\text{Average Loans and Advances}} \times 100\%$$

#### **vi. Fixed Assets Turnover Ratio**

Fixed asset turnover ratio shows how well fixed asset has been utilized and when the ratio has falling trend, it shows that the capacity of the fixed asset is decreasing and it is one of the serious indicator to be checked. If there is fall in fixed asset ratio than it is not wise to make lending. Fixed Asset Turnover Ratio is calculated as below.

$$\text{Fixed Asset Turnover Ratio} = \frac{\text{Net Sales}}{\text{Operating Fixed Assets}}$$

Net Sales = Sales revenue less cost of goods sold

Operating Fixed assets = Fixed Assets

#### **vii. Return on Investment (ROI)**

This ratio measures how well the investment is generating profit hence it is very important to check this ratio and this ratio should not be less than the lending rate of interest. This ratio is calculated as below.

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

Operating assets includes both fixed and current assets

ROI must be greater than interest rate.

#### **viii. Gross Profit Ratio**

Another operating ratio that is good measure of the viability of project is gross profit which is calculated as

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

#### **ix. Equity – Total Debt Ratio**

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

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

**x. Equity – Short Term Debt Ratio**

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

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

**xi. Current Ratio**

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

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

**xii. Inventory Turnover Ratio**

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

$$\text{Inventory Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Inventory}}$$

$$\text{No. of Days of Stock Holding} = \frac{\text{Inventory} \times 365}{\text{Cost of Goods Sold}}$$

**xiii. Interest Coverage Ratio or Debt Service Coverage Ratio**

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

$$\text{Interest Coverage Ratio} = \frac{\text{Profit Before Tax and Interest} + \text{Depreciation}}{\text{Interest} + \text{Other obligation to the Bank}}$$

#### **xiv. Receivable Turnover Ratio**

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

#### **xv. Payable Turnover Ratio**

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

### **3.4.3 Statistical Tools**

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

- **Mean or Average**

Mean or average represent a single value for the whole data of the observations. It is calculated as

$$\text{Mean or Average} = \frac{\text{Sum of observations}}{\text{No. of observations}} \times 100\%$$

### **3.5 Limitation of Methodology**

Various descriptive tools, financial tools like ratio analysis and statistical tools has been used for the study of credit management of Shangri-la Development Bank and these tools have certain limitations. For the study of credit management of the bank, five years data of bank, credit and recovery policy of the bank, different journals, website of Nepal Rastra Bank, unified directives of Nepal Rastra Bank and other sources of information has been adopted hence there are certain limitation regarding the information and method adopted for collection of data. Further the time and money spent has been a constraint for the study and the conclusion drawn for the study. Though there were certain limitations of the research work, it does not mean that they have weaken the basic finding of the study hence the study is reliable.

## **CHAPTER IV**

### **DATA PRESENTATION AND ANALYSIS**

#### **4.1 Data Presentation and Analysis**

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

##### **4.1.1 Different Aspect Covered by CPG of Shangri-la Development Bank Limited**

Credit Policy Guidelines generally called CPG is guideline which guides the bank's management in managing credit of the bank or in other word it can be called Bible for the bank's management for managing portfolio of the bank. It will set out different process and procedure of lending like, who is eligible for lending, in what sector to lend, what is the investment of prospective borrower in the project, what to obtain as collateral security, who holds the right over the decision of lending, what percent of interest to charge and what other sort of charges to be obtained from the borrower. It will further have process of recovery of loan in case of default and how to write of the loan when it is not recoverable, how to categorized the loan and provisioning of the loans and advances. One point to note is that the CPG will give a very board outline and on the basis of it a credit manual is prepared which is elaborates it and set standard for loans and advances sanctioning. Credit Manual sets risk mitigating standard and procedure not only that it will have minimum procedure for mitigating

minimum risk related to credit. Further on the basis of CPG and Credit Manual, a Credit Approval Memorandum is brought into practice which will check if the credit risks are addressed and mitigated. Hence a CPG needs to be studied in line with Credit Manual and Credit Approval Memorandum of the Bank. Let us study the aspects covered by CPG of the bank.

- Background Study of Borrower – Character of the Borrower.
- Investment of Borrower / Proposal – Capital of Borrower.
- Repayment or Cash flow of Borrower – Capacity of the Borrower.
- Security for Loan – Collateral.
- Industry or Environment Analysis – Condition.
- Charges for Services – Interest Rate.
- Recovery of Default Loan – Way outs.

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

#### **4.1.1.1 Background Study of Borrower**

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

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

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

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

- Completely fill up application form as prescribed by the bank.
  - Copy of citizenship of Borrower and Gurantors.
  - Photograph of borrower and gurantors.
  - Details of collateral offered to the bank.
  - Copy of lalpurja if the collateral offered is land and building.
  - Four Boundary Certificate if the collateral offered is land and building.
  - Tiro Rashid of land and building.
  - Cadastral map or blue print of the collateral offered.
  - Banking transaction detail if any – both deposit and lending.
  - Purpose of loan and amount required.
  - Income source justifying documents like salary, rental agreement etc. or audit report in case of business.
  - Approved Map of Building if the collateral offered includes building.
  - Building Completion certificate if the collateral offered is building.
  - Copy of blue book if the collateral is vehicle.
  - If the collateral offered is other than land and building and Vehicle than document showing the ownership over the assets.
- Additional Documents required in case of firm.
- Copy of registration certificate.
  - Copy of PAN.
  - Tax clearance and tax paid receipt.
  - Audit Report and Projected Reports.
- Additional Documents required in case of Company.
- Copy of MOA and AOA.

- Board Resolution for.
  - ✓ Obtaining loan.
  - ✓ Amount and tenure of loan.
  - ✓ Authorization of person to carry such activities.
  - ✓ Operations of account in the bank.
  - ✓ Authorization to complete work in malpot or yatayat.
  - ✓ Collateral security offered to the bank.
  - ✓ Lien over the stock of company to the amount of loan.

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

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

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

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

#### **4.1.1.2 Study of the Proposal–Investment of Borrower**

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

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

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

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

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

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

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

**a. Loan Provided to Purchase Vehicle–Hire Purchase Loan**

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

**b. Loan Provided to Purchase Land or Land and Building–Housing Loan**

CAM will check the portion of the bank in the total project through the assistance of technical persons. These technical persons are called the valuers of the bank and they are qualified civil engineers, the bank has made an agreement with them for obtaining professional service and the cost of professional service are charged directly to the customers. They will assess the fair market value of the property to be mortgaged in the favour of bank. Apart from it the CAM has made compulsory to

obtain "BainaPatta", an agreement between buyer and the seller of the property. Here the buyer is the customer of the bank. This bainapatta determines the cost of the project, however the bainapatta is not that reliable and CAM and CPG has made it mandatory to have the property valuated prior to make the lending decision. Portion of the bank in the project is determined by ascertainment of market value of the property.

### **Land Only**

Fair Market Value of the land is determined by taking weight age of market rate and government rate. For determining market rate of the land, the valuator makes inquiry of the market rate through the local resident and latest transaction rate of land in such location. Then a weight age of 50%-70% of it is taken of market and remaining weight age is taken of government. For example a property is located in Birauta of Pokhara. The land is ideal with front face 20 hatt and pichhad of 40 hatt (area of land is around 5 anna) and the access road is 20 feet, then the valuator makes inquiries with local resident for current rate at which the land is purchased and sold. If the rate of per hatt is around 150,000 then the valuator will take around 140,000 per hatt for valuation of the property. The the valuator will obtain Government rate from the book published by Malpot Office Kaski for determining the Government rate of the concern property. If as per the Government rate the cost of ropani is 2,000,000 then the Fair Market Value is calculated as the table under.

**Table 4.1**  
**Calculation of Fair Market Value of Land**

<b>Market Rate per hatt</b>	<b>Rs.150,000/-</b>
Market Rate adopted for Valuation	Rs.140,000/-
Government Rate per Ropani	Rs.2,000,000/-
Area of Land	0-5-0-0
Hatt	20
Govt. Rate for 0-5-0-0	625,000.00
Govt. Rate per hatt	31,250.00
70% of Market Rate	98,000.00
30% of Market Rate	9,375.00
Fair Market Rate per hatt	107,375.00
Fair Market Value of the Property (Weighted Rate per hatt x 20 hatt)	2,147,500.00

*Source: CPG of the Bank.*

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

### **Land and Building**

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

- Whether there is marble or not.
- If there is facility of hot and cold water system.
- Solar system.
- Number and size of iron rod used in the pillars and beam.
- Size of the building.
- Age of the building.
- If the building tallies with the approved map of the building.
- If the building has been built leaving the write off zone as per the rules and regulation of the Municipality.
- If the building has been built as per the approved area and floor for the approving authority.

At present the estimate cost of the building is determined by using the built up cost per unit square foot multiplied by the built up area. Present rate per square foot of building valuation range from 1000 to 2000 square foot. Hence fair market value of the building is determined by multiplying the built up area of building with the market rate of the building. For example if it is assumed that the building was constructed in the land discussed above then the fair market value of the land and building is as follows.

**Table 4.2****Calculation of Fair Market Value of Building**

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

*Source: CPG of the Bank.*

**c. Business Loan**

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

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

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

#### **d. Gold Loan**

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

**Table 4.3**  
**Calculation of Fair Market Value of Gold**

<b>Rate of Gold of per gram (Current Market as published in newspaper)</b>	<b>Rs.4,000/gram</b>
Rate of Gold adopted for valuation	Rs.3,000/gram
Weight of Gold	50gm
Deduction of Kediyeam	5gm
Net weight adopted for Valuation	45gm
Value of Gold	135,000.00
Margin Deduction	30%
Value of Margin Deduction	40,500.00
Net value of gold	94,500.00

*Source: Gold Loan Working Manual of the Bank.*

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

#### **e. Loan against Fixed Deposit Receipt (FDR)**

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

#### **f. Share Loan**

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

**g. Other Loans**

Other loans like consumer loans are fully based on the value of the collateral and the lending does not exceed 60% of the Fair Market Value of the proposed collateral.

Previously NRB had left the banks and financial institutions free to lend as per their discretion on the value of the collateral however, after the booming of real estate and failure of it, NRB sensed that the lending in real estate would bring the economy almost near to halt and it introduced directives to stop the further lending in real estate sector by the bank. It introduced directive that the lending should not exceed more than 60% of lending. Hence NRB has restricted banks for lending not more than 60% of the Fair Market Value of the collateral obtained as security for the loan sanctioned. However, NRB has left the ceiling of lending within 60% to two third of the collateral's fair market value in case of residential real estate i.e. in case of home loan and purchase of land and building for residential purpose. However, lending percentage on hire purchase loan and auto loan has been left on the part of the bank. Shangri-la Development Bank has strictly followed the direction of NRB in case of lending within the value of collateral. A study of 87 files of different categories was done and the result of such study is shown in the table as under.

**Table 4.4**

**Percentage of Loan Sanctioned against the Value of Collateral – Product wise**

<b>S.N</b>	<b>Types of Loan</b>	<b>No. of Files Studied</b>	<b>Loan to FMV Ratio</b>
1	Business Loan	26	50.24%
2	Housing Loan	13	54.57%
3	Personal Loan	22	46.69%
4	Hire Purchase Loan	13	74.30%
5	Auto Loan	13	58.74%

*Source: Internal file study of the Bank.*

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

#### **4.1.1.3 Industry or Environment Analysis–Condition**

CPG of the bank has specified the sector and what kind of credit facility to be sanctioned in those particular sectors. Once the sector is determined then the CAM will make in-depth analysis of that sector. For example if the lending has to be made in hotel industry, then CAM will check how the hotel industry is growing over time, what risk does the hotel industry faces, what is the current situation of tourism industry, what is the projected future of the industry, what is the flow of tourist in the region and at what percent is it growing. The CAM makes the analysis of both strength of the industry, weakness of the industry and projected growth of the industry in the future. The recent case of non-lending to real estate sector by the banks and financial institution can be taken as good example of bank and financial institutions taking real estate sector as risky sector and unfeasible for lending. Another good example would be tourism industry which suffered a loss during insurgency and the bank which made huge lending in tourism face the problem of high NPL.

Sector wise lending or concentration risk in particular sector is checked by NRB through making it mandatory to obtain approval from board in case the lending in particular sector exceeds 100 percent of its core capital. The concentration in a sector is checked through a report 9.3, which needs to be submitted within 15 days from the end of month of each month by all the banks and financial institutions. Shangri-la Development Bank has submitted all the reports within the stipulated time. Table below shows the sector wise lending of Shangri-la Development Bank and it has adhered to the norms of Nepal Rastra Bank and tried to diversify the loans and advances, however in some sector the lending is in excess of 100% of core capital and it has obtained approval from Board where the sectoral lending is excess than its core capital.

**Table 4.5**

**Sector-wise Loans and Advance of Shangri-la Development Bank Ltd.**

Sector / Years	2064-65		2065-66		2066-67		2067-68		2068-69	
	Principal	% of Core Capital	Principal	% of Core Capital	Principal	% of Core Capital	Principal	% of Core Capital	Principal	% of Core Capital
Core Capital		39900		82678		148843		367125		384640
Agricultural and Forest Related	-	-	-	-	28	0.02%	1,372	0.37%	26,083	6.78%
Fishery Related	-	-	-	-	-	-	-	-	-	0.00%
Mining Related	-	-	-	-	-	-	-	-	-	0.00%
Manufacturing (Producing) Related	11,599	29.07%	26,141	31.62%	53,203	35.74%	80,120	21.82%	97,849	25.44%
Construction	16,757	42.00%	68,472	82.82%	111,152	74.68%	121,077	32.98%	163,802	42.59%
Electricity, Gas and Water	-	-	-	-	-	-	-	-	2,568	0.67%
Metal Products, Machinery & Electronic	600	1.50%	1,054	1.27%	-	-	12,269	3.34%	16,097	4.19%
Transport, Communication and Public Utilities	86,261	216.19%	145,104	175.50%	223,559	150.20%	239,493	65.23%	224,319	58.32%
Wholesaler & Retailer	36,873	92.41%	43,943	53.15%	226,704	152.31%	342,137	93.19%	364,174	94.68%
Finance, Insurance and Real Estate	14,770	37.02%	90,950	110.01%	156,179	104.93%	130,295	35.49%	96,957	25.21%
Hotel or Restaurant	-	-	-	-	-	-	30,205	8.23%	76,053	19.77%
Other Services	31,967	80.12%	33,405	40.40%	72,705	48.85%	57,901	15.77%	231,526	60.19%
Consumption Loans	1,088	2.73%	12,062	14.59%	21,331	14.33%	95,261	25.95%	129,080	33.56%
Local Government	-	-	-	-	-	-	-	-	-	0.00%
Others	106,800	267.67%	249,211	301.42%	439,933	295.57%	480,174	130.79%	693,931	180.41%
<b>Total</b>	<b>306,715</b>		<b>670,342</b>		<b>1,304,799</b>		<b>1,590,304</b>		<b>2,122,446</b>	

*Source : Monthly Report of the Bank.*

From the table it is very clear that the lending in Transport, Communication and Public Utilities and Other Loans exceeded 100% than its core capital in the year FY 2064-65, likewise in the year FY 2065-66 the bank's loans and advances in three sectors exceeded its core capital viz. Transport, Communication & Public Utilities, Finance, Insurance & Real Estate and Other Loans. In the year FY 2066-67 four sectors exceeded the lending than its core capital, however in the later years FY 2067-68 and FY 2068-69 only one sector, other loan exceeded its core capital. This may be due increase in the core capital of the bank in the later year due to injection of new capital from outside as there is more than 100% increase in core capital of the bank.

Not only have that in the later years the loans were diversified. The sector like agriculture and manufacturing had no loans or very little loan and in the initial years and in later years the loan were disbursed in those sectors as well, the table shows that there is lending of 6.78% of core capital in Agriculture in FY 2068-69 and 25.44% of core capital in Manufacturing sector in FY 2068-69. Hence this good sign that the sectoral risk or concentration risk has been mitigated to some extent in the later years. As the approval from the board has been obtained for the excess lending Shangri-la Development has complied with the directives issued by the central bank.

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

#### **4.1.1.4 Concentration in Single Borrower or Single Group**

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

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

management will have full right over not allowing such transfer and any credit facilities sanctioned to the group may be revoked with specific notice.

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

**Table 4.6**

**Percentage of top 5 borrower (Single or Group) to Core Capital of the Bank**

FY 2066-67			FY 2067-68			FY 2068-69		
Top Five Single Groups	Limit	Percent age of Core Capital	Top Five Single Groups	Limit	Percent age of Core Capital	Top Five Single Groups	Limit	Percentage of Core Capital
Group A	21,748	14.61%	Group A	34,230	9.32%	Group A	60,000	15.60%
Group B	21,034	14.13%	Group B	33,770	9.20%	Group B	41,500	10.79%
Group C	14,700	9.88%	Group C	28,500	7.76%	Group C	41,000	10.66%
Group D	12,316	8.27%	Group D	20,698	5.64%	Group D	26,680	6.94%
Group E	12,151	8.16%	Group E	17,894	4.87%	Group E	24,070	6.26%
Core Capital	148,843		Core Capital	367,125		Core Capital	384,640	

*Source : Single Obligor Group Report of the Bank to NRB.*

Concentration of loans and advances of single group of borrower or single borrower is least in FY 2067-68, i.e. maximum of 9.32% of core capital, and highest concentration of 15.60% in FY 2068-69. When absolute value is compared the largest borrower or group of borrower of the bank has increased by 2.75 times from FY 2066-67 to FY 2068-69. Even though the loans and advances to single borrower or single group of borrower has increased in absolute value from FY 2066-67 to FY 2067-68, there is decrease in comparison to the core capital of the bank. This is due to 2.47 times increase in core capital of the bank from FY 2066-67 to FY 2067-68.

The table presents that so far the bank have made the lending to single borrower or single group of borrower within the limit prescribed by CPG and NRB.

Now when risk is analyzed in single group of borrower or single borrower in comparison to net profit of the bank, than the bank seems to be lending a bit more to single borrower or single group of borrower. The analysis of this also has to be done

because if top one or two borrowers goes in default or becomes non performing, than the profit and loss account of the bank will be hit hard due to provisioning of such loans and advances. This may result in negative balance sheet of the bank.

**Table 4.7**  
**Percentage of Loans of Single Borrower or Single Group of borrower in Comparison to Net Profit**

FY 2066-67			FY 2067-68			FY 2068-69		
Top Five Single Groups	Limit	Percentage of Core Capital	Top Five Single Groups	Limit	Percentage of Core Capital	Top Five Single Groups	Limit	Percentage of Core Capital
Group A	21,748	152.46%	Group A	34,230	105.22%	Group A	60,000	119.99%
Group B	21,034	147.46%	Group B	33,770	103.81%	Group B	41,500	82.99%
Group C	14,700	103.05%	Group C	28,500	87.61%	Group C	41,000	81.99%
Group D	12,316	86.34%	Group D	20,698	63.62%	Group D	26,680	53.35%
Group E	12,151	85.18%	Group E	17,894	55.00%	Group E	24,070	48.14%
Net Profit	14,264		Net Profit	32,531		Net Profit	50,004	

*Source : Single Obligor Report to NRB and Unaudited Report of the Bank.*

Though there is low amount in absolute figure of 21,748 thousand of top borrower in FY 2066-67, when compared to net profit of the bank it is 152.46%. This shows that had the top borrower of the bank gone in default than the profit and loss account of the bank would have gone negative. Likewise in FY 2067-68 and FY 2068-69, the top borrower still exceed the net profit of the bank, hence if top borrower of the bank goes in default, than the profit and loss account of the bank would go in negative.

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

#### **4.1.1.5 Collateral-Security for Loans and Advances**

CPG of Shangri-la Development Bank has restricted the management of the bank from lending without any collateral. Collateral may be any one of the following items.

- Land which is suitable for construction of residential or business purpose building.
- Land and Building which is suitable for resident or business.
- Gold and Silver.

- Shares or debentures of reputed and listed public companies.
- Government bond and securities.
- NRB bonds and securities.

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

### **Land and Building**

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

### **Vehicle and Machinery**

- Vehicle which is old and which can't be resold in the market.
- Vehicle which has been caught in accident and can't be used for commercial or private use.

- Vehicle which has been auctioned once.
- Vehicle which can't be insured or not accepted by the insurance company of Nepal.
- Vehicle or machinery which can't be auctioned.
- Vehicle or machinery which ownership is not clear.
- Vehicle or machinery which will not cover the credit facilities which has been sanctioned.
- Vehicle or machinery which is deemed unfit by the management of the bank.

### **Other Materials**

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

One thing that is clear is that no credit facility should be sanctioned against the securities of the collateral that is not resalable, which can't be auction or which is not sufficient to cover the sanctioned credit facility. In short it says that a collateral should cover the loan if the borrower defaults in repayment of the loan.

CPG has clearly outlined that the collateral has to have following properties so that it can be taken as collateral security.

### **Land and Building**

- The access road has to be very clear and should be motor able, in case the access road is not clear in blue print, then it should be certified from the municipality or VDC and should be enforceable.
- Free from any litigation and free from mohi and guthi.
- The land should be suitable for construction of building and should be useful for the resident or business purpose.
- The ownership should be single or joint but it should not be disputable and easy transferrable.
- The property should not affect the interest of public.
- The property should not be of minor nor should it be of person of unsound mind.

- The property should not be near of steep hills, near river, near gorges and under high tension wire.
- The property should not be in the area which may be taken by Government for their use.
- Houses should have been constructed in RCC frame work and it should have been made by cement and rods.

### **Vehicles and Machinery**

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

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

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

## **I. Land and Building**

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

## **II. Vehicle and other collateral**

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

**Table 4.8**  
**Security wise Loans and Advance of Shangri-la Development Bank**

Collaterals (Securities)	2064-65		2065-66		2066-67		2067-68		2068-69	
	No.	Amount	No	Amount	No.	Amount	No.	Amount	No.	Amount
Gold and Silver	-	-	-	-	17	3,071	116	8,349	231	15,890
Government Securities	-	-	-	-	-	-	-	-	-	-
Non-Governmental Securities	-	-	-	-	1	2,800	1	1,983	1	1,105
Fixed Deposit Receipts	4	1,088	25	12,062	43	18,261	100	22,181	144	31,173
Collateral of Properties	372	305,626	667	685,280	1,063	1,280,667	1,433	1,519,074	1837	1,993,723
Real Estate (Land and Building)	220	216,698	442	520,260	677	1,020,029	906	1,184,237	1230	1,651,126
Machinery and Equipment	-	-	-	-	2	222	2	4,872	2	6,053
Vehicles	152	88,928	225	138,020	384	260,417	525	329,966	605	336,545
Against security of Bill	-	-	-	-	-	-	-	-	-	-
Against Guarantee	-	-	-	-	-	-	834	38,723	2700	80,555
Credit Card	-	-	-	-	-	-	-	-	-	-
Others	-	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>376</b>	<b>306,714</b>	<b>692</b>	<b>670,342</b>	<b>1124</b>	<b>1,304,799</b>	<b>2484</b>	<b>1,590,310</b>	<b>4913</b>	<b>2,122,446</b>

*Source: NRB Reporting of the Bank.*

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

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

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

#### **4.1.1.6 Guarantors**

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

##### **a. Mitigating Collateral Risk**

If the guarantee is not obtained from the family members and those individuals who holds right over the collateral security than the risk of being the collateral subprime will be high. For example if the borrower does not repay the loans and advances and the bank have to auction the property than if guarantee has not be obtained from even one member of the family or who holds right over the property than that person can claim his right over the property and stop the auction process. Even the court will allow the auction only when the right of the person who has claimed is settled than only the portion of the bank can be settled. Hence it is very clear that without the guarantee of the right holder of the property the loan and advances will be subprime.

A survey was done among 12 Branch Managers and 6 credit staff of the bank among the importance of personal guarantee and the result has been illustrated in the table below.

**Table 4.9**  
**Necessity of Obtaining Personal Guarantee**

	<b>Must</b>	<b>If Possible</b>	<b>Few would be enough</b>	<b>Not necessary</b>	<b>Total</b>
Guarantee of Family Members	15	3	0	0	18
Guarantee of Brother and Sisters who have separated	8	5	3	2	18
Guarantee of Neighbour	0	18	0	0	18
Guarantee of Friends	4	14	0	0	18

*Source : Field survey 2012.*

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

**b. Providing Additional Security of Loans and Advances**

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

NRB has no specific rules for obtaining guarantee but it has made it mandatory to obtain family detail of the borrower hence it is one of the way the central bank want all the family member to provide guarantee for the loan sanction. In case of Shangri-la Development Bank it has made it mandatory to obtain bio data and family declaration

from the borrower which can be seen when the study of file and it is clearly stated in their checklist as well hence the bank has followed the instruction of the central bank.

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

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

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

#### **4.1.1.7 Repayment or Cash flow of Borrower-Capacity of the Borrower**

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

##### **a. Individuals**

Basic thing checked here is the cash inflow of the customers and regularity of such cash flow is checked. Regular income includes salary, rental income from house/land

and vehicles. Once the regular income of the individual is determined then the expenditure of the individual is studied, which is outflow of cash. Expenditure includes, rent payment, expenses on food, education, transportation, medicine and other contingency expenses. Cash outflow is deducted from cash inflow to determine disposable saving of the prospective borrower. This disposable saving determines the loan capacity of the customer. The table below shows the decision making process.

**Table 4.10**  
**Study of Cash Flow for Decision Making of Loans and Advances**

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

*Source: Credit Manual of the Bank.*

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

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

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

**Table 4.11**

**Source of Income and Supporting Documents Verifying Process**

Source of Income	Supporting Documents and Verifying Process
Salary	<ul style="list-style-type: none"> <li>• Letter from the organization where the client is working.</li> <li>• Statement of bank where client's office make deposit of salary.</li> <li>• Salary sheet of the organization where the client is working.</li> <li>• Statement of Bank where client deposits his salary income.</li> </ul> <p>Any one of the document will be enough but the bank statement will be considered as most reliable one.</p>
Rental Income	
Land	<ul style="list-style-type: none"> <li>• Rental agreement specifying the plot no, area, location and owner of land.</li> <li>• Land ownership certificate.</li> <li>• Photograph of the land.</li> </ul> <p>All three documents are necessary to justify the rental income.</p>
Building	<ul style="list-style-type: none"> <li>• Rental Agreement specifying the plot no., area of land, location and are of building to be used.</li> <li>• Building completion certificate from municipality.</li> <li>• Photograph of Building.</li> </ul>
Vehicle	<ul style="list-style-type: none"> <li>• Blue Book of Vehicle – There should be no loan on vehicle.</li> <li>• Route permit of vehicle.</li> </ul> <p>These two document must be presented.</p>
Remittance Income	<ul style="list-style-type: none"> <li>• Remittance received slip.</li> <li>• Statement of remittance received in regular interval.</li> <li>• Copy of passport with valid visa.</li> </ul>
Pension Income	<ul style="list-style-type: none"> <li>• Pension receiving certificate.</li> <li>• Statement of receiving pension in bank.</li> </ul>
Other	<ul style="list-style-type: none"> <li>• Fee received for professional service rendered.</li> <li>• Any documents to support the income stated by the customer.</li> </ul>

*Source: Credit Manual of the Bank.*

Further a detailed expenses of the customer is obtained to check saving of the customer so that what the customer earns would be enough to meet his day to day expense and meet installment obligation of the bank. A study was made among 18 staff of the bank (12 Branch Manager and 6 credit staff of Head Office), asking what percentage of installment to saving or disposable income would they consider safe for lending or what standard ratio have they maintained for their branch and following result was obtained.

**Table 4.12**

**Maximum Ratio between Installment Amounts to Saving for Obtaining Loan**

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

*Source: Structured Question asked to the staff of the Bank.*

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

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

**b. Commercial Vehicle**

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

**c. Firm/Company**

Analysis of the firm and company is quite complicated than analysis of the individuals. Here the financial statement is studied in comparison with its own past data and compared with the industry average where possible. Major thing that has to

be studied is cash flow of firm and check if it is generating enough profit to pay at least the interest of the bank loan. The major item studied in the financial statement are the financial ratios like current ratio, quick ratio, debt equity ratio, solvency ratio, interest coverage ratio, gross profit and gross profitability, net profit, net profitability, return on investment, fixed asset turnover ratio and along with these ratio the physical stock verification and growth in sales, debtors/ receivable and inventory turnover are also studied.

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

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

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

## Ratio Analysis

### i. Fixed Assets Turnover Ratio

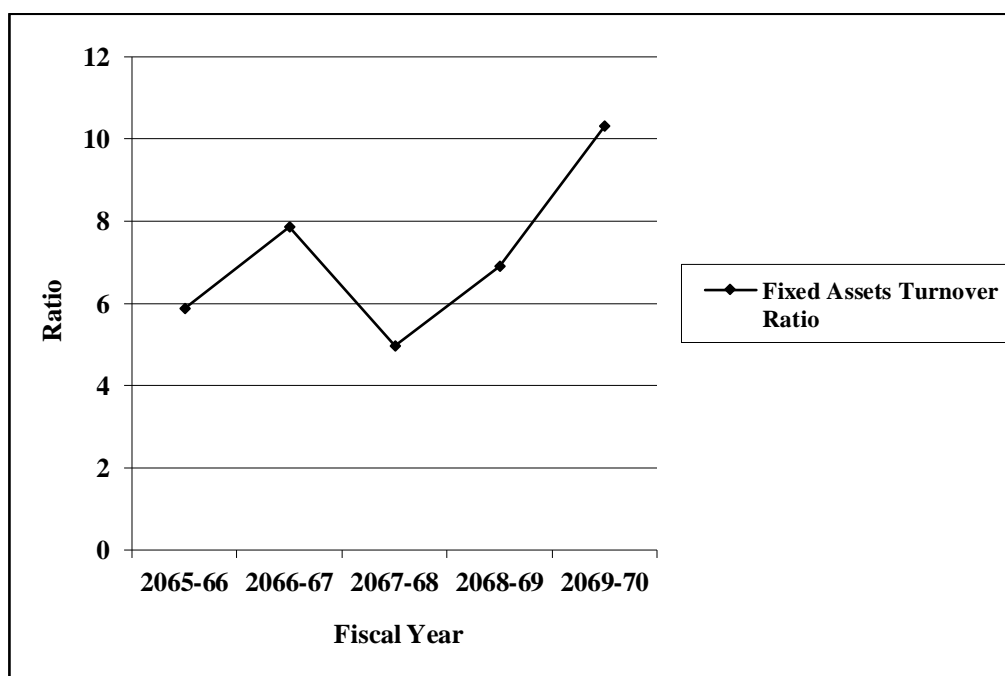
Fixed asset turnover ratio shows how well fixed asset has been utilized and when the ratio has falling trend, it shows that the capacity of the fixed asset is decreasing and it is one of the serious indicator to be checked. If there is fall in fixed asset ratio than it is not wise to make lending. Sometime,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

**Table 4.13**  
**Fixed Assets Turnover Ratio of ABC Company Limited**

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

*Source: Financial Statement of ABC Company Ltd.*

**Fig. 4.1**  
**Fixed Assets Turnover Ratio**



Fixed asset turnover ratio is calculated as net sales divided operating fixed asset. When we study the fixed asset ratio of the company it is showing rise from 5.88 to 7.86 and fall to 4.97 and again rise to 6.91 and to 10.31, respectively in the FY 2065-66, FY2066-67, FY 2067-68, FY 2068-69 and FY 2069-70. The figure of the FY

2068-69 and FY 2069-70 are projected figure of the company. Though there is fall in fixed asset turnover ratio in year FY 2067-68, but there is consistent increase in the fixed asset turnover ratio, hence the ratio is showing good increasing trend. Further there is increase in fixed assets as well, hence there is additional of new assets which is increasing the operation of the firm. Hence according to the study of this ratio the lending to the firm is viable.

**ii. Return on Investment (ROI)**

Operating ratio is calculated as operating profit divided by operating assets. Here operating assets includes both operating fixed assets and current assets. Table no. shows the return on investment of the company.

**Table 4.14**

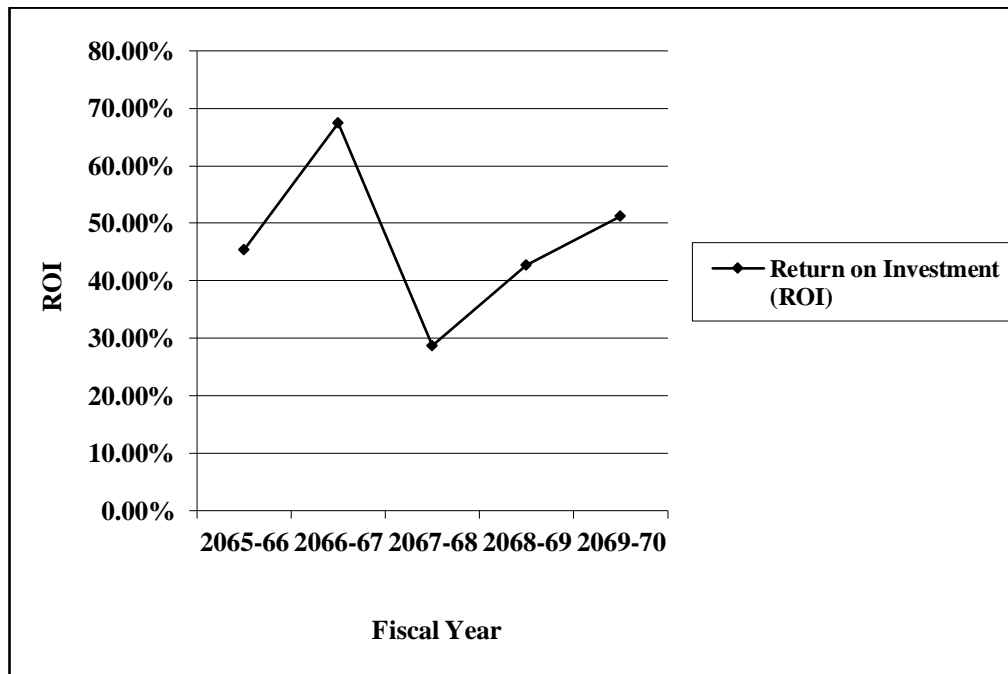
**Return of Investment of the ABC Company Limited**

	2065-66	2066-67	2067-68	2068-69	2069-70
Return on Investment (ROI)	45.41%	67.44%	28.71%	42.67%	51.29%

*Source : Financial Statement of the ABC Company Limited.*

**Fig. 4.2**

**Return on Investment of ABC Company Limited**



When a trend analysis of the return on investment of the company is made, there is rise from 45.41% to 67.44% and after that there is fall to 28.71%. After that there is rise of 42.67% and to 51.29% in FY 2065-66, FY2066-67, FY 2067-68, FY 2068-69 and FY 2069-70 respectively. Though there is fall in the return on investment it is still

above than the normal return of 12% to 15% or maximum rate of interest charged by the bank i.e. 18%, hence it is quite feasible to lend as per return on investment ratio. If the trend was only decreasing then it would be quite a serious thing to consider but there is again rise in return on investment.

### iii. Gross Profit Ratio

Another operating ratio that is good measure of the viability of project is gross profit which is calculated as gross profit divided by net sales. The table no. shows gross profit ratio of ABC Company Limited.

**Table 4.15**  
**Gross Profit Ratio of ABC Company Limited**

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

*Source : Financial Statement of ABC Company Limited.*

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

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

### iv. Equity-Total Debt Ratio

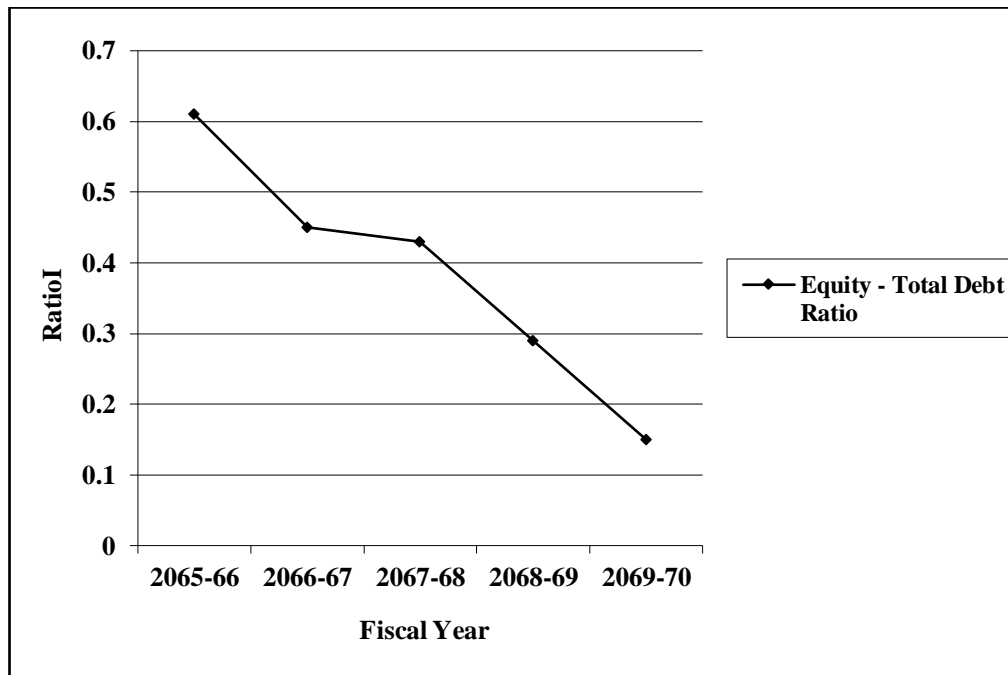
Equity–Total Debt Ratio measure the long term financial risk of the business. It also attempts to measure the efficiency of the company in striking a balance between risk and profitability in its capital structure because these two are often inversely related to each other. The standard norm is that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

**Table 4.16**  
**Equity – Total Debt Ratio**

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

*Source : Financial Statement of ABC Company Limited.*

**Fig.4.3**  
**Equity – Total Debt Ratio**



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

**v. Equity–Short Term Debt Ratio**

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

**Table 4.17**

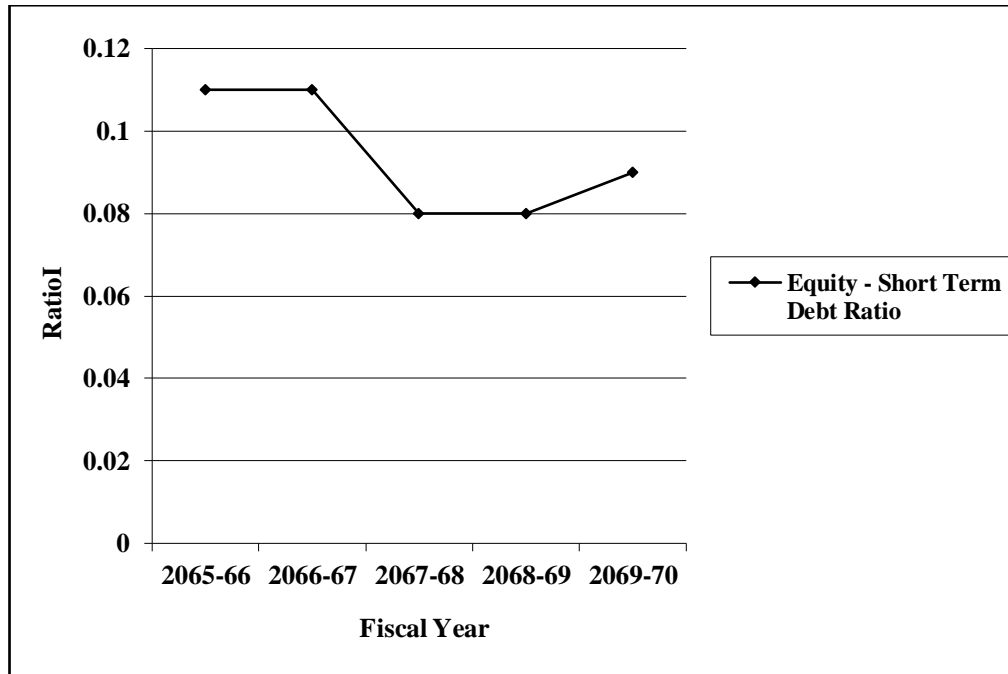
**Equity-Short Term Debt Ratio**

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

*Source : Financial Statement of ABC Company.*

**Fig. 4.4**

**Equity-Short Term Debt Ratio**



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

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

**vi. Current Ratio**

This is the most common and most widely used financial ratio for the study of firms and companies over the world. This ratio is calculated as current assets divided by current liabilities. The standard for this ratio is 2 which shows that current liabilities be just half of its current assets. But in case of your company it is hovering around 10 i.e. current assets is around 10 times of current liabilities. This shows a bit mismatch

in current asset and current liabilities but what has been discussed earlier that the Nepalese market does not prefer credit sales and higher cost on credit sale are the reason for company not preferring higher amount of current liabilities.

**Table 4.18**

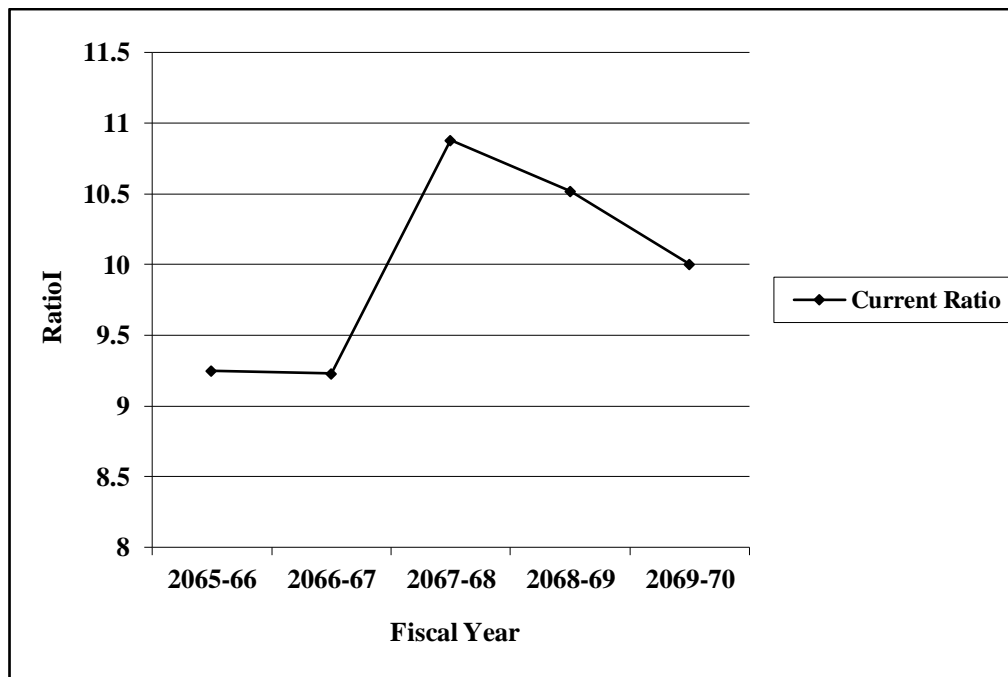
**Current Ratio of ABC Company Ltd.**

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

*Source: Financial Statement of ABC Company Ltd.*

**Fig. 4.5**

**Current Ratio of ABC Company Ltd.**



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

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

**vii. Inventory Turnover Ratio**

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

$$\text{Inventory Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Inventory}}$$

$$\text{No. of Days of Stock Holding} = \frac{\text{Inventory} \times 365}{\text{Cost of Goods Sold}}$$

**Table 4.19**

**Inventory Turnover Ratio and No. of Days Holding of Inventory**

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

*Source: Financial Statement of ABC Company Ltd.*

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

**viii. Interest Coverage Ratio or Debt Service Coverage Ratio**

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

$$\text{Interest Coverage Ratio} = \frac{\text{Profit Before Tax and Interest} + \text{Depreciation}}{\text{Interest} + \text{other obligation to the bank}}$$

**Table 4.20**

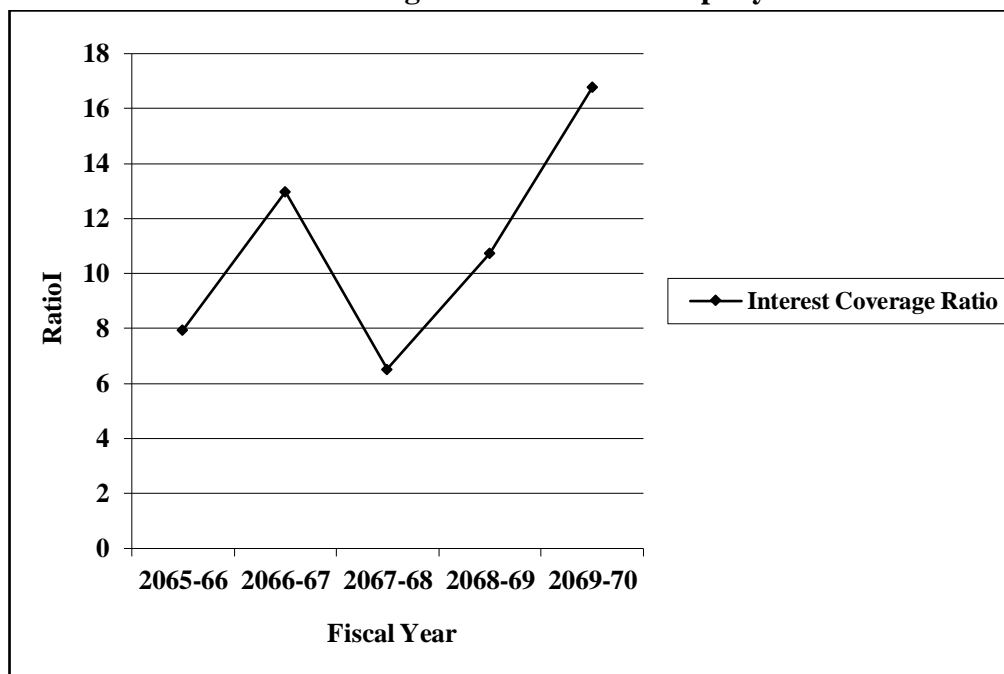
**Interest Coverage Ratio of ABC Company Ltd.**

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

*Source: Financial Statement of ABC Company Ltd.*

**Fig. 4.6**

### Interest Coverage Ratio of ABC Company Ltd.



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

#### ix. Receivable Turnover Ratio

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

**Table 4.21**

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

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

*Source: Financial Statement of ABC Company Ltd.*

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

**x. Payable Turnover Ratio**

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

**Table 4.22**  
**Payable Turnover Ratio and No. of Day of Holding of Creditors**

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

*Source: Financial Statement of ABC Company.*

Holding of payable is 18.25 days, which is less than a month. This shows that the repayment of the company is good. Since the interest payment or installment of the bank will be on monthly basis the payment of the company will be good.

As the financial ratios and operating ratios of the firm is good it is safe for lending and now how much to lend is determined by what kind of loan is requested by the firm. If the firm is requesting for long term loans for purchase of plant & machinery, purchase of land or building or construction of building than installments or obligation meeting capacity of the firm is tested which determines the amount of loan i.e. interest coverage or debt servicing ratio should be more than 1. Further if the request is for short term cash need like working capital or overdraft loan than cash conversion cycle is studied along with the working capital of the firm.

**4.1.1.8 Interest Rate and Charge**

CPG of the bank has left the management for determining the interest rate and charges applicable for the credit facilities provided by the bank. Though the CPG has given the discretionary power to determine the rate of interest and other applicable charges, it is mandatory to approve such rate of interest and charges from the board of directors of the bank. Prior to changing the rate of interest and charges and applying new rates, the management needs to obtain approval from the board. The management of the bank will obtain approval of rate of interest within a rage so that they will be

able to charge the interest depending on the risk factor associated with the credit facility.

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

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

**Table 4.23**  
**Sector Wise Weighted Interest Rate**

<b>S.N</b>	<b>Types of Loan</b>	<b>No. of Files Studied</b>	<b>Interest Rate</b>
1	Business Loan	26	15.47%
2	Housing Loan	13	16.17%
3	Personal Loan	22	17.13%
4	Hire Purchase Loan	13	16.83%
5	Auto Loan	13	16.77%

*Source: Internal Record of the Bank.*

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

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

- Auto Loan

Weighted interest of the sector was calculated for each sector and the calculated interest is illustrated in the table no. , Sector Wise Weighted Interest Rate. The rate of interest rate charged on different sector loan is different and the reason is due to the risk associated with that sector as a whole. Rate of interest on business loan is least i.e. 15.47% and maximum is in personal loan i.e. 17.13%. The reason of charging higher rate on personal loan is due to the uncertainty of the use of fund obtained from the bank and during the time of real estate boom, large number of people were involved in real estate and the fund was diverted in real estate hence the rate of interest is higher. Further NRB, will categorized personal loans and advances with limit greater than 5 million as real estate hence this is also another reason for charging higher rate of interest on the loans and advances.

The reason for lower rate of interest on business loan is not only less risk associated with it but also the greater limit of loan in that sector. When the limit of loan is higher the rate will fall and when the limit is lower than interest rate will be higher. This can be best studies with the composition of loans and advances in total loan.

Pie Chart no. Composition of Loans and Advances of FY 2068-69, shows composition of loans and advances. The chart shows that Business loans covers 63.39%, Hire Purchase and Auto Loan covers 16.27%, Other Loans covers 7.8%, Home Loan covers 6.65% and Real Estate Loan covers 5.85%. Hence the loan in business is highest so the rate is lower in business loan. Detail of composition of loans and advances has been done in ratio analysis section.

#### **4.1.1.9 Decision Making and Mitigating Risk Associated**

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

- Limit and type of credit facility.
- Tenure of loan and mode of repayment.
- Interest rate per annum and other charges.
- Disbursement criteria.
- What the borrower has to offer as collateral security.

- Who needs to provide personal guarantee.
- Charges on default of loan and authority of the bank when the credit goes in default.
- Binding clauses what the borrower has to do and should not do.
- Borrower will be accept change in terms and condition imposed by the bank and NRB.
- Will be bind by prevailing laws of the nation.
- Other special terms agreed between borrower and the bank.
- Any other terms and conditions that the bank feels necessary to put in the contract.

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

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

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

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

After the contract is signed and applicable charges are deposited by the borrower then, mortgaged of the property will be made in concern malpot or ownership is transferred in the name of the bank in case of vehicle.

After the completion of all these documents, legal risk of the credit facilities is mitigated.

#### **4.1.1.10 Disbursal of Loan**

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

#### **4.1.1.11 Repayment of Loan**

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

- Installment—interest on outstanding principle and part of principle every month or quarter.

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

- Interest only on monthly or quarterly and principle at maturity.

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

The repayment of loan is checked by the NPL of the bank; if the NPL of the bank is low the repayment of the loan is good but if NPL is high repayment of loan and

advances is not good. This is because the provision and categorization of loan is done on the basis of ageing of due of the outstanding of the loans and advances. The table below shows the categorization of loan on the basis of ageing.

**Table 4.24**

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

<b>Name of Loan and Advances</b>	<b>Provision Required</b>
Standard Loans and Advances	No Dues or Dues outstanding till 3 months
Sub-standard Loans and Advances	Due outstanding more than 3 months and less than 6 months
Doubtful Loans and Advances	Due outstanding more than 6 months and less than 1 year
Bad or Loss Loans and Advances	Dues outstanding more than 1 year

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

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

**4.1.1.12 Recovery of Loan**

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

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

- Extending the time of credit facility, however; the extended time duration should be no more than 6 months from the time of expiry of loan.

- By making agreement with the customer and changing the terms and condition that is feasible to the customer.
- Transferring collateral security in the name of the bank.
- Initiating legal action.
- Auctioning of collateral security or securities of the borrower.
- Any other method that is suitable for recovery of loan to the borrower and management.

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

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

#### **a. Auction of the Collateral Security**

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

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

**Table 4.25****Action taken by Bank according to Outstanding Dues on the Basis of Ageing**

<b>Duration of Default</b>	<b>Action to be taken by management</b>
<b>Stage 1.</b>	
Default is less than 3 months – (Reminder of dues and installment)	Inform the customer about the dues and installment dues through telephone
Default is more than 3 months but less than 4 months – (Meeting with customer)	Meet the customer and learn about the difficulties and problem faced by the customer. If the customer has some kind of serious problem that is beyond his control than ask for his/her application for time extension for repayment of dues. If the borrower has no serious problem than ask him/her to repay the dues to the bank.
<b>Stage 2.</b>	
Default more than 2 months and less than 5 months – ( 35 Days letter to clear the dues)	If the customer does not pay the dues even when the bank official meets him or her than the bank will issue letter reminding him or her about his or her due to the bank. The letter shall be issued with strict instruction that the dues needs to be cleared within 35 days from the date of letter.
Default more than 6 months and less than 7 months – (15 days letter to clear the dues)	When the borrower is issued a letter instructing him or her about clearing dues within 35 days and still the borrower does not clear the due or does not initiate any procedure for payment of dues than the bank shall issue a letter instructing the borrower that he or she has to clear the due by 15 days from the day of letter else the bank will publish public notice in the newspaper for repayment of entire loan.
<b>Stage 3.</b>	
Default is more than 8 months and less than 10 months–(35 days Public Notice for clearing entire loan and due)	When the borrower is issued two letters of 35 days and 15 days to clear the dues or else the publish notice in the newspaper and still the borrower is reluctant to repays the dues than the management of the bank will publish public notice in newspaper for clearing entire loan amount due to the bank within 35 days from the date of public notice.
Default is more than 10 month and less than 12 months – (15 days public notice for clearing entire loan and due to the bank)	When a 35 days of public notice in newspaper is published to clear entire loans and outstanding to the bank and still the loan is not recovered than the public bank will publish final notice in newspaper asking borrower to clear all the loan and due to the bank within 15 days from the date of publish of such notice in newspaper or else initiate legal process and auction the property to recover the loan.

<b>Stage 4.</b>	
Default is more than 1 year –(35 Days Public Notice of Auctioning of Collateral Property)	Two letters to clear the due and two public notice in newspaper to clear all the loan and due to the bank and still the borrower does not clear the loan and due to the bank than the bank shall publish a public notice in the newspapers stating that the borrower repay entire loans and dues to the bank or else at the end of 35 days the bank shall initiate legal process of auction and auction the property.
7 Days of collection of Seal Bid from the interest buyer of the collateral security	No initiation from the side of default borrower to repay the loan outstanding with the bank than the bank will start the auction process and collect the seal bidding from interested buyer of the collateral property in the prescribed format of the bank. 5% of cash margin has to be deposited in the bank by the interested buyer of the price he is ready to offer for the collateral security.
<b>Stage 5.</b>	
Auction of Property	<p>The seal bid submitted by the interest borrower shall be opened in the stated day in the public notice in presence of the following representative for different organization.</p> <ul style="list-style-type: none"> <li>• Representative from the Office of Government of Nepal</li> <li>• Representative from the Office of Nepal Police</li> <li>• Representative from Municipality or Village Development Committee</li> <li>• Staff from the bank</li> </ul> <p>Seal Bid shall be opened in presence of all these representatives and the bidder who has bided highest amount shall win the bid.</p> <p>The highest bidder shall deposit the remaining amount to the bank deducting 5% cash deposit that he/she has deposited in the account of the bank within 15 days from the date of auction and the bank shall transfer the ownership title to such bidder. However, if the bidder is not able to deposit remaining amount within the stipulated time than bank will forfeit such deposit and transfer the ownership to the second highest bidder in the auction.</p>
Stoppage of Auction Procedure	<p>In the following event the bank will stop the auction procedure.</p> <ul style="list-style-type: none"> <li>• If the borrower repays the entire loan amount to the bank</li> <li>• If the court of law send a stoppage notice to the bank for stopping the auction process</li> <li>• If the borrower repays entire interest dues to the bank and apply written application for time extension than the bank will stop the auction and provide time duration of at the most 6 months.</li> </ul>

*Source :Field Survey 2012.*

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

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

**b. Transferring the Ownership of Collateral in the Name of the Bank**

There are cases when the auction of the property will also not recover the loan amount sanctioned to the borrower and the bank will not have any other option than to transfer ownership of the collateral in the name of the bank. CPG of Shangri-la Development is very clear how to obtain the ownership in the name of the bank and at what conditions shall the bank obtain the ownership of the collateral in the name of the bank. CPG of Shangri-la Development allows the bank to obtain the ownership of the collateral in the following conditions.

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

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

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

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

**c. Use of the Non Banking Assets, Provisioning of Loans, Write off of Default Loan and other**

The non banking assets shall be used properly by the bank and the bank needs to sell the such property as soon as possible and as stipulated in the directive of Nepal Rastra Bank.

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

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

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

#### **4.1.2 Financial Analysis of SDBL**

##### **4.1.2.1 Loans and Advances of the Bank**

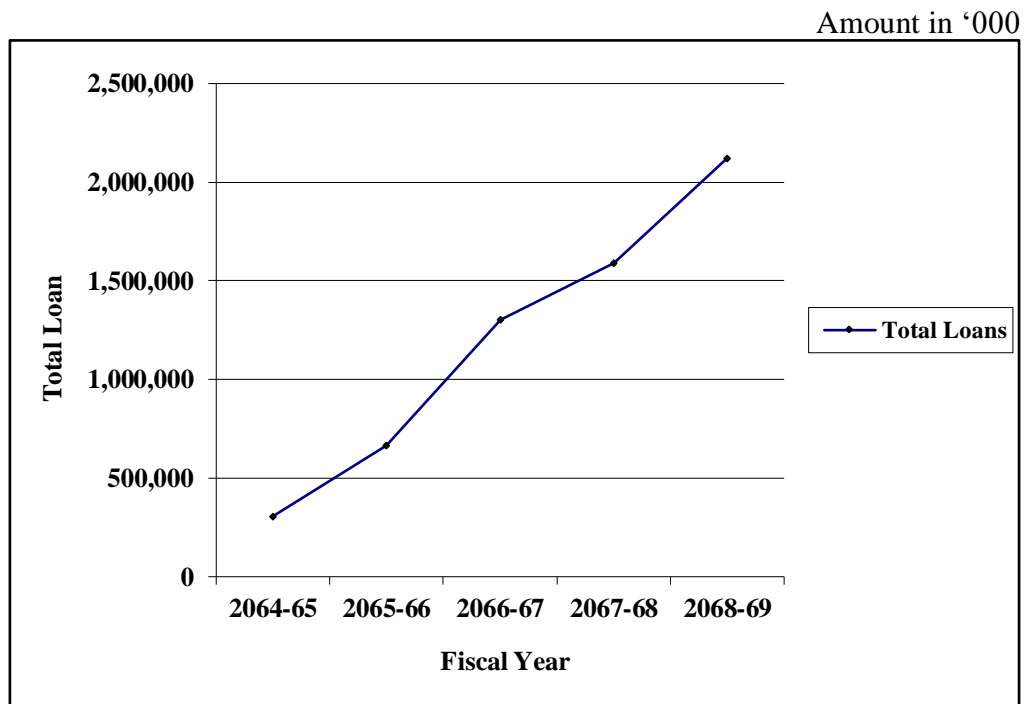
When a study of last five years data is made, Shangri-la Development has made continuous growth in its loans and advances. In the initial stage of the bank the growth in loans and advances seems to be much higher than in the later years. From the Table Loans and Advances and its growth, it is clear that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

**Table 4.26**  
**Loans and Advances and Its Growth**

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

*Source: Unaudited Financial Report of Shangri-la Development.*

**Fig. 4.7**  
**Growth of Loans and Advances**



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

**Table 4.27****Composition of Loans and Advance of Shangri-La Development Bank Ltd.**

Types of Loans and Advances / Year	2066-67		2067-68		2068-69	
	Amount	%	Amount	%	Amount	%
Real Estate Loan	205,666.42	15.76%	156,179.09	9.82%	124,075.47	5.85%
Home Loan / Residential Real Estate	113,867.89	8.73%	106,015.00	6.67%	141,042.74	6.65%
Margin Type Loan	2,800.00	0.21%	1,983.00	0.12%	1,105.00	0.05%
Business Loan - Capital Investment (Term Loan)	103,607.14	7.94%	155,340.19	9.77%	296,147.87	13.95%
Business Loan - Overdraft Loan / Working Capital Loan	556,965.00	42.69%	719,638.92	45.25%	1,049,274.88	49.44%
Hire Purchase / Auto Loan	259,872.16	19.92%	336,588.93	21.16%	345,231.93	16.27%
Others Loans	62,020.84	4.75%	114,565.67	7.20%	165,568.35	7.80%
Total Loans & Advances	1,304,799.45	100.00%	1,590,310.80	100.00%	2,122,446.24	100.00%

Source : Unaudited Financial Reports of the Bank.

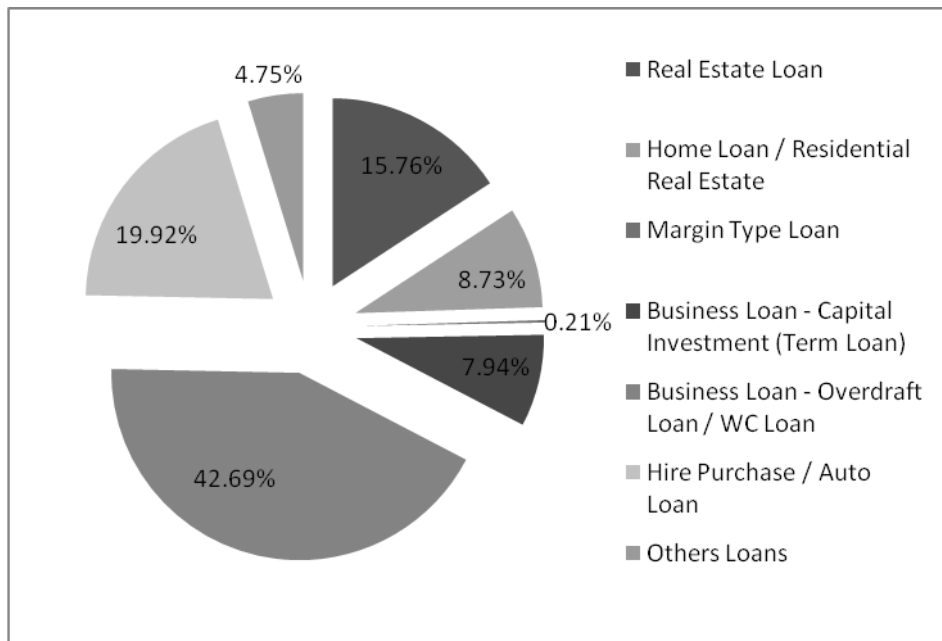
Let us make a study of composition of loans and advance of the bank. Prior to study of the composition of loans and advances it is better to know what sort of loans has been categorized in particular heading.

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

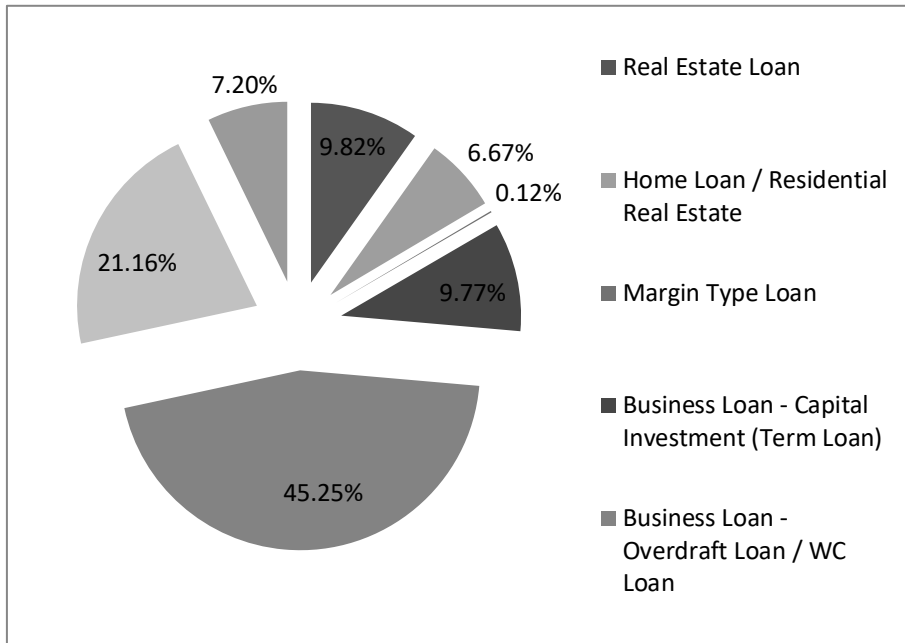
- Hire Purchase and Auto loans are the loan sanctioned against the security of vehicle and provided to individual and corporate house for commercial use or private use.
- Other Loans cover the remaining loans like Loan against Gold & Silver, Loan against FDR, Micro Finance Credit, lending on deprived sector, education loan and all other consumption loans and advances.

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

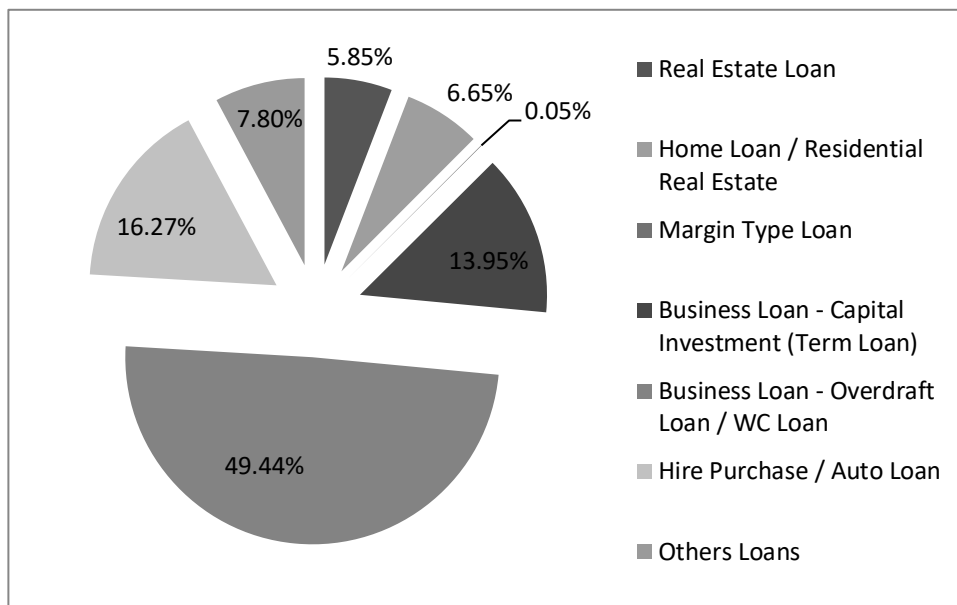
**Fig.4.8  
Composition of Loans and Advances FY 2066-67**



**Fig. 4.9**  
**Composition of Loans and Advances FY 2067-68**



**Fig. 4.10**  
**Composition of Loans and Advances - FY 2068-69**



The fig. show that very large share of the loans and advances is covered by business loans. After business loan is hire purchase loans which covers 19.92%, 21.16% and 16.27% respectively in the FY 2066-67, 2067-68 and 2068-69. One point to note is that there is drastic fall in the real estate loan over the study period. We all know that real estate business boomed in the FY 2066-67 and there was fall in the real

estate business. Even during that time the exposure in real estate loan was just 15.76% and its percentage over the total loan has fall sharply. Not only the percentage of loan has fall over the total loans and advances, but the absolute amount has also fall down. This shows that there is very little risky asset in the portfolio. This fact has been supported by low NPL and higher return on the loans and advances which shall be dealt in the passage below.

#### **4.1.2.2 Interest Income and Average Yield on Loans and Advances**

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

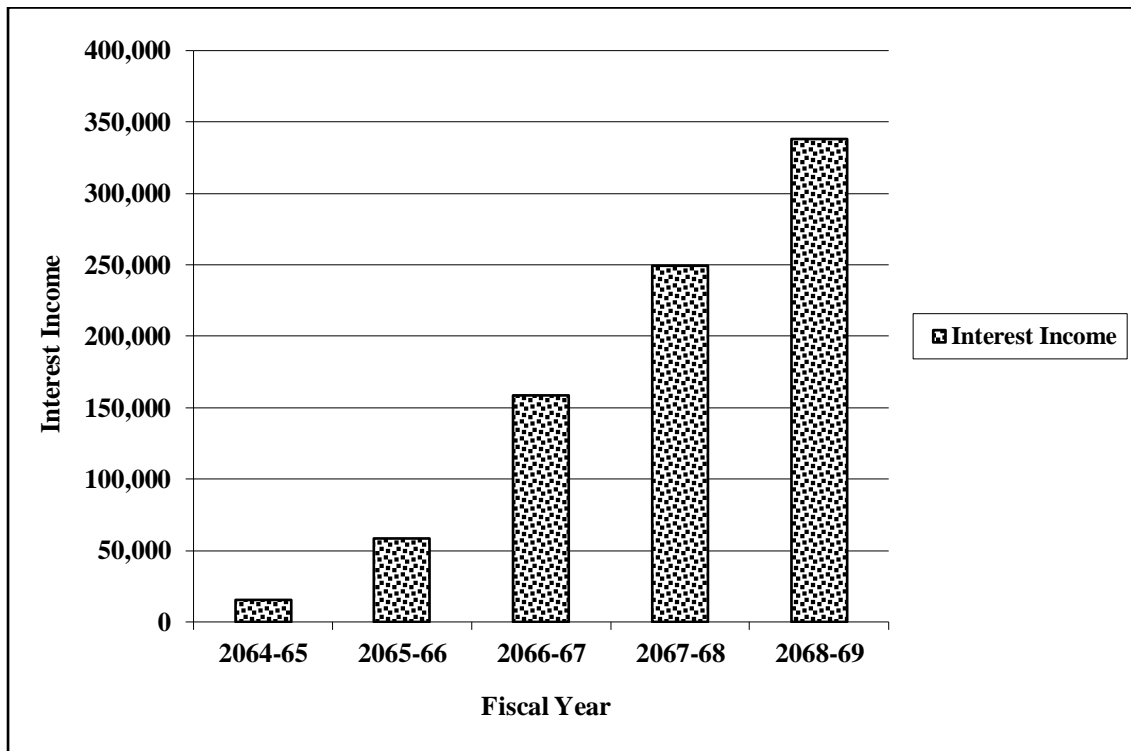
**Table 4.28**  
**Interest Income, Growth of Interest Income and Average Yield on Loans and Advances**

	Amount in '000				
	<b>2064-65</b>	<b>2065-66</b>	<b>2066-67</b>	<b>2067-68</b>	<b>2068-69</b>
Interest Income	15,166	58,733	158,383	249,540	338,294
Growth		287.27%	169.67%	57.55%	35.57%
Average Loans	152,881	521,478	1,121,554	1,454,014	1,914,937
Average Yield on Loan	9.92%	11.26%	14.12%	17.16%	17.67%

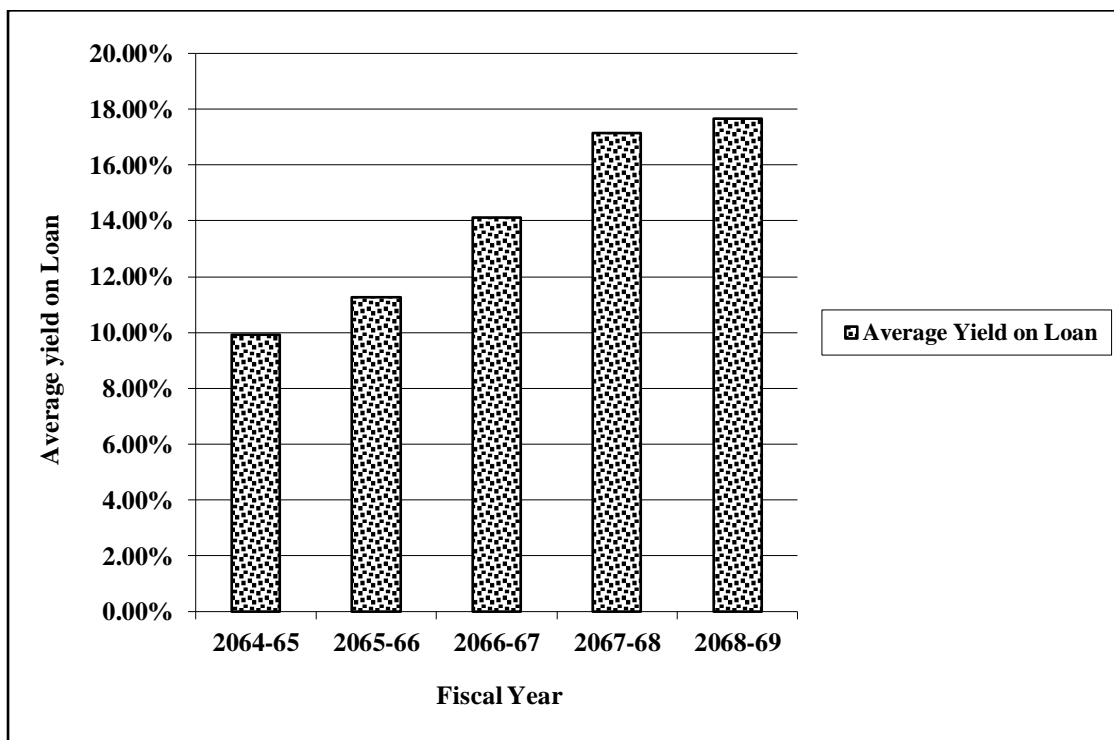
Source : Unaudited Financial Report of SDBL

\* *Note* - Average Yield on Loan = Interest Income divided by Average Loans  
 - Average Loan = Sum of loans of 4 quarter divided by four quarter

**Fig. 4.11**  
**Interest Income of SDBL**



**Fig. 4.12**  
**Average Yield on Loans and Advances**



We can see that interest income of the bank has increased sharply and when compared between FY 2064-65 and FY 2065-66, there is increase of as high as 287.27%. When

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

#### **4.1.2.3 Net Interest Income and Spread Rate**

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

**Table 4.29**

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

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

*Source: Unaudited Financial Reports of the Bank.*

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

#### **4.1.2.4 CD Ratio-Credit Deposit Ratio**

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

**Table 4.30**

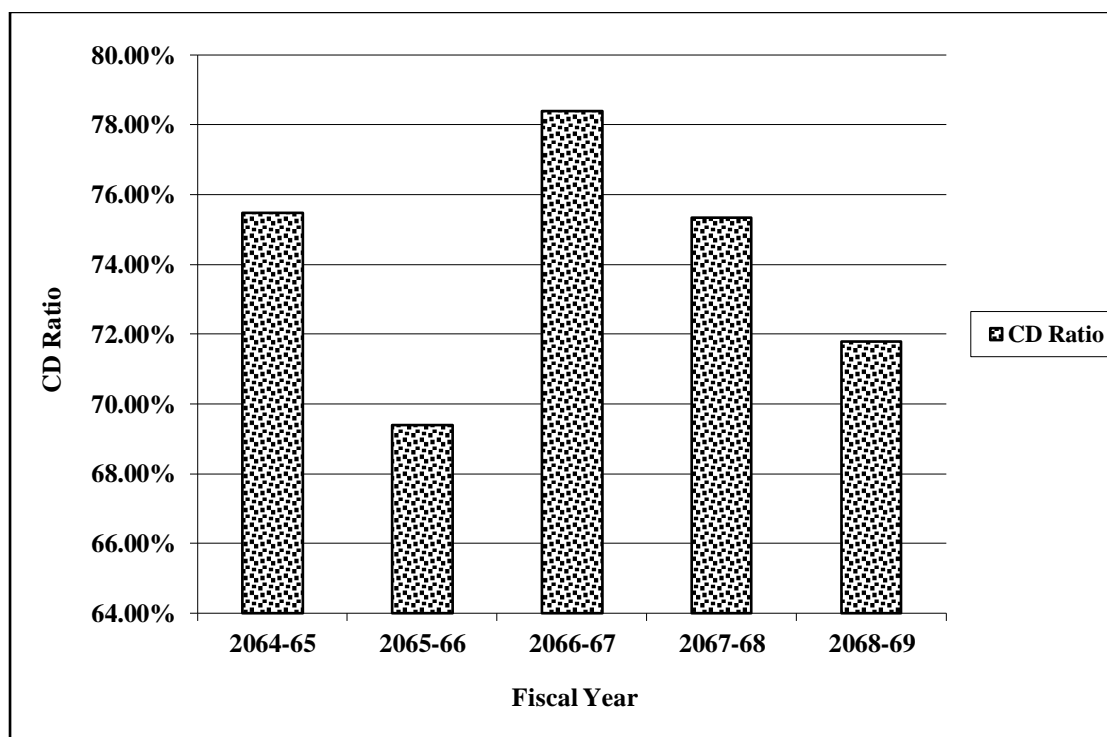
**CD ratio of Shangri-la Development Bank Ltd.**

	<b>2064-65</b>	<b>2065-66</b>	<b>2066-67</b>	<b>2067-68</b>	<b>2068-69</b>
CD Ratio	75.47%	69.40%	78.39%	75.35%	71.79%

*Source: Unaudited Financial Report of the Bank.*

**Fig. 4.13**

**CD Ratio of the SDBL**



Bank's CD ratio hovers around 75% to 80% a upper limit fixed by the central bank of Nepal, hence the CD ratio of the bank is good except in the FY 2056-66 and FY 2068-69 where CD Ratio is 69.40% and 71.79% respectively. But one point to note is that during the second half of FY 2068-69 there was very growth of deposit in the economy and all the banks and financial institutions had higher growth in deposit than in their lending. Hence when compared to the industry average of 65% in FY 2068-69 the CD ratio of the bank is very good. Hence the utilization of deposit of the bank is good. Further the growth of deposit exceeded in only those financial institution which has good image in the market hence the image of the bank in general public is good which shows the standing of the bank is good and one of the major indicator of goodness is good credit as well.

#### **4.1.2.5 Non Performing Loan (NPL) or Sub Standard Loan**

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

**Table 4.31**  
**Non Performing Loans and Percentage of Non Performing Loan to Total Loans**

	Amount in '000				
	<b>2064-65</b>	<b>2065-66</b>	<b>2066-67</b>	<b>2067-68</b>	<b>2068-69</b>
NPL	-	2,784	6,132	5,566	15,918
NPL/Total Loans	-	0.42%	0.47%	0.35%	0.75%

*Source: Unaudited Financial Reports of the Bank.*

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

However, without knowing what the population consist of would not be good. Because there are few development banks whose NPL is more than 50% like Nepal Industrial Development Corporation whose NPL is 71.81% and Gorkha Development Bank whose NPL is 50.69% and after these two the third one is United Development

Bank whose NPL is 12.98%, fourth one is Public Development Bank whose NPL is 9.07% and the fifth one is Vibor Bikas Bank Ltd. whose NPL is 6.64%. Table No. shows NPL of five developments whose NPL is highest and calculation of NPL of the remaining developments banks.

**Table 4.32**  
**Industry Average NPL of Development Banks (Mid July 2011) and Highest five NPL Development Banks**

Amount in '000

Name of Development Banks	Total Loans	NPL	NPL to Total Loans
Total Loans of Development Banks	889,690	37,771	4.25%
Public Development Bank	5,696	516	9.07%
ViborBikas Bank	24,135	1,558	6.46%
GorkhaDevelopment Bank	38,567	19,548	50.69%
United Development Bank	697	90	12.98%
Nepal Industrial Development Corporation	13,035	9,361	71.81%
Total of Top Five NPL Development Bank	82,133	31,075	
Total Loans Except top Five	807,557	6,695	0.83%

*Source: NRB (Banking and Financial Statistics, Mid July 2011).*

As per the table no. 4.30, shows that the average NPL of development is 0.83% and compared to that NPL Shangri-la Development Bank is less than industry average which is 0.35%. NPL of 0.35% is less than 50% of the industry average which shows that the asset quality of the bank or loans and advances of the bank is good one.

Not only that when average NPL of development banks over last four years is compared the asset quality of Shangri-la Development is good. The Table No. 4.30 shows comparison of NPL of Shangri-la Development Bank with the average NPL of Development Banks.

**Table 4.33****Comparison of NPL of Shangri-la Development Bank with Average NPL of Development Banks**

Amount in '000

Year	Development Banks			Shangri-la Development Bank		
	Total Loans	NPL	NPL to Total Loans	Total Loans	NPL	NPL to Total Loans
2064-65	21,332,300	809,000	3.79%	306,715	-	-
2065-66	39,684,395	598,770	1.51%	662,956	2,784	0.42%
2066-67	90,706,746	1,099,284	1.56%	1,304,799	6,132	0.47%
2067-68	889,690	37,771	4.25%	1,590,310	5,566	0.35%

*Source: Nepal Rastra Bank (Banking and Financial Statistic) and Unaudited Financial of Shangri-la Development Bank Ltd.*

In the FY year Shangri-la Development Bank has no NPL and the industry average is 3.79%, in FY 2065-66 Shangri-la Development Bank has NPL of 0.42% and Industry Average is 1.51%, in FY industry average is 1.56% and that of Shangri-la Development Bank is 0.47 and finally in FY 2067-68 NPL of Shangri-la Development Bank Ltd. is 0.35% and that of industry is 4.25% hence from the start of its operations Shangri-la Development Bank has low NPL and this a good sign that the asset qualities of the Bank is good. It shows that the management of the bank has managed their portfolio in a better fashion.

**4.1.2.6 Provision for Loan Loss**

Provisioning is a way of securing against the possible loss and provision of loan loss is the way to separate certain portion of profit to secure against the probability of loan and advances going bad. It is not certain that the loans and advances granted to the people and business entity will always be good and secure, hence to protect against the bad loans, banks and financial institutions will make provision for the possible loss due to loans and advances turning bad. When a provision is adequately made then even when the loan and advance turns bad, then the bank will be able to maintain quite well. The portion of bad loans covered by provision will not make any threat to the banks and financial institutions unless the profit of the banks and financial institution is hit hard. The table below, Table No. 4.32 shows provision made by the bank and percentage of NPL to Provision.

**Table 4.34****Provisions for Possible Loan Loss and Percentage of NPL to Provision**

Amount in '000

	<b>2064-65</b>	<b>2065-66</b>	<b>2066-67</b>	<b>2067-68</b>	<b>2068-69</b>
Provision	3,067	7,238	16,205	18,087	28,016
NPL	-	2,784	6,132	5,566	15,918
Provision/ NPL	-	259.95%	264.26%	324.96%	176.00%
Total Loans	306,715	662,956	1,304,799	1,590,310	2,122,446

*Source: Unaudited Financial Statement of Shangri-La Development.*

The table shows that so far non performing loans and advances are adequately provisioned. In the FY 2064-65 there is no non-performing loans but the bank has made provision of 3067.15 thousand, in FY 2065-66 there is NPL of 2784.42 thousands and bank has provision of Rs.7238.09 which is 259.95% of the NPL. Likewise in the FY 2066-67 there is NPL of 6132.56 thousands and provision has been set of Rs.16205.90 which is 264.26% of NPL. Similarly in the FY 2067-68 there is 5566.09 thousand NPL and provision of 18087.56 thousands has been made which is 324.96%. In the same way in FY 2068-69 there is NPL of 15918.35 thousand and the Bank has made provision of Rs.28016.45 thousand which covers 176.00%. Hence the non performing loans and advances has been adequately secured and even if the provisioned amount's loans and advances goes bad as well it will not affect the bank. The data from above table shows that credit of the bank is managed properly. The risk of the loans and advances has been mitigated quite while by setting a provision for the possible loan loss.

**4.1.2.7 Capital Adequacy**

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

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

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

Risk is assigned from 0% to 150% for different assets according to their inherent risk.

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

In case of Shangri-la Development Bank it has been able to maintain required level of capital through the study period. Table No. : Capital Adequacy of Shangri-la Development Bank Ltd.

**Table 4.35**  
**Capital Adequacy and Core Capital of Shangri-la Development**

Amount in '000

	<b>2064-65</b>	<b>2065-66</b>	<b>2066-67</b>	<b>2067-68</b>	<b>2068-69</b>
Capital Adequacy	11.37%	11.55%	11.59%	22.70%	17.74%
Core Capital	39,900	82,678	148,843	367,125	384,640

*Source: Unaudited Financial of the Bank.*

What is evident from the table is that in the first three FYs, FY 2064-65, FY 2065-66 and FY 2066-67, Capital Adequacy of the bank is hovering around the required level. From the table no. above in the first three years the capital is Rs.39,900 thousand, Rs.82,678 thousand and Rs.148,843 thousand respectively which compared to later years is less than half. Capital adequacy of FY 2068-69 is lower than FY 2067-68 even though the core capital of later year is more than the former year because the growth of loans and advance is more compared to the FY 2067-68. Hence, when the loans and advance of the bank increases then the capital requirement of the bank will increase too and this how the loans and advances of the bank will be limited by its capital as well.

## 4.2 Major Findings

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

- CPG of the Shangri-la Development Bank makes mandatory to make detail study of the Background of borrower prior to making lending decision by Bank's Management.
- NRB has made it mandatory to obtain CIB Report of the borrower prior to sanctioning of loan with limit greater than one million.
- CPG of Shangri-la Development Bank has let the management of the bank to decide the percentage of lending in the project. While making study of the different projects it was discovered that
  1. The Business loan has loan to FMV ratio of 50.24%
  2. Housing Loan has loan to FMV ratio of 54.57%
  3. Personal Loan has loan to FMV ratio of 46.57%
  4. Hire Purchase loan has Loan to FMV ratio of 74.30%
  5. Auto Loan has loan to FMV ratio of 58/74%
- CPG of Shangri-la Development bank has enlisted the sector for providing credit facility and those sectors are thoroughly studied through CAM prior to making credit sanctioning decision. Shangri-la Development Bank's has exceeded 100% in some of the sector in all the study period as follows
  1. Transport, Communication and Public Utilities with 216.19%, 175.50%, 150.20% in FY 2064/65, FY 2065/66 and FY 2066/67 respectively.
  2. Other Sector with 267.67%, 302.42%, 295.57%, 130.79% and 180.41% in FY 2064/65, FY 2065/66, FY 2066/67, FY 2067/68 and FY 2068/69 respectively.
  3. Finance, Insurance and Real Estate with 110.01% and 104.93% in FY 2065/66 and FY 2066/67.
  4. Wholesaler and Retailer with 152.31% in FY 2066/67.
- Concentration risk of loans and advanced being sanctioned in particular sector or industry has been checked by NRB through 9.3 report and it has made it mandatory to obtained approval from Board prior to making lending in excess than 100% of Bank's Core Capital in single sector.

- Lending of the bank has been more diversified in the later years of study as loans and advances have been sanctioned in new sectors like Agriculture with 25.44% in FY 2068-69 and Hotel and Restaurant with 19.77% in FY 2068/69.
- Concentration of Loans and Advances of Single Group of Borrower or Single Borrower is least in FY 2067-68, i.e. minimum of 9.32% of core capital, and highest concentration of 15.60% in FY 2068-69.
- Since the percentage of loan and advances of Single Borrower or Single Group of Borrower is less than 25% of its core capital, the Bank has followed the directive issued by NRB of providing loans and advances to Single Borrower or Single Borrower within 25% of Bank's core capital.
- Percentage of Single Borrower or Single Group of Borrower with respect to Net Profit of the Bank is quite high and it is as high as 152.46% of Net Profit in FY 2066-67 and top borrower in FY 2068-69 is 119.99%. This figure is high because in case the borrower goes in default than the Balance Sheet of the Bank will be adversely affected with negative profit figure.
- CPG of the Bank has restricted bank the bank's management from providing credit facility without collateral and collateral may be land, land and building, gold and silver, shares or debentures, government bonds and securities, plants and machinery, and FD Receipts.
- NRB has not restricted the banks and financial institutions from providing credit facility without collateral but an extra provision of 20% has to be made when lending is made without collateral.
- SDBL has sanctioned very large portion of loans and advances on the basis of land and building as collateral. It is as high as 77.79% in the FY 2068-69. Second highest one is based on vehicle as collateral which is 15.86% in FY 2068-69.
- While making lending decision personal guarantee has been taken as integral part of mitigation of different risk like collateral risk, repayment risk and additional security to the loans and advances. 83.33% of the BM and Credit Staff of the bank said it is must to obtain personal guarantee of family members of the borrower.
- CPG of the banks makes detail study of repayment capacity of the borrower through CAM and it has been outlined in the credit manual of the bank as

well. Credit Manual of the bank has instructed the management that installment or obligation to the saving must be less than 80%. 100% Of the 18 staff interviewed of the bank working in credit, responded that installment or obligation to bank to saving ratio must be within 80%.

- While making lending decision of company or firm the bank makes study of operating ratios and financial ratios viz. 1. Fixed Asset Turnover Ratio 2. Return on Investment 3. Gross Profit Ratio 4. Equity – Total Debt Ratio 5. Equity – Short Term Debt Ratio 6. Current Ratio 7. Inventory Turnover Ratio 8. Interest Coverage Ratio 9. Receivable Turnover Ratio.
- Interest rates on loans and advances are different for different types of loans and advances and it was lowest for Business loan 15.47% and highest for Personal loan 17.13%.
- CPG of the Bank has divided the stage of recovery into 5 different stages and it shall auction the property of the borrower if the borrower goes into default for more than 1 year continuously.
- CPG of the bank has allowed the bank to transfer the ownership of the collateral in the name of the bank in case the property of the borrower is not bid by any buyer during the auction process of the property of the defaulted borrower.
- During the study period the composition of the loans and advances of the bank is concentrated in Business Loan with highest percentage of 63.39% in FY 2068-69 and Lowest in Margin Loan with percentage of 0.05% only in FY 2068-69.
- There is consistent growth in the loans and advances of the bank during the study period with highest growth of 116.15% in FY 2065-66.
- There is growth in absolute value of interest income of the Bank, however the growth of interest income is decreasing. The growth of interest income is highest in FY 2065-66 with growth of 287.27% and lowest growth of 35.57% in FY 2068-69.
- Average yield on loan of the bank is increasing consistently and it is highest in the FY 2068-69 with 17.67% and lowest in FY 2064-65 with 9.92%.
- Spread rate of the Bank is also in increasing trend during the study period. It is highest in FY 2-68-69 with 8.35% and lowest in FY 2064-65 with 4.90%.

- CD ratio of the Bank is hovering around 75% with average of 74.08% during study period. It is highest during FY 2066-67 with 78.39% and lowest during FY 2065-66 with 69.40%. CD ratio of the bank is within 80% ceiling put by NRB. Further the CD ratio of 71.79% during FY 2068-69 is quite high compared to industry average of 65% for the FY 2068-69.
- NPL of the Bank is highest during FY 2068-69 with 0.75% and it is quite low compare to industry average of 4.25%. During the study period NPL of the Bank is less than industry average.
- The bank has adequately provisioned against non performing loan and it has provisioned maximum during FY 2067-68 with 324.96% and lowest provision is during FY 2068-69 176%.
- The Bank has maintained capital adequacy above the standard norm set by the central bank of Nepal i.e. 11% for development banks. During the study period capital adequacy is highest during FY 2067-68 which is 22.70% and lowest during FY 2064-65 with 11.37%.

## **CHAPTER V**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **5.1 Summary**

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

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

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

The study was done by getting to the every details of the bank and tabulating necessary data wherever necessary thus facilitating the analysis. Two methods were

used for presentation of data and analysis of it, viz. one descriptive method and another financial method. Different risks associated with credit were studied and control over it by Credit Policy Guidelines of the Bank and Directives of Nepal Rastra Bank was shown.

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

## **5.2 Conclusion**

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

We can summarize the conclusions reached in the following points.

- Nepalese economy though not directly is effected by the turnouts in the world economy, which we could see in the economic slowdown of our economy too.
- Nepalese economy is largely driven by the remittance send by the migrant worker from abroad and if the remittance inflow decreased than Nepalese economy would be effected to substantial volume.
- Banking industry is the only one industry which survived all the ups and down faced by the Nation's Economy.
- Banking industry went into boom after the Nation adopted free economy policy after reinstate of democracy in 1990s and more rapidly after the end of Maoists insurgency.
- Credit Management of Banks and Financial Institutions is a rare piece of work and even if the study has been done it is mostly related to financial analysis and comparative study of commercial banks was done. Hence this study of credit policy guidelines and directives of NRB regarding mitigation of risk is an exception in this case and that two of Development Bank and Shangri-la Development Bank in special.

- The Credit Policy Guidelines of the bank is good one and has tried to address different risk associated with credit. Management of the bank has developed a good Credit Appraisal System call Credit Appraisal Memorandum (CAM) which makes detail study of the different aspect prior to making lending decision after addressing different risk associated with credit.
- CAM makes study of different credit risk like.
  - ✓ Back Ground Study / Credit History /Character risk.
  - ✓ Repayment Risk / Cash Flow.
  - ✓ Collateral Risk / Securities to be obtained and its adequateness.
  - ✓ Legal Risk /legally binding customers.
  - ✓ Capital Investment of the customer/ Project risk.
  - ✓ Condition Risk / Industry Risk.
- Bank's lending is adequately secured as the loan limit sanctioned to Fair Market Value (FMV) of collateral is less than 75% even of the sector where the Loan to FMV ratio is highest. i.e. in hire purchase sector. Likewise, the lowest one is Personal Loan which has Loan to FMV ratio of 46.69%.
- Shangri-la Development Bank has made lending within 100% of its core capital in most of the sector and has obtained approval from board where the lending has exceeded more than 100% of its core capital. The sector which exceeded lending than its core capital is other sector in FY 2068-69 and FY 2067-68. However, in FY 2066-67 four sectors had excess lending viz. 1. Transport, Communication and Public Utilities, 2. Wholesaler and Retailer 3. Finance, Insurance and Real Estate and 4. Other sector.
- Income source, collateral and background study are major things that are studied prior to making lending to the individuals and while making lending decision in case of business loan, a detail study of project, financial structure both operating and financial ratios are studied, collateral securities offered and its adequateness, future prospect of industry and its present study is made, what portion does the lending cover in total project cost, what is the background and how is character of the individuals of the firm or company is done.
- CD ratio of the bank is quite low in FY 2065-66 which is just 69.40% which shows low utilization of fund but in other years the ratio is good.

- NPL of the bank is low compared to industry average and the NPL are adequately covered by the provision made for possible loss on loan. When NPL to provision is studied the ratio is not less than 176.00% in all years and it was highest in FY 2067-68 when the ratio was 324.96%.
- Growth of the loans and advances is steady and Bank has been able to maintain its portfolio quite well. Loans and advances is highest in the FY 2069-69 which is 2,122,446,24 thousand and increasing every year.
- The capital requirement of the bank for making lending or the capital adequacy of the bank is maintained well. In the first three years this ratio hovers around minimum requirement but in the later two years it is quite high and in the FY 2067-68 it is the highest, i.e. 22.70%.
- Credit Policy Guidelines (CPG) of the bank restrict the bank from lending without collateral and the lending of the bank has been as per instructed by CPG.

### **5.3 Recommendation**

No research paper or study would be beneficial unless some recommendation can be derived from it. On the basis of the detailed study that has been performed many insights have been derived or reached and on the basis of such conclusions, following recommendations has been suggested to the management as well as other bankers.

#### **5.3.1 Lending on the basis of Personal Guarantee and Corporate Guarantee**

Lending without collateral has been restricted by CPG of the Bank, however, it is not good to restrict the lending without collateral as professional like doctors, CAs and engineers are provided loans on the basis of their earning capacity and based on their qualification and bank may miss opportunity of earning good sum of interest and service charges from the elite group of society and further it will provide good brand image of the bank in the society. However, certain limit needs to be provided as cap for lending on the basis of personal guarantee to a single borrower or single group of borrower and to certain percentage of total portfolio. May be a limit to single borrower or group of borrower should not be more than 2 million.

### **5.3.2 Setting Standard for Installment to Saving and Financial Ratios, Introducing Credit Rating**

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

### **5.3.3 Improvement in Fund Utilization**

During the study period, it is seen that the bank has not fully utilized its fund which it has collected as deposit. During FY 2065-66 it is as low as 69.4% hence for higher profitability, the bank need to focus on higher fund utilization even though the Central Bank has put the ceiling of 80% of sum of its deposit and core capital.

This can be done through proper matching of funds so that the funds are not remained idle. If the bank is can make a proper lending at the cost of fund plus spread rate to be maintained then only to obtained the deposit or focusing on the alternative investment opportunity and putting the excess fund in other investment instruments.

### **5.3.4 Repayment of Loans with Collateral as Depreciating Assets to be made more in the Earlier Period**

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

- Due to wear and tear the assets will lose its value.
- Due to change in technology, the assets will become obsolete.
- Repair and maintenance will be higher in later year and decrease the value of assets.

Hence the value of assets may be lower than the principle amount outstanding with the borrower. This may put the bank in collateral risk as the borrower may be reluctant pay the amount has what he has to pay is higher than what he gets at the end.

Further the repayment capacity of borrower may be less in later year due to high repair and maintenance cost and lower production capacity of the plant and machinery or vehicle.

Hence it is recommended to have interest installment amount in the initial year of lending in case of depreciating assets. What can be done is that in addition to the EMI a certain fixed principle repayment should be made mandatory. For example as per EMI method a borrower has to pay Rs.25,000.00 as installment than in addition to the installment a borrower to be asked to pay Rs.5,000.00 per month which to be deducted from the principle amount and subsequent installment to be same but the interest portion to be adjusted as per the outstanding balance. This method to be adopted at least to the mid life of depreciating asset or till mid tenure of loans and advances.

### **5.3.5 Reduction of Concentration in Single borrower or Single Group of Borrower**

Though the bank has followed the directive of NRB and CPG of the bank regarding loan limit for single borrower or single group of borrower and loan limit sanctioned is within the prescribed limit of 25% of core capital of the bank but when compared with the net profit of the bank the loan sanctioned to big borrower or group of borrower seems to be high. Loan limit sanctioned to the top borrower is quite high compared to the net profit of the bank, in the FY 2068-69 loan to top single borrower or top single group of borrower exceeds the net profit of the bank and it is 119.99% of its net profit and second top borrower is 82.99% and third one is 81.99% of net profit hence if the top borrower goes in default than Balance sheet of the bank will be negative and even if other top borrower goes default the profit of the bank will be very low.

Hence it is recommended to reduce the concentration of risk in single borrower or single group of borrower and bring it to the limit of around 50% - 60% of the net profit of the bank.

### **5.3.6 Making System of Internal Blacklisting**

Though the bank have followed the system of obtaining CIB report prior to sanctioning of loan limit greater than 1 million but there is lack of system of internal black listing and checking if the prospective borrower's name has been published in

the newspaper. Hence it is recommended to prepare the information system of internal blacklisting and preparing database of those person whose name has been published in the newspaper due to non payment obligation to the bank.

### **5.3.7 Diversify the portfolio of the bank further**

As the bank has exceeded 100% ceiling in few of the sector of lending it is recommended to identify new sector like hydro power, tourism and agriculture for new lending which shall further diversify the portfolio of the bank and risk of concentration of loan in few sector shall be mitigated.

### **5.3.8 Making analysis of business cycle and working capital need assessment**

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

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Unified Directives for Banks and Financial Institutions of Nepal: Nepal Rastra Bank

# ANNEX – I

## Questionnaires Given to the Employees of Shangri-la Development Bank Limited

Dear Respondents,

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

.....

**(Researcher)**

Name : .....

Position : .....

Questionnaires for Survey

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

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

2. What up to what percentage of FMV would it be safe to make lending? Please tick mark the one you feel is the minimum requirement.
  - a. Less than 40%
  - b. Between 40% to 50%
  - c. Between 50% to 60%
  - d. Between 60% to 70%

- e. Between 70% to 80%
  - f. Between 80% to 90%
  - g. Greater than 90%
3. Which sector loan in your opinion is less risky? Please rank the following sector of loan in the order of risk. Riskiest one to be ranked 1.

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

4. How much saving (Disposable Income) should a person have in order to obtain loan? Please tick the one you feel it the minimum requirement.
- a. Installment to Saving ratio should be less than 50%
  - b. Installment to Saving ratio should be between 50% - 60%
  - c. Installment to Saving ratio should be between 60% - 70%
  - d. Installment to Saving ratio should be between 70% - 80%
  - e. Installment to Saving ratio should be between 80% - 90%
  - f. Installment to Saving ratio may be more than 90%
5. Is personal guarantee necessary?
- a. Yes
  - b. No
6. If your answer to question no. 5 is yes, then tick the appropriate box of each row.

S. N	Guarantee from	Must	If Possible	Few would be enough	Not necessary
1	Guarantee of Family Members				
2	Guarantee of Brother and Sisters who have separated				
3	Guarantee of Neighbour				
4	Guarantee of Friends				

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

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## ANNEX -II

### List of Development Banks of Nepal

S.N.	Names	Date of Operations	Head Office
1	Nepal Industrial Development Corporation	15/06/1959	Durbar Marg, Kathmandu
2	Malika Development Bank Ltd.	27/12/1998	Dhangadhi, Kailali
3	Siddhartha Development Bank Ltd.	20/08/1998	Butawal-11, Rupandehi
4	United Development Bank Ltd.	16/03/2002	Jeetpur, Bara
5	Manakamana Development Bank Ltd.	19/06/2001	Heritage Plaza, Kathmandu
6	Narayani Development Bank Ltd.	17/10/2001	Ratna Nagar-1, Chitawan
7	Pashimanchal Development Bank Ltd.	2/3/2003	Butawal-8, Rupandehi
8	SahayogiBikas Bank Ltd.	21/10/2003	Janakpurdham
9	Axis Development Bank Ltd.	01/01/2004	Banepa, Kavre
10	KarnaliBikash Bank Ltd.	14/02/2004	Nepalgunj, Banke
11	Triveni Development Bank Limited	26/07/2004	Bharatpur, Chitawan
12	BhrikutiBikas Bank Limited	19/08/2004	Butawal, Rupandehi
13	Suprim Development Bank Ltd.	23/01/2004	Nayabaneshwor, Kathmandu
14	ShubhechchhaBikas Bank Limited	14/09/2004	Narayangadh, Chitawan
15	Bageshowri Development Bank Limited	19/10/2004	Nepalgunj, Banke
16	Gaurishankar Development Bank Ltd.	29/11/2004	Kawasoti, Nawalparasi
17	GorkhaBikas Bank Limited	1/12/2004	Putalisadak, Kathmandu
18	GandakiBikas Bank Ltd.	19/01/2005	Pokhara, Kaski
19	Infrastructure Development Bank Ltd.	29/04/2005	Banepa, Kavre
20	Business Universal Development Bank Ltd.	10/5/2005	Pokhara, Kaski
21	BiratlaxmiBikas Bank Limited	11/5/2005	Biratnagar, Morang
22	Excel Development Bank Ltd.	21/07/2005	Anarmani, Jhapa
23	Western Development Bank Ltd.	15/09/2005	Dang
24	H. & B. Development Bank Limited	7/11/2005 and 15/6/2011	Kamalpokhari, Kathmandu
25	Arniko Development Bank Ltd.	6/7/2006	Dhulekhel, Kavre
26	Nepal Dev. and Employment Promotion Bank Ltd.	17/07/2006	Kamaladi, Kathmandu
27	Clean Energy Development Bank Ltd.	6/9/2006	Sitapaila, Kathmandu
28	Miteri Development Bank Ltd.	13/10/2006	Mahendrapath, Dharan
29	TinauBikas Bank Ltd.	13/10/2006	Sangampath, Butwol
30	Rising Development Bank Ltd.	18/12/2006	Navalparasi, Gaidakot
31	Muktinath Bikas Bank Ltd.	18/12/2006	Pokhara, Kaski
32	SewaBikas Bank Ltd.	25/02/2007	Butawal, Rupandehi

33	KankaiBikas Bank Ltd.	4/5/2007	Damak , Jhapa
34	Public Development Bank Ltd.	7/6/2007	Birjunj , Parsa
35	Ace Development Bank Ltd.	18/8/2007	Narayanchaur, Kathmandu
36	MahakaliBikas Bank Ltd.	18/08/2007	Mahendranagar, Kanchanpur
37	Shangri-la Development Bank Ltd.	26/08/2007	Pokhara, Kaski
38	BhargabBikas Bank Ltd.	30/08/2007	Nepalgunj, Banke
39	ViborBikas Bank Ltd.	4/10/2007	Tripureshwor, Kathmadu
40	ResungaBikas Bank Ltd.	26/09/2007	Tamghas, Gulmi
41	RaraBikas Bank Ltd.	30/09/2007	Birendranagar, Surkhet
42	DiyaloBikas Bank Ltd.	1/10/2007	Banepa, Kavre
43	Country Development Bank Ltd.	4/10/2007	Banepa, Kavre
44	Kasthamandap Development Bank Ltd.	25/10/2007	New Road, Kathmandu
45	Alpine Development Bank Ltd.	5/10/2007	Hetauda, Makawanpur
46	NilgiriBikas Bank Ltd.	25/10/2007	Beni, Maygdi
47	Corporate Development Bank Ltd.	25/10/2007	Birjung, Parsa
48	KamanaBikas Bank Ltd.	29/09/2007	Lekhnath, Kaski
49	City Development Bank Ltd.	19/10/2007	Pokhara, Kaski
50	GarimaBikas Bank Ltd.	23/11/2007	Sangja
51	BiswoBikas Bank Ltd.	21/11/2007	Pokhara, Kaski
52	PathibharaBikas Bank	21/11/2007	Urlabari, Morang
53	Professional Bikas Bank Ltd.	17/10/2007	Banepa, Kavre
54	KabeliBikas Bank Ltd.	15/11/2007	Dhankuta
55	PurnimaBikas Bank Ltd.	20/05/2008	Sidhardhanagar, Rupandehi
56	Jyoti Development Bank Ltd.	25/08/2008	Kamalpokhari, Kathmandu
57	Shine Development Bank Ltd.	22/02/2009	Butawal, Rupandehi
58	Bagmati Development Bank Ltd.	23/03/2009	Hariwon,Sarlahi
59	HamroBikas Bank Ltd.	19/04/2009	Nuwokot
60	Kakre Bihar Bikas Bank Ltd.	15/05/2009	Surkhet
61	Pacific Development Bank Ltd.	20/05/2008	Beshishahar, Lamjung
62	Civic Development Bank Ltd.	25/08/2008	Dhadingbesi, Dhading
63	International Development Bank Ltd.	22/02/2009	Taku, Kathmandu
64	Kanchan Development Bank Ltd.	23/03/2009	Mahendranagar, Kanchanpur
65	GulmiBikas Bank Ltd.	19/04/2009	Tamghas, Gulmi
66	Bright Development Bank Ltd.	14/05/2009	Panuti, Kavre
67	MatribhumiBikas Bank Ltd.	15/05/2009	Sindhulimadi, Sindhuli
68	Innovative Development Bank Ltd.	13/11/2009	Sidhardhanagar, Rupandehi
69	JhimrukBikas Bank Ltd.	8/12/2009	Pyuthan

70	Metro Development Bank Ltd.	16/12/2009	Pokhara, Kaski
71	RaptiVeri Development Bank Ltd.	4/10/2007	Nepalgunj, Banke
72	Gaumukhi Development bank Ltd.	15/1/2010	Bijubar, Pyuthan
73	Nepal Consumer Development Bank Ltd.	5/2/2010	Pokhara, Kaski
74	Khandbari Development Bank Ltd.	5/3/2010	Khandbari, Shankhuwasabha
75	Tourism Development Bank Ltd.	18/3/2010	Thamel, Kathmandu
76	Mission Development Bank Ltd.	15/6/2010	Butawal, Rupandehi
77	Surya Development Bank Ltd.	18/7/2010	Charikot, Dolkha
78	Mount Makalu Development Bank Ltd.	21/7/2010	Basantapur, Terathum
79	SindhuBikas Bank Ltd.	9/9/2010	Barhabise, Sindhupalchowk
80	Sahara Development Bank Ltd.	27/10/2010	Mahangawa, Sarlahi
81	Social Development Bank Ltd.	12/10/2010	Naxal, Kathmandu
82	Nepal Community Development Bank Ltd.	3/11/2010	Butawal, Rupandehi
83	Cosmos Development Bank Ltd.	17/11/2010	Gorkhabazar, Gorkha
84	Manasalu Development Bank Ltd.	14/12/2010	Buspark, Gorkha
85	Samabridhi Development Bank Ltd.	31/12/2010	Gajuri, Dhading
86	EkataBikash Bank Ltd.	24/10/2011	Rupandehi, Butwal
87	Kalinchowk Development Bank Ltd.	15/02/2012	Charikot, Dolkha
88	Kailash Development Bank Ltd.	1993/09/03	Chipledhunga, Pokhara
89	SalapaBikash Bank Ltd.	16/07/2012	Diktel, Khotang

*Source: NRB (List of Banks and Financial Institutions).*

## ANNEX-III

### Calculating Core capital and Supplementary Capital

<b>A. Core Capital</b>		
S.N.	Description	Amount
1	Paid up Capital (ordinary shares)	
2	Proposed bonus share	
3	Share premium	
4	Irredeemable preferential share	
5	General Reserve Fund	
6	Accumulated profit/(loss)	
7	Profit & loss a/c as per balance-sheet	
8	Capital Redemption Reserve Fund	
9	Capital Adjustment Fund	
10	Calls in advance	
11	Other Free Reserves	
<b>Deductions:</b>		
a	Goodwill	
b	Investment on shares and securities in excess of limits	
c	Investment to the company having financial interests	-
d	Fictitious Asset	
e	Investment on land and building for self use not complying the Directives of NRB	
f	Investment on land development and housing construction in excess of limits	
g	Underwriting share not sold within the stipulated time	
h	Credit and other facilities banned by the prevailing laws	
<b>Total Core Capital (A)</b>		
<b>B Supplementary capital</b>		
S.N.	Description	Amount
1	Provisions of loan loss made for pass loan	
2	Additional loan loss provision	
3	Hybrid capital instruments	
4	Unsecured Subordinated Term Debt	
5	Exchange Equalization Fund	
6	Assets revaluation Fund (max. 2% of Supplementary capital is added automatically)	
7	Investment adjustment Fund	
<b>Total Supplementary Capital (B)</b>		
<b>C Total Capital Fund (A+B)</b>		

Source: NRB (Unified Directives).

## ANNEX-IV

### Format of sending report of Loans and Advances sanctioned to Promoters/ CEO/ Directors and staff of the bank

NRB Directive Form No. 9.6

**Name of Bank or Financial Institution**

**Loans and Advances to Director/ CEO/Promoters/ Staff and Shareholder**

**(Date/ Month - Report)**

Name of Promoters / Directors/ CEO	Last Quarter's Outstanding		This Quarter Repayment		This Quarter Outstanding	
	Principle	Interest	Principle	Interest	Principle	Interest
a. Directors						
1						
2						
b. Executives						
1						
2						
c. Promoters						
1						
2						
d. Staff						
1						
2						
e. Shareholders						
1						
2						
Total						

Prepared by

Sign

Name

Position

Date

Prepared by

Sign

Name

Position

Date

## ANNEX-V

### Financial Highlights of Shangri-la Development Bank Ltd.

	2064-65				2065-66				2066-67				2067-68				2068-69			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Total Loans	30,210	120,289	154,310	306,715	391,897	471,892	559,168	662,956	775,832	1,177,924	1,227,664	1,304,800	1,344,148	1,418,162	1,463,439	1,590,311	1,767,308	1,786,004	1,983,993	2,122,446
Deposit	80,489	203,945	211,353	368,683	489,816	601,429	686,655	871,184	1,195,120	1,398,294	1,438,127	1,513,874	1,559,830	1,619,802	1,686,083	1,740,570	1,850,341	2,112,681	2,340,375	2,571,918
Interest Income	381	2,854	7,211	15,166	8,643	23,448	38,984	58,733	24,897	60,666	104,794	158,383	52,486	112,566	172,633	249,540	72,986	154,974	235,635	338,294
Interest Expenses	425	2,548	5,727	10,847	7,207	15,087	24,465	37,087	18,131	42,467	69,566	100,572	34,440	70,712	110,129	153,354	44,989	93,796	147,935	206,698
Cost of Fund										7.52%	8.27%	8.95%	9.17%	9.83%	9.94%	9.98%	10.08%	9.94%	8.80%	8.04%
CD Ratio	25.36%	49.81%	62.23%	75.47%	74.40%	69.62%	72.46%	69.40%	60.61%	76.69%	77.65%	78.39%	78.18%	75.56%	75.18%	75.35%	78.93%	72.32%	73.33%	71.79%
NPL	-	-	-	-	-	-	-	2,784	-	-	4,309	6,133	26,011	13,735	38,566	5,566	50,368	46,793	46,425	15,918
Provision	302	1,203	1,543	3,067	3,919	4,719	5,592	7,238	7,758	11,779	13,624	16,206	20,373	17,596	25,146	18,088	32,684	29,017	35,710	28,017
NPL/Total Loans	-	-	-	-	-	-	-	0.42%	-	-	0.35%	0.47%	1.94%	0.97%	2.64%	0.35%	2.85%	2.62%	2.34%	0.75%
Provision/ NPL	-	-	-	-	-	-	-	259.95%	-	-	316.21%	264.26%	78.32%	128.11%	65.20%	324.96%	64.89%	62.01%	76.92%	176.00%
Capital Adequacy	70.00%	23.00%	19.77%	11.37%	8.94%	15.04%	14.40%	11.55%	10.09%	11.61%	11.40%	11.59%	12.04%	17.73%	17.16%	22.70%	21.68%	21.63%	18.02%	17.74%
Net Profit	(1,282)	(2,349)	(3,306)	(2,200)	(818)	4,200	8,226	5,988	755	3,352	8,052	14,264	2,113	15,590	19,171	32,532	7,528	22,389	30,361	50,005

## ANNEX-VI

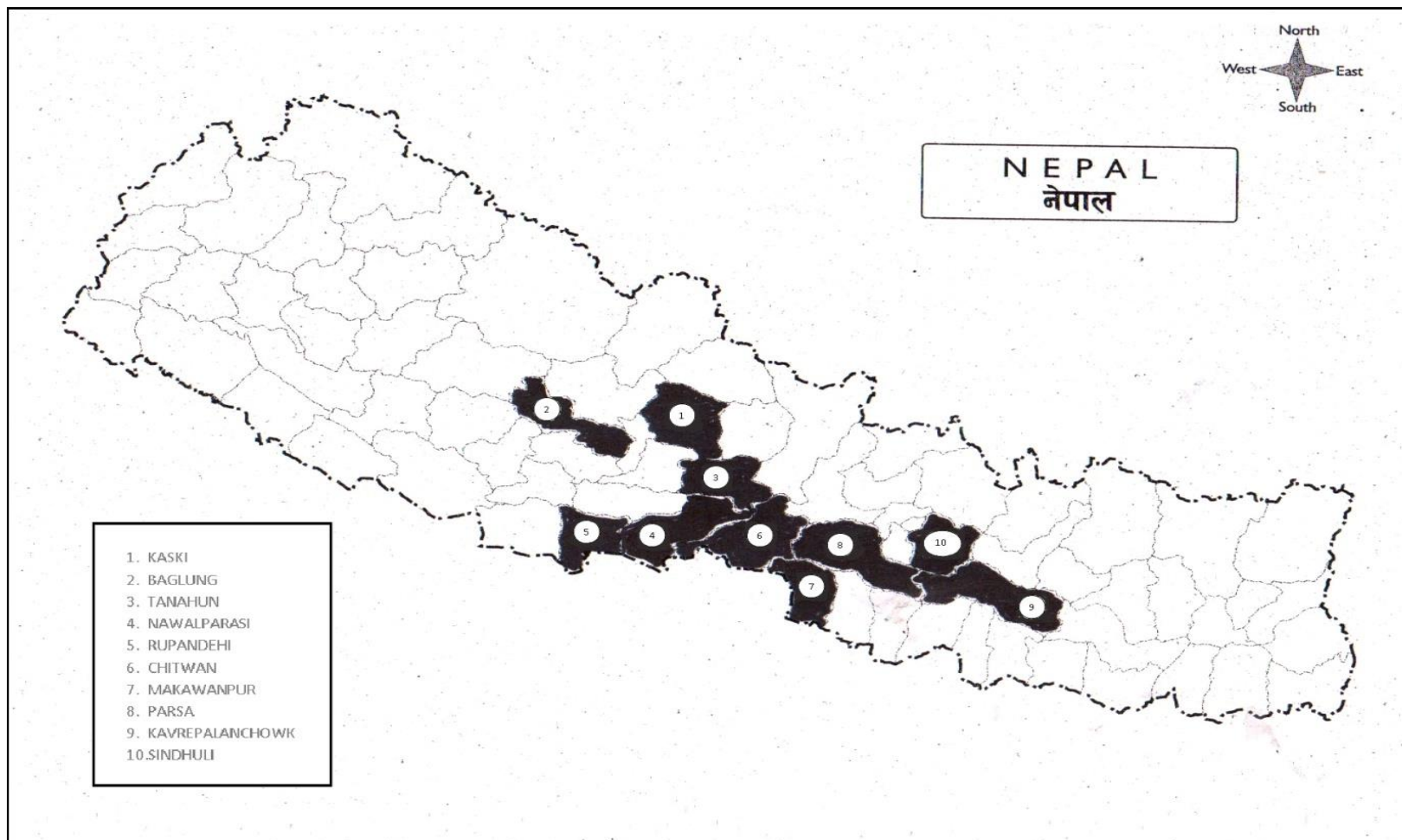
### Indicators of Financial Expansions

SN	Particulars	Unit	Mid – July										
			2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1	Gross Domestic Product	Rs. In million	441519	459443	492231	536749	589412	654055	727089	818401	960011	1170993	1345767
2	No. of Branches of Commercial Banks	In Unit	430	413	447	423	422	437	470	555	752	987	1245
3	Population per Branch	In Thousand	53.84	57.31	54.14	58.49	59.95	59.18	56.26	48.7	36.76	28.37	21.38
4	Deposits in Commercial Banks	Rs. In million	181767	185145	203879	233811	252410	291246	337497	426080.3	563604.4	630880.8	687587.9
5	Per Capita Deposit	Rs. In Unit	7851.71	7997.61	8806.88	10099.8	10903	11515	13344	15763.24	20390.9	22324.95	25829.75
6	Loan and Advances of Commercial Banks	Rs. In million	109121	113175	124522	140031	163719	176820	231830	302913.4	398143	469279.8	528023.1
7	Per Capita Loan	Rs. In Unit	4713.66	4888.75	5378.94	6048.87	7072.1	6991.2	9166.2	11206.56	14404.59	16606.39	19835.58
8	Paid up Capital & Reserve Fund	Rs. In million	8230.2	10202.5	11814.6	14854.4	15153	16567	28641	41208.2	56912.9	66877.97	83578.54

*Source: Nepal Rastra Bank (Banking and Financial Statistics), Mid-July 2011.*

## ANNEX - VII

### Approved Districts of Shangri-la Development Bank Ltd.



## ANNEX -VIII

## Calculation of Risk Weighted Assets

<b>A. On Balance Sheet Items</b>		
<b>S.N</b>	<b>Name of Assets</b>	<b>Risk Assigned to the Assets (in %)</b>
1	Cash Balance	0
2	Gold (Tradable)	0
3	NRB Balance	0
4	Investment to Govt. Bond	0
5	Investment to NRB Bond	0
6	Loan against Own FD	0
7	Loan against Govt. Bond	0
8	Accrued interests on Govt. bond	0
9	Investment to Youth and Small Entrepreneurs Self-employment Fund	0
10	Balance on domestic banks and financial institutions	20
11	Loan against other banks' and financial institutions' FD	20
12	Foreign bank balance	20
13	Money at call	20
14	Loan against internationally rated bank guarantee	20
15	Investment to internationally rated Banks	20
16	Inter-bank lending	20
17	Investment on shares/debentures/bonds	100
18	Other investments	100
19	Loans & advances, bills purchase/discount	100
20	Fixed assets	100
21	Net interest receivables (Total IR - 8 - Interest suspense)	100
22	Other assets (Except advance tax payment)	100
23	Real estate/residential housing loans exceeding the limits	150
<b>Total On-Balance-sheet Items (A)</b>		
<b>B. Off Balance Sheet Items</b>		
<b>S.N</b>	<b>Name of Assets</b>	<b>Risk Assigned to the Assets (in %)</b>
1	Bills collection	0
2	Forward foreign exchange contract	10
3	L/C with maturity less than six months (Outstanding value)	20
4	Guarantee against International rated bank's counter guarantee	20
5	L/C with maturity more than six months (Outstanding value)	50
6	Bid bond, performance bond and underwriting	50
7	Loan sale with repurchase agreement	50
8	Advance payment guarantee	100
9	Financial and other guarantee	100
10	Irrevocable loan commitment	100
11	Possible liabilities for income tax	100
12	All types of possible liabilities including acceptance	100
13	Rediscounted bills	100
14	Unpaid portion of partly paid share investment	100
15	Unpaid guarantee claims	200
<b>Total Off-Balance-sheet Items (B)</b>		
<b>Total Risk Weighted Assets (A) + (B)</b>		

Source : NRB (Unified Directives).

## ANNEX – IX

<b>Balance Sheet of ABC Company Ltd.</b>					
	<b>Audited Figures</b>			<b>Projected Figures</b>	
	<b>2065-66</b>	<b>2066-67</b>	<b>2067-68</b>	<b>2068-69</b>	<b>2069-70</b>
<b>Assets</b>					
<b>Current Assets</b>					
Cash	5,225,661	5,808,954	10,027,418	10,748,217	11,292,407
Accounts Receivable	270,000	297,000	445,500	490,050	539,055
Inventory	750,000	750,000	1,650,000	1,650,000	1,650,000
<b>Total Current Assets</b>	<b>6,245,661</b>	<b>6,855,954</b>	<b>12,122,918</b>	<b>12,888,267</b>	<b>13,481,462</b>
<b>Long term Assets</b>					
Furniture	2,100,000	2,100,000	4,800,000	4,800,000	4,800,000
Utensils	1,200,000	1,200,000	2,700,000	2,700,000	2,700,000
Machinery	2,100,000	2,100,000	4,950,000	4,950,000	4,950,000
Less: Accumulated Depreciation	810,000	1,620,000	3,487,500	5,355,000	7,222,500
<b>Total Long term Assets</b>	<b>4,590,000</b>	<b>3,780,000</b>	<b>8,962,500</b>	<b>7,095,000</b>	<b>5,227,500</b>
<b>Total Assets</b>	<b>10,835,661</b>	<b>10,635,954</b>	<b>21,085,418</b>	<b>19,983,267</b>	<b>18,708,962</b>
<b>Capital and Liabilities</b>					
<b>Current Liabilities</b>					
Accounts Payable	675,000	742,500	1,113,750	1,225,125	1,347,638
<b>Total Current Liabilities</b>	<b>675,000</b>	<b>742,500</b>	<b>1,113,750</b>	<b>1,225,125</b>	<b>1,347,638</b>
<b>Long term Liabilities</b>					
Long term loan	3,845,661	3,086,627	6,051,807	4,271,418	2,206,148
<b>Total long term loan</b>	<b>3,845,661</b>	<b>3,086,627</b>	<b>6,051,807</b>	<b>4,271,418</b>	<b>2,206,148</b>
<b>Capital</b>					
Shareholders' equity	6,000,000	6,000,000	12,750,000	12,750,000	12,750,000
Retained Earnings	315,000	806,828	1,169,861	1,736,724	2,405,159
<b>Total Capital</b>	<b>6,315,000</b>	<b>6,806,828</b>	<b>13,919,861</b>	<b>14,486,724</b>	<b>15,155,159</b>
<b>Total Capital and Liabilities</b>	<b>10,835,661</b>	<b>10,635,954</b>	<b>21,085,418</b>	<b>19,983,267</b>	<b>18,708,944</b>

## ANNEX – X

<b>Income Statement of ABC Company Ltd.</b>					
<b>Particulars</b>	<b>Audited Figures</b>			<b>Projected Figures</b>	
	<b>2065-66</b>	<b>2066-67</b>	<b>2067-68</b>	<b>2068-69</b>	<b>2069-70</b>
<b>Sales</b>	<b>27,000,000</b>	<b>29,700,000</b>	<b>44,550,000</b>	<b>49,005,000</b>	<b>53,905,500</b>
Less: Cost of goods sold	13,500,000	14,850,000	22,275,000	24,502,500	26,952,750
<b>Gross Margin</b>	<b>13,500,000</b>	<b>14,850,000</b>	<b>22,275,000</b>	<b>24,502,500</b>	<b>26,952,750</b>
Less: Other expenses					
Rent	1,800,000	1,980,000	4,356,000	4,791,600	5,270,760
Marketing Expenses	1,500,000	1,650,000	1,815,000	1,996,500	2,196,150
Staff Expenses	2,160,000	2,376,000	5,227,200	5,749,920	6,324,912
Utilities	360,000	396,000	792,000	871,200	958,320
Repairs and maintenance	150,000	165,000	363,000	399,300	439,230
Interior Decorations	1,500,000		1,500,000		
Miscellaneous	300,000	300,000	300,000	300,000	300,000
<b>EBDIT</b>	<b>5,730,000</b>	<b>7,983,000</b>	<b>7,921,800</b>	<b>10,393,980</b>	<b>11,463,378</b>
Less: Depreciation	810,000	810,000	1,867,500	1,867,500	1,867,500
<b>EBIT</b>	<b>4,920,000</b>	<b>7,173,000</b>	<b>6,054,300</b>	<b>8,526,480</b>	<b>9,595,878</b>
Less: Interest expense	720,000	615,306	1,213,860	968,289	683,427
<b>EBT</b>	<b>4,200,000</b>	<b>6,557,694</b>	<b>4,840,440</b>	<b>7,558,191</b>	<b>8,912,451</b>
Less: Tax (25%)	1,050,000	1,639,424	1,210,110	1,889,547	2,228,114
<b>Net Income</b>	<b>3,150,000</b>	<b>4,918,271</b>	<b>3,630,330</b>	<b>5,668,643</b>	<b>6,684,339</b>