

**CREDIT MANAGEMENT OF
COMMERCIAL BANKS IN NEPAL**
(Bank of Kathmandu and Nepal Investment Bank Ltd.)

BY

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A

Thesis

Submitted to:

Office of the Dean

Faculty of Management

Tribhuvan University

Kirtipur

In partial fulfillment of the requirements for the degree of

Master of Business Studies (MBS)

Nepalgunj

September, 2012

RECOMMENDATION

This is to certify that the thesis

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

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VIVA- VOCE SHEET

We have conducted the viva-voce examination of the thesis submitted by

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and found the thesis to be the original work of the student written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for Master of Business Studies (MBS)

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DECLARATION

I hereby declare that the work reported in this thesis entitled **Credit Management of Commercial Banks in Nepal (Bank of Kathmandu and Nepal Investment Bank Ltd.)** submitted to Office of the Dean, Faculty of Management, Tribhuvan University is my original work done in the form of partial fulfillment of the requirement of Master's Degree in Business Studies (M.B.S.) under the guidance and supervision of Mr. Prakash Lamichhane, (Lecturer) of Mahendra Multiple Campus, Nepalgunj. Hence, the sole responsibility would be remained on me regarding this thesis for any positive or negative implication if emerged in future.

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ACKNOWLEDGEMENTS

The present study though particularly related to the credit management in Investment Bank Ltd. and Bank of Kathmandu from the view of shareholders protection would help the shareholders to understand the different aspect related to the welfare and betterment of the shareholders. Writing research work needs help of so many persons. I am grateful with all of them who have helped, guided and supervised to complete this work without whose co-operation it would have been simply impossible to complete this research work.

This thesis has been as a partial requirement for the MBS. It would not be possible to complete this without the co-operation of different well wishers. The completion of the present study is a product of help and support of several hands. So, I would like to express my heartfelt gratitude, to all those respondents for their support and help.

First of all, I would like to express my sincere thanks and gratitude to my guide Mr. Prakash Lamichhane and other staff of Management Faculty are also in the memory of mine. I would like to pay my sincere to Mr. Laxman Pokhrel, Department Chief of Management, Mahendra Multiple Campus, Nepalgunj, Mr. Chakra Bahadur Bom, Head of Research Department (MBS), Mahendra Multiple Campus, Nepalgunj. I could not remain without thanking to my teachers, especially to friend Binod Neupane, wife Krishnamaya Koirala Pathak who helped me during my study of MBS and during preparation of this thesis report.

I express my deep thanks Sabin Luitel of New Lumbini Pustak Pasal, Nepalgunj who helped to provide computer setting properly and timely.

September, 2012
Nepalgunj

Ganesh Prasad Pathak

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LIST OF ACRONYMS

3c	=	Character, Capacity and Capital
5c	=	Character, Capacity, Capital, Collateral, Condition
A/C	=	Account
ADBL	=	Agricultural Development Bank Limited
BOK	=	Bank of Kathmandu
Ext.	=	External
F/Y	=	Fiscal year
HBL	=	Himalayan Bank Limited
i.e	=	that is
INGO	=	International Non Government Organization
L/C	=	Letter of Credit
MFI	=	Micro Finance Institution
NGS	=	Nepal Government Securities
NIBL	=	Nepal Investment Bank Limited
NBL	=	Nepal Bank Limited
NRB	=	Nepal Rastra Bank
NGO	=	Non Government Organization
NIDC	=	Nepal Industrial Development Corporation
RDB	=	Rural Development Bank
RA	=	Regression Analysis
SLR	=	Statutory Liquidity Ratio
S.d	=	Standard Deviation
T.U	=	Tribhuvan University

CHAPTER –I

INTRODUCTION

1.1 Background of the Study

Nepal is sandwiched between the two giant countries, India and China and survives with her own natural beauty in Asia. Its half-century of experiments and efforts to raise the quality of life of its populace is defeated. Almost half of its population lies under absolute poverty line, especially living in the rural areas are deprived of even basic needs and facilities like enough calories pure drinking water sanitation facilities, electricity, road facility etc. Some of the basic human indicators like life expectancy, literacy, nutrition level etc. also show that Nepal occupies among the nation to eliminate the massive poverty persisting in the country through gradual development of the total nation and by providing and availing basic needs to poor people. Actually slow pace of developing of Nepal is due to nothing but landlocked position, poor resources mobilization and its utilization, weak infrastructure development and more over unstable eco-political environment.

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

The concept of the banking has been developed from the ancient history with the effort of ancient goldsmiths who developed the practice of storing people's gold and valuables under such arrangement the depositors would leave their

gold for safekeeping would get back their gold and valuable after paying a small amount as fee for safekeeping and serving.

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

The financial institutions are:

-) Commercial Banks
-) Development Banks
-) Finance companies
-) Savings and Credit Associations
-) Mutual Saving Banks
-) Credit Unions
-) Insurance Companies
-) Pension Funds
-) Investment Companies
-) Investment Bankers
-) Securities Brokers and Dealers
-) Finance Companies

Banks grant loan and advances to industries, people and companies that result in the increase in the productivity of nation. For example; The loan against to agricultural sector enhances the agricultural product on. The loan amount can be used by the farmers as per their need to produce their product that will promote the agriculture product on. Similarly the loan and advances to different people and corporate bodies help to increase their income and profits. They can use the amount as per their need at right place at the right time. Bank is a business organization where monetary transaction occurs. It creates fund from its clients saving and lends the same to needy person or business companies in term loans, advances and investment. So proper financial decision making is more important in banking transactions for its efficiency and profitability. so efficient management of lending policy is needed.

The source of finance is the most essential element for the establishment and operation of any profit and non-profit institutions. Profit oriented institutions usually obtain these sources through ownership capital, public capital through the issues of shares and through financial institutions such as banks, in the form of credits, overdrafts etc Commercial banks, others banking institutions (OBIs), Non Bank Financial Institutions occupy important role in mobilizing financial resources. There are about 30 insurance companies including deposit insurance and Credit Guarantee Corporation, one Employee Provident Fund and one Citizen Investment Trust belong to this type of financial institutions. Apart from this, securities such as corporate shares debentures and bonds.

Banking plays a significant role in the economic development of a country. Nepal Bank Limited (NBL) is the first commercial bank of the country. Commercial banks are the heart of the financial institutions. They hold the deposits of many persons, government establishments and business units. They made funds available through their lending and investing activities to borrowers, individuals, business firms and government establishments. In doing so, they assist both the flow of goods and services from the producer to consumers and financial activities of the government, they provide a large

proportion of the medium of exchange. They are the media through which monetary policy is affected. These facts show that the commercial banking system of the nation is important to the functioning of the economy. Bank is a resource for the economic development, which maintains the self-confidence of various segments of society and extends credit to the people.

The more developed financial systems of the world characteristically fall into three parts. The Central Bank, The Commercial Banks and other financial institutions. They are known as financial intermediaries. The banking business has its agencies from its function of lending. Lending is the most fundamental function of a bank. The importance of lending in banking business is undoubtedly unchanged and remains vital as it was early days of this business. Lending has its different forms. It can be divided into fund based and non-fund based lending. The fund based lending can be further divided into cash credit, overdrafts, demand and term credits, bills purchased and discounted and export packing credit, project loan, etc. Similarly, non- fund based credit can be classified into documentary credit, guarantees and bill co- acceptance facility. for the study we have choose two banks; Bank of Kathmandu and Nepal investment Bank ltd.

1.2 Introduction of Sample Organization under Study

1.2.1 Bank of Kathmandu Ltd.

Bank of Kathmandu Ltd. was incorporated in 1993 and came into operation in March 1995 as a joint venture bank with Siam Commercial Bank of Thailand. The head office of the bank is situated at Kamalpokhari, Kathmandu, Nepal. At the beginning, this bank was managed by Siam commercial bank of Thailand and later on Siam commercial bank divests their share holding and now it is fully owned and managed by Nepali professional.

Bank of Kathmandu, since its inception, has been using information technology for its mainstream banking activities. All its branches including rural areas are interconnected to the bank's internet system providing online real time. Any Branch Banking system to its valued customers. Continuous updates, upgrades and replacements of its equipments and software have become one of the major focuses of the bank to stand up to the challenges posed by the fast changing environment. It has total paid up & issued capital is Rs 1359480700. It has 43 branches in Nepal. It has collected deposit Rs 21018417209. Out of total rupees Rs18044000000.(F.Y report 2067/68) has been lending.

Bank of Kathmandu has well-developed correspondent relationships with over 160 banks globally to help its customers to carry out their business worldwide promptly and conveniently. Bank of Kathmandu have maintained accounts in major currencies in the internationally renowned banks as well tied up with various Instant Money Transfer Companies (IMTC) like X-press Money Service Ltd., Money Gram, International Money Express P. Ltd etc for efficient execution of international banking business and also enables inflow of foreign exchange earnings to the country with high security. This bank came into operation with a objectives of catering new business yet not identified and offering new banking products and services with a modern look by adopting modern banking technology.

Bank of Kathmandu has just entered into the nineteen year of successful operation. During its nineteen years of operation, it has become one of the leaders in the banking sector and was able to establish a good banking image in the banking history of Nepal. It gets the” **Bank of the year 2011**” due to its well management. It has gain lot of popularity among its customer, due to its pioneer service provided to its customer.

1.2.2 Nepal Investment Bank Ltd.

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French

partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world.

. It has total paid up & issued capital is Rs 20509480700. It has 41 branches in Nepal. It has collected deposit Rs 25017417209. Out of total rupees Rs20053087500.(F.Y report 2067/68) has been lending.

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

The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank's Annual General Meeting. Out of the 32 commercial bank in Nepal, it has occupies strength position in banking sector. Nepal Rastra Bank and Company Registrar's office with the following shareholding structure:

- A group of companies holding 50% of the capital
- Rashtriya Banijya Bank holding 15% of the Capital.
- Rashtriya Beema Sansthan holding 15% percentage

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

1.3 Statement of the Problem

Most of the major banking problem have been caused by weakness in credit management. Banks should have a keen awareness of the need to identify; measure, monitor and control credit as well as to determine that they hold adequate capital against it. These risks that they are adequately compensated for risks incurred. So to establish credibility position is a major issue in commercial banking sector during these days.

It is no debate that high profitable or successful organization can easily fulfill the every need of organization, customer and can serve the society. To improve the profitability situation of the bank. It is necessary to establish the higher credibility position of the bank. Thus, the credibility position is the major strategy of every commercial bank.

Credit is the most effective and sincere area in commercial bank. It is regarded as the heart of every commercial bank. But the banking sector is far from this fact. Thus, credit management is considered as the heart issues in Nepalese Commercial Banking sector.

Credit management concept has appeared as a major research gap in Nepalese Commercial banking sector. There is lack of such scientific and empirical research that could indentify the issue of credit management in Nepalese commercial banks. In this regard, the performance of Nepalese commercial banks is to be analyzed in term of their credit. Some research question regarding to the credit practices, credit efficiencies, liquidity position, industrial environment, management, management quality, organization climate are considered as a clear evident in present situation. Thus, the specific research questions regarding credit management in Nepalese commercial banking sector are identified as follows:

- a. Is the credit practice adopted by commercial Banks in good position?
- b. What is the credit efficiency of the Nepalese Commercial banks?
- c. Is there any relationship between credit position and profitability situation?

Nepal is a small country with small market economic condition of the country is degrading due to conflict since 2052 B.S. But the situation has been changed and peace process is finished. Due to peace Process all manufacturing and banks economic condition is going on in good condition. However, the financial institutions are increasing regularly. Liquidity is minimum with the financial institutions are competing among themselves.

1.5 Objectives of the Study

There is no doubt that the role of the commercial banks is significant in the development of the country. Banks help in the development of the country by providing credit to the necessary sectors.

The objectives of the study are as follows:

1. To analyze practices adopted by banks regarding to credit policy
2. To analyze the credits and advances provided by Banks.
3. To analyze the recovery status of the credit disbursed by Banks.
4. To find out the strength and weakness in the credit administration.
5. To compare the sound credit policy practices between the banks
6. To analyze the position of maintaining govt. rules and policies in regards to credit management.

1.6 Significance of the Study

There are few researchers in commercial banking and especially on their lending practice, insufficient books for the study. Lending is one of the essential and main function where the whole banking business is rested upon. Thus, a study on the commercial banks and especially in their lending and investment practices carry a great significance to various groups but in particular is directed to a certain groups of people/organization, which are:

- a. Importance to shareholders
- b. Importance to the management bodies of these banks for the evaluation of the performance of their banks and in comparison with other banks.
- c. Importance to “outsiders” which are mainly the customers, financial agencies, stock exchange.

- d. Importance to the government bodies or the policy makers such as the central bank.
- e. This study would be important for the students as it provide theoretical as well as conceptual frame work of different aspect of credit management.

1.7 Limitation of the Study

Limitation exists everywhere and the research study is also not an exception. The data problem is actual in Nepal, in order to make a study to get all types of information. Therefore, due to time constraint and area of study covered by this research, it has certain limitation. They are as follows:

- a. Due to the lack of time and financial resources only two companies are selected for the study i.e., Bank of Kathmandu and Nepal Investment Bank limited.
- b. This study has covered only secondary data.
- c. This study has covered only a period of 6 years from fiscal years i.e. 2006/07 to 2010/11 and processed for drawing conclusion.
- d. Most of the data are collected from financial statement. Therefore, the accuracy of the research work solely depends on the data provided by the concern company.
- e. This study has been conducted to fulfill the requirement of the MBS program of T. U for the Prescribed time not for generalization purpose.

1.8 Organization of the Study

Chapter1: Introduction of the study

Chapter one deals with introduction, problem of the study, and objective of study, limitation of the study, need of the study, research methodology.

Chapter II: Review of Literature

Chapter two consists of review of literature. This chapter is subdivided into various sections such as conceptual framework, review from different studies, review from journal, article and magazine and review from master's thesis for the concerned topic.

Chapter III: Research Methodology

Chapter three present methodologies adopted for the research. It comprises research design, sources of data method of analysis and its descriptive presentation.

Chapter IV: Presentation and Analysis of Data

Chapter Four deals with the techniques used in analyzing the collected data and its presentation in the descriptive and analytical manner.

Chapter V: Summary, Conclusions and Recommendations

Chapter Five consists of summary, conclusion and recommendation about the topic concerned.

CHAPTER –II

REVIEW OF LITERATURE

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 books, reports, journals and research studies published by various institution unpublished dissertations submitted by master

Level students have been reviewed. It is divided into two headings:

-) Conceptual Review
-) Review of related studies

2.1 Conceptual Review

The review of textbook and other reference materials such as: newspaper, magazines, research articles, journals and past thesis have been included in this topic. Credit administration involves the creation and management of risk assets. The process of lending takes into consideration about the people and system required for the evaluation and approval of loan requests, negotiation of terms, documentation, disbursement, administration of outstanding loans and workouts, knowledge of the process and awareness of its strength and weakness are important in setting objectives and goals for lending activities and for allocating available funds to various lending functions such as commercial, installment and mortgage portfolios (Johnson, 1940, P.132).

Bajracharya (2001), in his article “Monetary policy and deposit mobilization in Nepal” has concluded that mobilization of the domestic saving is one of the prime objectives of the monetary policy in Nepal. And commercial banks are the most active financial intermediary for generating resources in the form of

deposit of private sector and providing credit to the investors in different sectors of the economy.

It is very important to be reminded that most of the bank failures in the world are due to shrinkage in the value of loan and advance. Hence, risk of non-payment of loan is known as credit risk default risk (Dahal, 2002, P.114).

Book named “**Banking Management**” say that in banking sector or transaction, an unavoidable of loan management and its methodology is regarded very important. Under this management, many subject matters like the policy of loan flow, the documents of loan flow, loan administration, audit of loan, the condition of loan flow the provision of security, this management plays a great role in healthy competitive activities (Bhandari, 2003, P.170).

Portfolio management helps to minimize or manage the credit risks by spreading over the risk to various portfolios. This method of managing credit risk is guided by the saying do not put all the eggs in a single basket (Bhandari, 2004, P. 300).

2.1.1 Concept of Commercial Bank

Before defining the term commercial bank, let us define the meaning of bank and commercial. According to S. and S. s definition of bank, a banker or bank is a person or company carrying on the business of receiving money and collecting drafts, for customers subject to the obligation of honoring cheque drawn upon them from time to time by the customers to the extent of the amount available on their customer (Shekher&Shekher, 1999, P.4).

Commercial banks are organized as a joint stock company system, primarily for the purpose of earning profit. They can be either of the branch banking types as we see in most of countries, with a large network branches like in Nepal or of the unit banking type, as we see in the United States where a banks operations are confined to a single office or to a few branches within a strictly limited area (Shekher&Shekher, 1999, P.4).

Commercial banks act as an intermediately; accepting deposits and providing credits to the needy area. The main source of the commercial bank is current deposit, so they give more importance to the liquidity of investment and as such they specialize in commercial banks are restricted to invest their funds in corporate securities. Their business is confined to financing the short-term needs of trade and industry such as working capital financing. They cannot finance in fixed assets. They grant credits in the form of cash credits and overdrafts. Apart from financing, they also render services like collection of bills and cheque, safe keeping of valuables, financial advising, etc to their customers (Vaidhya, 1999, P.24).

Paget states that no one can be a banker who does not take deposit accounts take current accounts, issue and pay cheque of crossed and uncrossed, for his customers. He further adds that if the banking business carried on by any person is subsidiary to some other business; he cannot be regarded as a banker (Paget, 2005, P.2).

2.1.2 Functions of Commercial Banks

The business of commercial bank is primarily to hold deposit and make credits and investments with the object of securing profits for its shareholders. Its primary motive is to earn profit; other consideration is secondary (Sudharsanam, 1976, P. 123).The major functions of commercial banks are as follows.

- Accepting Deposit
- Advancing Credit
- Agency Services
- Credit Creation
- Financing of Foreign Trade

- Safekeeping of Valuable Goods
- Making Venture
- Capital Credits
- Financial Advising, Security Brokerage Services.

2.1.2.1 Assist in Foreign Trade:

The bank assist the traders engaged in foreign trade of the country. He discounts the bills of exchange drawn by exports to receive money in the home currency. Similarly, he also accepts the bills drawn by foreign exports (Vaidhya, 1999, P.29)

2.1.2.2 Offers Investment Banking and Merchant Banking Services

Banks today are following in the footsteps of leading of financial institutions all over the globe in offering investment banking and merchant banking services to corporations. These services include identifying possible merger targets, financing acquisitions of other companies, dealing in security underwriting, providing strategic marketing advice and offering hedging services to protect their customers against risk from fluctuating world currency prices and changing interest rates, (Vaidhya,1999,P.29). Further, they support the overall economic development of the country by various modes of financing.

2.1.3 Concept of Credit

Credit is financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for an obligation of repay on specified date on demand. Banks generally grants credit on four ways (Chhabra and Taneja, 1991, P.4)

Credit is the amount of money lent by the creditor (bank) to the borrower (customers) either on the basis of security or without security. Sum of the

money lent by a bank, is known as credit (Oxford Advanced Learners Dictionary, 1992, P.279).

Credit and advances is an important item on the asset side of the balance sheet of a commercial bank. Bank earns interest on credits and advances, which is one of the major sources of income for banks. Bank prepares credit portfolio, otherwise it will not only add bad debts but also affect profitability adversely, (Varshney and Swaroop, 1994, P.6)

- Overdraft
- Cash Credit
- Direct Credit
- Discounting of Bills

2.1.4 Types of Credit

2.1.4.1 Overdraft

It denotes the excess amount withdraw over their deposits.

2.1.4.2 Cash Credit

The credit is not given directly in cash but deposit account is being opened on the name of credit taker and the amount credited to that account. In this way, every credit creates deposit.

2.1.4.3 Term Credit

It refers to money lent in lump sum to the borrowers. It is principal form of medium term debt financing having maturities of 1 to 10 years. Barely and Myers urge that bank credits with maturities exceeding 1 years are called term credits. The firm agrees to pay interest based on the bank's prime rate and to repay principal in the regular installments. Special patterns of principal

payments over time can be negotiated to meet the firm's special needs (Richard, 1996, P. 80).

2.1.4.4 Working Capital Credit

Working capital denotes the difference between current assets and current liabilities. It is granted to the customers to meet their working capital gap for supporting production process. A natural process develops in funds moving through the cycle are generated to repay a working capital credit.

2.1.4.5 Priority or Deprived Sector Credit

Commercial banks are required to extend advances to the priority and deprived sector .12% of the total Credit must be towards priority sector including deprived sector. Rs.2million for agriculture service sector and Rs.2.5 million for single borrows are limit sanctioned to priority sector. Institutional support to 'Agriculture Development Bank' and 'Rural Development Bank' are also considered under this category, deprived sector lending includes:

- Advances to poor/downtrodden /week/ derived people up to Rs. 30,000 for generating income or employment.
- Institutional Credit to Rural Development Bank.
- Credit to NGOs those are permitted to carryout banking transaction for lending up to Rs 30, 000.

2.1.4.6 Hire-purchase financing (Installment Credit)

Hire- purchase credits are characterized by periodic repayment of principal and interest over the maturity of the credit. Hirer agrees to take the goods on hire at a stated rental including their repayment of principal as well as interest with an option to purchase. A recent survey of commercial banks indicates those bank are planning to offer installment credits on a variable rate basis. It can be secured and unsecured as well as direct and indirect installment credit.

2.1.4.7 Housing Credit (Real Estate Credit)

Financial institutions also extend housing credit to their customers. It is different types, such as: residential building, commercial complex, construction of warehouse etc. It is given to those who have regular income or can earn revenue from housing project itself.

2.1.4.8 Project Credit

Project Credit is granted to the customers as per project viability. The borrowers have to invest certain proportion to the project from their equity and the rest will be financed as project credit. Construction credit is short-term credits made to develop for the purpose of completing proposed projects. Maturities on construction credits range from 12 months to as long as 4 to 5 years, depending on the size of the specific project (Johnson, 1940, P.242). The basic guiding principle involved in disbursement policy is to advance funds corresponding to the completion stage of the project. Hence, what percent of the credit will be disbursed at which stage of completion must be spelled in disbursement policy? Term of credit needed for project fall under it.

2.1.4.9 Consortium Credit

No single financial institution grant credit to the project due to single borrower limit or other reasons and two or more such institution may consent to grant credit facility to the project among them. Financiers bank equal (or Likely) charge on the project's assets.

2.1.4.10 Off- Balance Sheet Transaction

In fact, bank guarantee and letter of credit refer to off balance sheet transactions of financial institution. It is also known as contingent liability. Contingent liability pinpoints the liability which may or may not arise during the happening of certain event. Footnotes are kept as reference to them instead of recording in the books of accounts. It is non funded based remunerative

facilities but more risky than the funded until adequate collateral are not taken. Lets its two varieties be described separately.

2.1.4.11 Bank Guarantee

It is used for the sake of the customers in favor of the other party (beneficiary) up to the approved limit. Generally, a certain percent amount is taken as margin from the customer and the customer's margin account is credited.

2.1.4.12 Letter of credit (L/C)

It is issued on behalf of the customer (importer) in favor of the exporter (Seller) for the import of goods and services stating to pay certain sum of money on the submission of certain documents complying the stipulated terms and conditions as per as the agreement of L/ C . It is also known as importers letter of credit since the bank of importer do not open separate L/C for the trade of sum commodities.

2.1.5 Lending Criteria

According to “**The Book Essential of Managerial Finance**” While screening a credit application, 5-cs to be first considered supported by documents(Scot Besley,1986,P.400). They are;

2.1.5.1 Character

Character is the analysis of the applicant as to his ability to meet the obligations put forth by the lending institution. For this analysis, generally the following documents are needed.

- Memorandum and Articles of Association
- Registration certification
- Tax registration certificate (Renewed)
- Resolution to borrow

- Authorization- person authorizing to deal with the bank

2.1.5.2. Capacity

Describes customer's ability to pay. It measured by applicants past performance records and followed by physical observation. For this, an interview with applicant's customers/suppliers will further clarify the situation, Documents relating to this area were:

- Certified balance sheet and profit loss account for at least past 3 years.
- In case of the personal loan they have to submit the proof source of income.
- References or other lenders with whom the applicant has dealt in the past or bank A/C.

2.1.5.3. Capital

This indicates applicant's capacity to inject his own money. By capacity analysis, it can be concluded that whether borrower is trying to play with lender's money only or is also injecting his own fund to the project. For capital analysis, financial statements, like certified balance sheet, profit and loss account is the only tools.

2.1.5.4. Collateral

Collateral is the security proposed by the borrower. Collateral may be of either nature movable or immovable. Movable collateral comprises right from stock, inventories to plying vehicles. In case of immovable it may be land with or without building or fixtures, plant machineries attached to it.

2.1.5.5 Conditions

Once the funding company is satisfied with the character, capacity, capital and collateral then a credit agreement (Sanction letter) is issued in favor of the

Borrower stating conditions of the credit to which borrower's acceptance is accepted.

2.1.6 Principles of Sound Lending Policy

Lending constitutes the main business of a banking company. A major chunk of the profits of a bank comes out of this function. But no lending can take place without some inherent risks. As bankers are trustees of the depositors' money, they cannot take undue risks. A banker has to follow a cautious policy and conduct the business of lending on the basis of certain sound principles. Here are some of the important principles of sound lending (Shekher & Shekhar 2004, P.134).

2.1.6.1. Safety

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

If the banker has to ensure safe lending, he has to look to the three C's of the borrower namely Character, Capacity and Capital. Character of the borrower is important because that determines his willingness to repay the loan. His capital and capacity to run the business successfully determine his capacity to pay. The safety of the loan depends on both his capacity to repay and willingness to repay.

Banks will have to keep a portion of the deposits received for honoring the demands made by the customers. Only the balance can be safely. The bank's endeavor is of course to lend as much of the deposits as possible, without which he will not be in a position to meet his interest, obligations and the

maintenance of establishment. Therefore, he has to lend with a view to earn interest but lend it safe.

2.1.6.2. Liquidity

By liquidity is meant the readiness with which the bank can convert the assets into cash. Liquidity means short-term solvency of the borrower. A banker is essentially the lender of short-term funds because he knows that the bulk of his deposits are repayable on demand or at short notice. As the banker's deposits are subject to the legal obligation of being repayable on demand and at short notice, he must ensure liquidity also while lending, so that in times of need, he will be able to convert the assets into cash.

Bank can ensure high liquidity by keeping all deposits in the form of cash only. In such a case, he will not be in position to meet the interest obligations and expenditure of the establishment. From experience, he has learnt that he can safely lend out a substantial portion of the funds. But while lending he should try to ensure liquidity, i.e. in times of need, he must be able to obtain repayment of the money within a reasonably short time. Liquidity also implies that the assets can be sold without any loss. Thus the concept of liquidity has twin aspects namely quick sale ability or convert ability of the assets and the absence of risk of loss in such conversion.

2.1.6.3. Profitability

Commercial banks obtain funds from shareholders and naturally if dividend is to be paid on such shares it can only be paid by earning profits. Even in the case of public sector banks although they are service motivated they will have to justify their existence by earning profits. This is not possible unless the funds are employed profitably. From out of the revenue earned, the banker has to pay interest on deposits, salary to the staff, meet other establishment expenses, build-up reserves and the balance must permit the payment of dividend to shareholders. So for the bank to sustain on a long run, it has to seek many

profitable sectors where it can mobilize its collected fund. Before lending, a banker has to see that the advance and credit is on the whole profitable. Lending rates are affected by banks' internal policy like credit rating of the borrower, bank rate of NRB, inter-bank competition and NRB's guidelines on lending rates.

2.1.6.4. Purpose of Loan

Nowadays, the purpose for which loans are granted has acquired precedence over the principle of security. If a loan is required for a non-productive or speculative purpose, a banker will be reluctant to entertain the proposal. Loans for social functions, ceremonies, pleasure trips or for repayment of prior loans are not favored by a banker, as they are unproductive in nature. But it is very difficult for the bank to ensure that the advance has been used for the purpose for which it was taken. A person may take a loan obviously for a productive use, but may spend it on speculation. The central bank through its directives, also determines the policy to be followed by the banks with regard to the purpose for which advances may not be granted. So a banker should enquire the purpose for which it is taken for safe lending.

2.1.6.5. Security

Traditionally, bankers have been security oriented. The security offered against a loan can be of various types. It may vary from a piece of land or a building to a commercial paper or bullion. Whatever may be the security, a banker has to realize that it only a cushion to fall back upon in case of need and its adequacy alone should not form the sole consideration for advance. It must be ensured that the security when accepted must be adequate, readily marketable, easy to handle and free from encumbrances.

2.1.6.6. Diversification of Loans

There is a very familiar saying that "Do not put all the eggs in the same basket." Banker should try to diversify loans as far as possible, so that he may

minimize his risks in lending. If the banker lends only to one industry or only to few big firms or concentrates in a certain geographical area, the risk is great. He should diversify lending, so that he may not be affected by the failure of one industry or of a few big borrowers. A banker who puts all his eggs in one basket is not a prudent banker.

2.1.6.7. National Interest and Suitability

Bankers must ascertain on what type of business the customer is involved whether it serves the national interest or not, whether the firm is acting responsibly towards the society that it is operating in like brick industry or the cement industry and the precautions taken by it against environment pollution. Central bank issues directives, prohibiting banks to invest in various sectors such as the import of arms and ammunitions etc. Also bankers must remain vigilant of the law and order situation where borrower carries its business.

2.1.7 Some Important Banking Terms

The study in this section comprises of some important banking terms for which efforts have been made to clarify the meaning, which are frequently used in this study, which are given below (Shekhar & Shekhar, 2004, P.145).

2.1.7.1 Deposits

Deposit is the most important source of liquidity for a commercial bank. It is also the main source of fund that a bank usually uses for the generation of profit. Therefore, the efficiency depends on its ability to attract deposits. Banks collect the scattered savings of the public through various accounts type like saving, current, fixed etc. Deposit being the borrowed amount from the depositors or from general public and institutions, it constitutes the liability of a bank. The management of a bank is always influencing it through deliberate policy action; the deposits of a bank are affected by various factors (Shekhar & Shekhar, 2004, P.148) They are as follows.

-) Types of customers
-) Physical facilities of bank
-) Management accessibility of customers
-) Types and range of services offered by the bank.
-) Interest rate paid on deposits.
-) Goodwill and financial position of the bank

In addition to the above, the prevailing economic conditions exert a decisive influence on the amount of deposit the bank receives.

2.1.7.2 Loan and Advances

"Loan, advance and overdraft are the main sources of income for a bank. Bank deposits can cross beyond a desired level but level of loans, advances and overdraft will never cross it. The facilities of granting loan, advances and overdrafts are the main services in which customer of the bank can enjoy.

Fund borrowed from bank are much cheaper than those borrowed from unorganized money lenders. The demand for loan has excessively increased due to cheaper interest rate. Furthermore, an increase in an economic and business activity always increases the demand for the fund. Due to limited resources and increasing loans, there is some fear that commercial banks and other financial institutions too may take more preferential collateral while granting loans causing unnecessary trouble to the general customers.

In addition to this, some portion of loan advances and overdraft includes that amount which is given to staff of the bank for house loan, vehicle loan, personal loan and others. In mobilization of commercial banks fund, loan advance and overdrafts have occupied a large portion.

2.1.7.3 Investment on Government Securities, Share and Debenture

"Though a commercial bank can earn some interest and dividend from the investment of government securities, share and debenture, it is not the major portion of income, but it is treated as a second source of banking business. A commercial bank may extend credit by treating it as a second source of banking business. A commercial bank may extend credit by purchasing government securities bonds and shares for several reasons.

Some of them are given as:

-) It may want to space it matures so that the inflow of cash coincide with expect withdrawals by depositors or large loan demands of its customers.
-) It may wish to have high grade marketable securities to liquidate if its primary reserve becomes inadequate.
-) It may also be forced to invest because the demand for loans has decreased or is not sufficient to absorb its excess reserves.

However, investment portfolio of commercial bank is established and maintained primarily with a view of nature of banks liabilities that is since depositors may demand fund in great volume without previous notice to banks. The investment must be of a type that can be marketed quickly with little or no shrinkage in value.

2.1.7.4 Investment on other Company's Share and Debentures

Most of commercial banks invest their excess fund to the share and debenture of the other financial and non-financial companies. Due to excess funds but least opportunity to invest those funds in much more profitable sector and to meet the requirement of NRB directives, the commercial banks purchase shares and debenture of regional development bank, NIDC and other development banks.

2.1.7.5 Liquidity

Liquidity is the ability of bank to meet its obligations on time, especially in relation to repayment of inter-bank borrowings and customer deposits. Liquidity management is a very crucial job of commercial bank and the bank should maintain adequate amount of cash in its vault and NRB for its daily operation and administrative purpose. As per the arrangement of NRB effective from fiscal year 2010/11, the commercial banks are required to maintain cash reserve of 5% with NRB of its total deposit liability with NRB. The previous provision of cash in vault maintenance has been withdrawn now.

2.1.7.6 Capital Adequacy

Capital is the blood of any business without which business cannot be run or established. In financial term, capital is the excess of assets over liabilities and can be defined as the wealth, which is employed for the production. Capital is required by a bank as a cushion to absorb losses, which should be borne by shareholders rather than depositors and to finance the infrastructure of the business. Capital adequacy is to maintain adequate amount of capital or fund to safeguard the money of the depositors against any possible loss. NRB requires banks to maintain a certain capital adequacy ratio based on the total risk weighted assets and the banks are supposed to meet the minimum requirement of CAR.

2.1.7.7 Off-Balance Sheet Activities

Off balance sheet activities involve contracts for future purchase or sale of assets and all these activities are contingent obligations. These are not recognized as assets or liabilities on balance sheet. Some examples of these items are letter of credit, letter of guarantee, bills of collection etc. These activities are very important, as they are the good source of profit of bank though they have risk. Nowadays, some economists and finance specialists to expand the modern transactions of a bank stressfully highlight such activities.

2.1.7.8. Banking Risks

Normally, banks confront different kinds of risks, which are categorized as follows:

2.1.7.8.1 Credit Risk

Credit risk arises whenever another party enters into an obligation to make payment or deliver value to the bank. This risk is mostly associated with the lending.

2.1.7.8.2 Liquidity Risk

Liquidity risk arises when bank itself fail to meet its obligation. The bank required to make payments to the different parties at different times, when they fall due to other parties, it is the liquidity risk

2.1.7.8.3 Yield Risk

It is the risk that bank's assets may generate less income than expense generated by its liabilities.

2.1.7.8.4 Market Risk

The risk of loss resulting from movements in the market price of financial instruments in which the bank has a position is the market risk. Such instruments include bonds, equities, foreign exchange and associated derivative products.

2.1.7.8.5 Operational Risk

The risk of failure in the banks procedures or controls, whether from external or internal causes or as a result of error or fraud within the institution is the operational risk.

2.1.7.8.6 Ownership/Management Risk

The risk that shareholders directors or senior management be unfit for their respective positions or dishonest.

2.1.8 Project Appraisal

Before providing credit to the customer, bank makes analysis of project from various aspects and angles. It will help the bank to see whether project is really suitable to invest. The purpose of project appraisal answers the following questions:

-) Is the project technically sound?
-) Will the project provide a reasonable return?
-) Is the project in line with the overall economic objectives of the economy?

Generally, the project appraisal involves the investigation from the following aspects (Gautam, 2004,P. 258):

-) Financial aspect
-) Economic aspect
-) Management / Organizational aspect
-) Legal aspect

2.1.9 Provision of NRB for Extending Advances & Investment in Productive, Priority and Deprived Sector

2.1.9.1 Productive Sector

Productive Sector include advances to Priority Sector and Other Productive Sector which includes advances and investment in shares and debentures of

small, medium and large industries as defined in industrial enterprises act; pre-shipment credit like purchase of merchandise, processing, assembling, packaging etc.; export bill financing, advances for purchase of public transport like truck, bus, tempo etc. and agricultural/farm equipment; investments on shares and debentures of government/semi-government or private sector agricultural insurance, godown, banking or like companies (NRB Report, 2006, P.36) etc.

As per NRB regulation, commercial banks are required to extend 40% of the total advances to productive sector, which also includes 12% to priority sector including deprived sector.

2.1.9.2 Priority Sector Credit Program

"Priority sector" is defined to include micro and small enterprises which help increase production, employment and income as prioritized under the national development plans with an objective to uplift the living standard of general public particularly the deprived and low income people by progressively reducing the prevalent unemployment, poverty, economic inequality and backwardness. Micro and small enterprises are classified into agricultural enterprises, cottage and small industries and services. In addition, other businesses as specified by NRB from time to time are also included under Micro and small enterprises. All credits extended to priority sector up to the limit specified by NRB are termed as "Priority Sector Credit."

NRB has provided the requisite proportion of Priority Sector lending as follows:

Table No.2.1**NRB Requirement of Priority Sector Investment**

Fiscal Year	Minimum percent of Total Credit to be invested in Priority Sector
2006/07	7%
2007/08	6%
2008/09	5%
2009/10	4%
2010/11	4%

Source: NRB Directives 2010

Effective from FY 2007/08, investment in Priority Sector shall not compulsory. Before FY 2006/07, the commercial banks were directed to invest 8% of their total credit to priority sector.

2.1.9.3 Deprived Sector Lending

"Deprived Sector" includes low income and particularly socially backward women, tribes, lower caste, blind, hearing impaired and physically handicapped persons and Squatters(landless) family. All credits extended for the operation of self-employment oriented micro-enterprises for the upliftment of economic and social status of deprived sector up to the limit specified by NRB report 2010 is termed as "Deprived Sector Credit for all Nepal". "Deprived Sector Credit" for all Nepal is considered as integral part of priority sector credit and this credit comprise micro-credit programs and projects also.(NRB Directives2010,P.68)

The businesses under the Priority Sector Credit Program have been classified under the following four major heads:

-) Agriculture and Agro-bases business

-) Cottage and small industries
-) Services
-) Other business

Lending in Deprived Sector will be included in Priority Sector for the purpose of compliance test for 12% credit to Priority sector.

Deprived sector credit is advances up to Rs.30, 000 per borrower family meant for weak, poor and deprived people extended in the following manner by the commercial banks shall qualify to be included under deprived sector credit:

-) Direct investment made by the commercial banks themselves in income generating employment oriented programs.
-) Investments made by commercial banks in share capital of Rural Development Banks, Rural Micro Finance Development Center and other Development Banks established with an objective to extend credit to deprived sector.
-) Advances to the Rural Development Banks and other Development Banks engaged in the similar poverty alleviation programs.
-) Advances to Cooperatives, Non-governmental Organization and Small Farmers Cooperatives approved by NRB for carrying out banking transactions.
-) Advances to Micro-Finance Institutions (Rural Development Banks and other financial institutions, cooperatives and non-governmental organizations approved by NRB for intermediation) stipulating the condition to disburse such credit to deprived sector only.
-) Loans extended by commercial banks to development banks engaged in micro credit activities with stipulated condition to disburse the credit

only to the deprived sector up to Rs.30,000 a family shall be eligible for the purpose of inclusion under Deprived Sector Credit.

Effective from FY 2006/07, Nabil and HBL shall compulsorily extend advances to the deprived sector by 3% of its total outstanding credit while new commercial banks are required to invest 0.25% of total outstanding credit to the deprived sector.

2.1.9.4 Regulation relating to Loan Classification and Loan Loss Provisioning

With an objective to minimize the possible loss of credits extended by commercial banks as provided under section 23 (1) of Nepal Rastra Bank Act 2012 (with amendment) relating to development and regulation and banking system . This directive in respect of loan classification & provisioning has been issued in exercised of authority under section 56 of bank and financial institutions act 2063.

2.1.9.5 Classification of Outstanding Loan and Advances on the Basis of Aging

Banks shall classify outstanding principal amount of loan and advances on the basis of aging.

2.1.9.6 Classification of Loans and Advances

Loan and advance shall be classified into the following 4 categories;(NRB Directives,2004,P.38)

2.1.9.6.1 Pass

Loans and Advances whose principal amount are not past due for a period up to 3(three) months shall be included in this category. These are classified and defined as performing Loans.

2.1.9.6.2 Substandard

All loans and advances that are past due for a period of 3 month to 6 month shall be included in this category.

2.1.9.6.3 Doubtful

All loans and advance which are past due for a period of 6 month to 1(one) year shall be included in this category.

2.1.9.6.4 Loss

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

Loans and advances failing in the category of sub-standard doubtful and loss are classified and defined as **Non-Performing Loan**.

Note:

-) If it is appropriate in the views of the Bank management there is not restriction in classifying the loan and advances from low risk category. For instance, loan falling under sub-standard may be classified into Doubtful or loss and loans falling under Doubtful may be classified into loss category.
-) The term loan and advances also includes Bills purchased and Discounted.

2.1.9.7 Submission of Return Relating to Classification of Loan and Advances

Bank shall, as of the Mid of October, January, April and July, prepare the statement of outstanding loans & advances classified on the basis of aging &

submit the particulars as per the enclosed Directives Form No.3 to the Banking Operation Department & Inspection & Supervision Department of Nepal Rasta Bank within 1(one) month from the end of each quarter. Classified Loans and Advances under the currently existing arrangement are required to be classified as per the Time Table in four phases:

2.1.9.8 Relating to Collateral

All collateral used back loan & advance shall be adequate to cover up the principal and interest and shall also be legally secured. In the event of non-realization of principal and interest of loan, there must be no difficulty in acquiring the title of the collateral asset.

2.1.9.9 Additional Arrangement in Respect of Pass Loan

Loans & advances fully secured by gold, silver, fixed deposit receipts and NG securities shall be included under “**pass**” category.

However, where collateral of fixed deposit receipt or NG securities or NRB Bonds is placed as security against loan for other purposes, such loans has to be classified on the basis of aging per clause 2.

2.1.9.10 Additional Arrangement in Respect of “Loss Loan”

Even if the loan is not past due, loans giving any or all of the following discrepancies shall be classified as “**Loss**”.

-) No security at all or security that is not in accordance with the borrower’s agreement with the bank,
-) The borrower has been declared bankrupt,
-) The borrower is absconding or cannot be found,
-) Purchased or discounted bills are not realized within 90 days from the due date.

-) The credit has not been used for the purpose originally intended.
-) Owing to non- recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation.
-) Loans provided to the borrowers included in the black list and where the **Credit Information Bureau** blacklists the borrower.
-) Additional Arrangement in Respect of Term Loan

In respect of term loans, the classification shall be made against the entire outstanding loan on the basis of the past due period of over due installment. In the event of conversion of contingent liabilities of the bank e.g. letters of credit, un-matured guarantees, into the liability of the bank, such amount becomes recoverable from the customers. Hence, such amount shall also be classified as per the classification norms applicable to loans & advances & accordingly be provided with requisite provisioning.

Prohibition to Recover Principal and Interest by Overdrawing the Current Account & Exceeding the Overdraft Limit Principal and interest on loans & advances shall not be recovered by overdrawing the borrower's current account or where overdraft facility has been extended, by overdrawing such limit. However, this arrangement shall not be construed as prohibitive for recovering the principal & interest by debiting the customer's account & recovery is made as such resulting in overdraft, which is not settled within one month, such overdrawn principal amount shall also be liable to be included under the outstanding loans & such loans shall be liable to be included under the outstanding loan and such loan shall be downgraded by one step from its current classification. In respect of recognition of interest, the same shall be as per the clause relating to income recognition mentioned in Directives No.4.

2.1.9.11 Loan Loss Provisioning

The Loan loss provisioning, on the basis of the outstanding loans & advances and purchase classified as per this Directives, shall be provided as follows:

Classification of Loan	Loan Loss Provision
Pass	1 percent
Substandard	25 percent
Doubtful	50 percent
Loss	100 percent

Note: Loss loan provision set aside for performing loan is defined as “general loan loss provision” and loan loss provision set aside for Non- performing loan is defined as “Specific Loan Loss Provision”.

2.1.9.12 Additional Provisioning in case of Personal Guarantee Loans

Where the loan is extended only against personal guarantee, a statement of the assets equivalent to the personal guarantee amount not claimable by any other shall be obtained. Such loans shall be classified as per above and where the loans fall under the category of Pass, Substandard and Doubtful, in addition to the normal loan loss provision applicable for the category, an additional provision by 20% point shall also be provided. Classification of such loans and advances shall be prepared separately.

2.1.9.13 Rescheduling and Restructuring of Loan

In respect of loans & advances falling under the category Substandard, Doubtful or Loss, banks may reschedule or restructure such loans only upon receipt of a written Plan of Action from the borrower citing the following reason:

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

In addition to written Plan of Action for rescheduling or restructuring of loan per Clause (13.1) above, payment of interest according to the loan contract as originally specified should have been collected. The loan loss provisioning, in respect of rescheduled, restructured and swap loans, shall be provided at minimum 12.5%. Separate statement shall be prepared for loans classified & provision made as per Clause 13.3 above.

2.1.9.14 Provisioning against Priority Sector Credit

Full provisioning as per clause (11) shall be made against the uninsured priority and deprived sector loans. However, in respect of insured loans; the requisite provisioning shall be 25% of the percentage state under clause (11).

2.1.9.15 Adjustment in Provisioning

Except in the following cases, banks are prohibited from making any adjustments in their loan loss provision amount:

-)] The loan has been completely written off:

-)] The principal amount of loan and interest has been fully settled by the borrower.
-)] Loan has been classified or reclassified and vision for loan loss is made.

However, no such adjustments shall be made in the case of reclassified loan by way of rescheduling or restructuring.

2.1.9.16 Action to be taken in case of Noncompliance

In cases where a bank has been found not complying the regulations in respect of loan classification and provisioning, Nepal Rastra Bank may ask for clarification. If the bank's response is not satisfactory, Nepal Rastra Bank shall initiate following action in exercise of its authority under section 23(1) of Nepal Rastra Bank Act. 2012.

Require reclassification of loan and advances and accordingly adjust the loan loss provisioning within 3 months. If the banks do not comply to the directive issued as per Sub-Clause 16.1 above, the following additional action shall be initiated in exercise of the authority under section 32 of Nepal Rastra Bank Act 2012 with amendment:

-)] Suspend declaration and distribution of dividends (including bonus shares)
-)] Suspend extension of loans
-)] Suspend acceptance of deposits

All earlier circulars issued by Nepal Rastra Bank relating to loan classification and loan loss provisioning have been repealed.

2.2 Review of Related Studies

Bhattarai (1978) in her thesis entitled “**Lending Policy of Commercial Banks in Nepal**” has made an effort to examine the lending policy of commercial banks. She has concluded that efficient utilization of resources is more important than collection of the same. Lower investment means lower capital formation that hampers economic development of the people and the country. So, she recommended that bank should give emphasis on efficient utilization of resources.

Pradhan (1980) in his thesis entitled, “**A Study on Investment Policy of Nepal Bank Ltd**” has emphasized that there is a greater relationship between deposits and loans and advances. He can include that though loan and advance as well as deposits is increasing trend, their increase is not in proportionate manner. Immense increase in deposit had led to little increase in loan and advances due to the increase in the interest rates. His recommendation was to great loan and advances without its lengthy process. He has suggested enhancing banking transactions up to rural sector of the kingdom.

Joshi (1982) in his thesis entitled, “**Lending Policy of Commercial Banks in Nepal.**” concludes that commercial banks have collected such resources from people but they are far behind in their utilization. Commercial banks in Nepal are still lazy to play an active role to utilize their resources collected from different sector in accordance with the need of the economy.

Khatriwada (2004) in his thesis entitled, “**Retail Banking an Emerging Trend in India**” has made an effort to analyzing the trend of retail banking product offered by Indian commercial banks and evaluating the contribution in Indian economy. He concluded that there is highly positive correlation co-efficient and co-efficient of determination of above 90% between per capita GDP and retail banking indicated the direct relationship between them. When one Rs. per capita GDP increase, the retail banking player can enhance its retail banking segment and housing finance segment by Rs.3.26 core and Rs.1.36 core

respectively. He finds that the retail banking segment has much low level of NPA than banking industry's NPA. Housing finance segment of the retail banking is the most leading segment. This segment contributes to retail banking by more than 40%. He suggests that there is tremendous upwards potential in this segment. The future of retail banking is dependent on technology facilities reduction in transaction cost and provides the ability to do business involutes. New kinds of management skill are required to manage the retail – landing portfolio.

Bakhati (2006) in his thesis entitled, “**A Comparative Study on Housing Finance of Everest Bank, Nepal Bangladesh Bank limited and Kumari Bank limited.**” concludes that the proportion of housing loan in total loan and advance for all the banks under study is in increasing trend. Among the sample banks, EBL has disbursed higher amount for housing loan. EBL is the pioneer bank in Nepal which initiates the housing loan scheme in Nepal. He suggests that the growth of housing loan depends upon interest rate, so the sample banks are requested to lower down the invest rate and make the procedure of getting loan easy.

Pant (2006) in his thesis entitled, “**A Study of Commercial Bank Deposit and its Utilization.**” He made an attempt to highlight the discrepancy between resource collection and research utilization. He concluded that commercial banks failure in resource utilization is due to their lending confined to short term only. He recommended the commercial banks to give emphasis also on long and medium term lending for better utilization of the deposit.

Aryal (2006) in his thesis entitled, “**An Analysis of Retail Leading in Market With Special Reference to Everest Bank limited**” concludes that the to get success in competitive banking environment depositors money must be utilized as loan and advance. The largest items of the bank in the assets sides in loan and advances. If it is neglected, it could be the main causes of liquidity Crisis in the banks and one of the main reasons for a banks failure. He recommended

that bank should follow liberal lending policy and invests more and more percentage of total deposit in loan and advances and similarly, maintains more stability in the investment policy.

Pandeya (2008) has carried out study with the objectives to find out the impact of changes in NRB directives on the performance of the commercial banks and to find out whether the directives were implemented or not. According to his findings the directives if not properly addressed have potential to implement the financial system of the country. The directives in themselves are not that important unless properly implemented. The implementation part depends upon the commercial banks. In case commercial banks are making such huge profit with full compliance of NRB directives, then the commercial banks would deserve votes of praise because they would then be instrumental in the economic development of the country. All the changes in NRB directives made impacts on the bank and the result are the followings:

- Increase in operational procedures of the bank, which increase the operational cost of the bank.
- A short term decreases in profitability, which result to fewer dividends to shareholders and less bonus to the employees.
- Reduction in the loan exposure of the bank, which decreases the interest income but increase the protection of the depositor's money.
- Increase protection to the money of the depositors through increased capital adequacy ratios and more stringent loan related documents.
- Increase demand from shareholder's contribution in the bank by foregoing dividends for loan loss provisions and various reserves to increase more capital.

All the aforesaid result lead to one direction the bank will be financially healthy and stronger in the future. HBL will be able to withstand tougher

economic situation in the future with adequate capital and provision for losses. The tough time through which the bank is undergoing at present will prevail only for a couple of years but in the long run, it will be strong enough to attract more deposits and expose itself to more risk with capital cushion behind it. The quality of the assets of the banks will become better as banks will be careful before creation credit. Ultimately, the changes in the directives will bring prosperity not only to the shareholders but also to the depositors and the employees and the economy of the country as a whole.

Pandeya (2008) has made his research on the impact on changes in new directives. In his study, he has studied only the provision related to loan provisioning and capital adequacy. However, besides Loan Loss Provision and capital adequacy, the other factors like concentration risk, sector-wise lending risk can further be discussed. A study on the organizational structure or management techniques applied for the proper implementation of NRB directives and for management of credit risk can also be made.

Bhattarai (2008) in his article "Something is rotten with the state of commercial banking in Nepal" starts with words like NPA, conflict of interest, merky offshore ownership, well connected defaulter, loan swapping and political obstruction to describe the commercial banks in Nepal. Mr. Bhattarai quoted the words of the Governor to describe the state of banking sector as 'terrible'. Also, he quotes one of the donor representatives involved in financial reform as "Nepal has the weakest central bank in the developing world." As per the author, bankers with patronage could get away with getting anything they wanted approved by the regulator. He quotes Mr. SJB Rana, the first governor of NRB, "only 3 out of 12 Governors actually completed their five year terms in its entire history because they were sacked for undefined agencies." He also quotes Mr. Shovan Dev Pant, the then Executive Director of Nabil, "The financial sector is in appalling state."

Regmi (2008) conducted a thesis “A study on credit practices of joint venture commercial banks with reference to Nepal SBI Bank Ltd. and Nepal Bangladesh Bank Ltd.”

The basic objectives of this thesis are:

- To determine impact of deposit in liquidity and its effect on lending practices.
- To know the volume of contribution made by both bank in lending.
- To examine lending efficiency and its contribution in profit.
- To analyze trend of deposit utilization towards loan and advances and net profit and their projection for next five years.

2.3 Research Gap

Since the above mentioned studies offer limited findings, more extensive testing , and adjustment of necessary variables are needed in order to be more conclusive about the credit Management. Previous studies were directed to find the effect of the credit management of different commercial banks. Similarly, Joshi's study is unable to present the exact condition of credit management in Nepalese banking sector Nepal.

Presently, this study aims to attempt to study about credit management of Nepalese commercial banks in Nepal. The previous relevant literature related to banking business has just reviewed to support the study. In Joshi's study, he failed to study the perfect credit management of Nepalese commercial banks. This study tries to fulfill this weakness. And there is also less research made in this topic especially in banking sector.

Credit Management has very big role to sustain any banking business. It is equally important to identify the relation of performance of the banking business. So, it tries to assess the credit management of banking sector and by

providing the proper atmosphere for the banking market in our country. The present study is based on five years data of commercial banks, which tries to achieve its objectives by analyzing secondary source of data. Thus, the earlier studies on these issues need to be updated and validated because of the many changes taking place in Nepalese banking sector. The current study is a supplement to overcome the weakness and limitation of previous studies.

CHAPTER- III

RESEARCH METHODOLOGY

3.1 Introduction

The basic framework of this study is descriptive as well as exploratory. In order to reach and accomplish the objectives of this study, different activities are carried out and different stages are crossed during the study period. For this purpose, the chapter aims to present and reflect the methods and techniques those are carried out and followed during the study period.

3.2 Research Design

There are many methods of research design and this study will be based on recent historical data. Mostly, secondary data and information to be collected, evaluated, verified and synthesized to reach a conclusion. To achieve the objective of this study descriptive data different journals and articles relevant with the study, annual reports of different fiscal years of concerned banks, NRB Directives, banking and financial statistics report published by NRB and other related materials are collected and studied. With the help of descriptor and research design, the study evaluates the Credit Management of Commercial Banks.

3.3 Population and Sample

There are altogether 32 commercial banks functioning all over the country at present, which are taken as a population of this study work. Among them, this study comprises only two commercial banks namely; Bank of Kathmandu Ltd and Nepal Investment Bank Ltd, which have been selected as a sample for this research study.

3.4 Sources of Data

These are secondary data and secondary data are extracted from published annual reports of the bank, published articles, journals, reports, previous related studies etc.

3.5 Method of Data Analysis

In this study, various financial, mathematical as well as statistical tools have been used to make the analysis more convenience, reliable and authentic too.

3.5.1 Financial Tools

Financial tools are used to examine the financial strength and weakness of the bank. In this study, following financial tools are used:

3.5.1.1 Loan Classification and Provisioning:

The amount of loans in the various categories has been calculated by using the models of NRB. Likewise, for each category, the actual loan loss provisioning amount has also been calculated according to the directions laid down by NRB.

3.5.1.2 Liquidity Ratio:

Liquidity ratios measure the firm's ability to meet current obligations. In fact, analysis of liquidity needs the preparation of cash budgets and cash and fund flow statements; but liquidity ratios, by establishing a relationship between cash and other current assets to current obligations, provide a quick measure of liquidity. (Dangol, 2008, P.601)

A firm should ensure that it does not suffer from lack of liquidity, and also that it does not have excess liquidity. According to the NRB requirement, the bank has to maintain at least 5% of its total deposit liability as a balance with NRB. The prior provision of Statutory Liquidity Ratio (SLR) and vault reserve has been fully removed now.(NRB Directives,2010,P.14)

The following ratios are evaluated under liquidity ratio :(Dangol, 2008, P.602)

1. Current Ratio:

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

2. Cash & Bank Balance to Current Assets Ratio:

$$\frac{\text{Cash \& Bank Balance}}{\text{Current Assets}}$$

3. Loans & Advances to Current Assets Ratio:

$$\frac{\text{Loan \& Advances}}{\text{Current Assets}}$$

4. Investment on Govt. Securities to Current Assets Ratio:

$$\frac{\text{Investment on Government Securities}}{\text{Current Assets}}$$

3.5.1.3 Investment Portfolio and Policy;

In order to make profits, banks must invest the funds collected from depositors in various productive sectors and different form of earning assets. Though the bank may have its own policy and theory of investment, it also has to look upon the criteria or requirement defined by NRB before making any investment decisions. Just like minimum requirement of investment to be made in productive, priority and deprived sector, regulation relating to investment in shares and securities by commercial banks etc.

The following ratios are evaluated for finding out investment portfolio and investment policy of subjected banks:(NRB Directives,2010,P.18)

1. Total Investment to Total Deposit Ratio:

$$\frac{\text{Total Investment}}{\text{Total Deposits}}$$

1. Loan & Advances to Total Deposit Ratio:

$$\frac{\text{Loan \& Advances}}{\text{Total Deposit}}$$

3. Loan & Advances to Total Working Fund:

$$\frac{\text{Loan \& Advances}}{\text{Total working fund}}$$

4. Total Investment to Working Fund Ratio:

$$\frac{\text{Total Investments}}{\text{Total Working Fund}}$$

3.5.2 Statistical Tools

Several numbers of statistical tools can be employed to examine the financial data of NIBL and BOK. Some of the statistical tools that are used for the purpose of this study are presented below.(Chaudhari,2002,P.103)

3.5.2.1 Arithmetic Mean

Most of the time when we refer to the “average” of something, we are talking about its arithmetic mean. To find out the arithmetic mean, we sum the values and divide by the number of observations. The mean can be calculated as;

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

Where,

\bar{x} X Mean

$\sum x$ X Sum of values of all observation

n X number of elements in the sample

3.5.2.2 Standard Deviation

The standard deviation is the square root of the average of the squared distances of the observations from the mean. It enables us to determine, with a great accuracy, where the values of a frequency distribution are located in relation to the mean. To compute the sample standard deviation, we use the following formula;

$$S.D. = \frac{\sum (x - \bar{x})^2}{n}$$

Where,

S.D. X Standard deviation

x X Value of each of the n observation

\bar{x} X Mean of the sample

$n =$ Number of observations in the sample minus 1

3.5.2.3 Karl Pearson's Correlation Coefficient

The Karl Pearson's correlation coefficient is one of the widely used mathematical methods of calculating the correlation or relationship between two different variables. These method summaries in one figure the degree of relationship as well as direction. It is simply denoted by "r" and it can be calculated by using the following formula;

$$r = \frac{\sum XY - (\sum X)(\sum Y)}{\sqrt{\{N \sum X^2 - (\sum X)^2\} \{N \sum Y^2 - (\sum Y)^2\}}}$$

CHAPTER-IV

PRESENTATION AND ANALYSIS OF DATA

Presentation and analysis of data is very important stage of research study. Its main purpose is to change the unprocessed data into understandable form. It is the process of organizing the data by tabulating and then placing that data in presentable form by using various tables, figures and sources.

Credit management is one of the most important factors that has been developed to facilitate effective performance of bank management. Credit management is the formal expression of the commercial banks goals and objectives stated in financial term for specific future period of time. Credit is the very basic indicator for determining profit.

The main purpose of the objective is to assess the credit management in selected commercial banks. Present chapter will discuss the various aspects of credit management and their actual accomplishment. Actually, credit management is a fundamental managerial tool, which is applied in commercial banks. For this respect, it will analyze the data by using various financial and statistical tools to meet the stated objectives of the study. It also compares the data between selected banks. Besides, it also presents the various funding generated from data analysis.

4.1 Financial Condition of Selected Nepalese Commercial Banks

Financial analysis assists in identifying the major strengths and weaknesses firm. It indicates whether a company has enough cash to meet its obligations ability to utilize properly their available resources. Financial analysis can also used to access the company's liability as an ongoing enterprise and determine whether a satisfactory return is being earned for the risks return. The necessary

to find out the comparative financial condition of the banks in terms of credit practices necessary to find out the comparative credit practices in those banks.

For research purpose, financial condition of both the banks in terms of credit practices, credit efficiency has analyzed the comparative credit position selected commercial banks.

4.2 Credit Practices in Bank of Kathmandu and Nepal Investment Bank

Credit practices show the lending policies and practices adopted by the selected commercial banks during the study period. It measures the ability of the organization in terms of credit practices by using historical data.

4.2.1 Total loans to Deposit Ratio

The main source of bank's lending depends on its deposit. 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. The ratios are presented in the following table.

Table 4.1

Total loans to deposit ratio

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	20010/11	Mean
BOK	0.501	0.553	0.543	0.478	0.523	0.520
NIBL	0.587	0.542	0.546	0.498	0.553	0.545

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

The table 4.1 shows that the ratio of credit deposit ratio in NIBL was 0.587, 0.542, 0.546, 0.498 and 0.553 in the fiscal year 2004/05 to fiscal year 2008/09 respectively. Similarly the ratio of BOK was 0.501, 0.553, 0.543, 0.478 & 0.523. In overall comparison, NIBL has the highest ratio in F/Y 2006/07 i.e. 0.587 and BOK has observed the lowest ratio in F/Y 2009/10 with 0.478.

For mean point of view, NIBL has maintained higher loan & advances to total deposit. In this way, it shows that NIBL seems to be strong to mobilize its total deposit as loan & advances. However higher ratio does not mean it is always better from the point of liquidity. Both banks are capable to use more than 50% of deposit on loan and advances. If maintained this, it helps to make consistency on the profitability of the banks.

4.2.2 Interest income to loans & advances

Interest income to loan & advances is one of the major sources of income for a commercial bank. The high volume of interest income is indicator of good performance of lending activities.

Table 4.2

Interest income to loan & advances

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	0.108	0.111	0.098	0.156	0.168	0.128
NIBL	0.088	0.092	0.102	0.093	0.095	0.094

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Table 4.2 shows the ratio of interest income to loan and advances of the selected companies over the study period. Interest income to loan and advances ratio of BOK ranges from the highest of 0.168 and to the lowest of 0.098 in the fiscal year 2010/10 and 2008/09 respectively. The mean ratio is 0.128, ratio of

last two years are above the mean and the ratio the of fiscal year 2006/07, 2007/08 and 2008/09 are below the average. The mean interest income to loan and the advances of the NIBL is 0.094. Ratio of NIBL does not show clear direction. Highest ratio is in the fiscal year 2008/09 and lowest in the fiscal year 2006/07 is 0.088. The mean interest income to loan and advances ratio of BOK, it terms of the ratio BOK has best performance than NIBL.

4.2.3 Non-Performing Loans to Total Loan and Advances Ratio

NRB has directed all the commercial banks to create loan loss provision against the doubtful and bad debts. But our concerned banks have not provided data on non-performing loan in Balance Sheet and Profit & Loss A/C. To measure the volume of non-performing loan to total loan & advances the main indicator of NIBL and BOK has been used. This ratio shows the percentage on non-recovery loans in total loan & advances.

Table 4.3

Non-performing loan to total loan and advances (in %)

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	0.089	0.074	0.085	0.068	0.073	0.078
NIBL	0.025	0.027	0.035	0.045	0.038	0.034

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Table 4.3 shows the Non- performing loan to total loan and advance over the study period. Ratio of BOK ranges highest of 0.089 and lowest 0.073, it shows decreasing trend in subsequent year. Likewise the ratio of NIBL ranges the highest of 0.045 and lowest 0.025, it is in fluctuating during the study period. The mean Non-performing loan to loan and advances of BOK and NIBL are 0.078 and 0.034. The Ratio of BOK in the year 2006/07 and 2008/09 are above

and below the average in the remaining fiscal year. Ratio of NIBL in the first two are below the average and ratio of last three years are above the average. NIBL has the lowest non performing loan to total loan and advances, this NIBL is best performer than the BOK.

Banking sector is seriously affected by the non-performing loan. Both banks are not far from this above fact. If non-performing loan increases, the overall banking business will be affected. So provisioned amount will increase and profit will decrease. So, it is suggested that both banks (NIBL & BOK) to be sincere while granting loan and to do effective follow up for recovery of non-performing loan.

4.2.4 Loans and Advances to Total Assets Ratio

Loan & advance is the major part of total assets for the bank. This ratio indicates the volume of loans & 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.

Table 4.4

Loans & advances to total assets ratio

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	0.483	0.497	0.521	0.472	0.498	0.494
NIBL	0.622	0.726	0.562	0.578	0.582	0.614

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Table 4.4 shows that the ratio of loans & advance to total assets in five years for the selected companies. Loans and advances to total assets ratio of BOK ranges the highest of 0.521 in the fiscal year 2008/09 and the lowest in the fiscal year 2009/10 is 0.472. Ratio of NIBL is highest in the fiscal year with 0.726 and lowest 0.578 in the fiscal year 2009/10. From the mean point of view, it can be said that mean ratio of NIBL has highest than BOK. It can be concluded that higher the mean ratio it indicates good lending performance. Here BOK should focus to increase loan and advances to total assess ratio to increase lending performance.

4.2.5 Loan and advances to current assets ratio

Loans & advances is the major component in total assets, which indicates the ability of banks to canalize its current assets in the form of loan & advance to earn high return. If sufficient loan and advances cannot be granted, it should be pay interest on those utilized current assets funds and may lose earnings. So commercial banks provide loan & advances in appropriate level to find out portion of current assets, which is granted as loan & advances.

Table 4.5

Loan & advances to current assets ratio

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	4.49	5.06	5.25	4.85	4.95	4.920
NIBL	6.43	6.09	5.95	6.12	5.78	6.074

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Table 4.5 shows the loan and advances to current assets of selected companies over the study period. Loans and advances to current assets ratio of BOK ranges highest of 5.25 times in the fiscal year 2008/09 and lowest 4.49 in the

fiscal year 2006/07. Loan and advances to current assets ratio of BOK in the fiscal year 2006/07 and 2009/10 are below the average and above the average in the rest of the fiscal year. This shows the increasing trend on loan and advances to current assets ratio of BOK. The Ratio of NIBL is the highest in the fiscal year 2006/07 with 6.43 and lowest 5.78 in the fiscal year 2010/11. From the mean point of view, it can be said that mean ratio of NIBL has highest than BOK. It can be concluded that the higher the mean ratio indicates the good short term lending performance. BOK should focus to increase loan and advances to current assets ratio to increase short term lending performance.

4.2.6 Loans loss provision to total loan and advances ratio

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. But its positive impact is that strengthens the financial conditions of banks by controlling the credit risk and reduces the risks related to deposits.

The low ratio indicates the good quality of assets in total volume of loan & advances. High ratio indicates move risky assets in total volume of loan & advances.

Table 4.6

Loan loss provision to total loan & advances

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	0.081	0.066	0.069	0.078	0.062	0.071
NIBL	0.027	0.036	0.042	0.039	0.034	0.036

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Above table 4.6 shows the loan loss provision to total loan and advances of selected over the study period. Ratio of BOK ranges highest 0.081 in the fiscal year 2006/07 and lowest 0.062 in the fiscal year 2010/11. Average ratio of BOK is 0.071, ratio in fiscal year 2006/07 and 2009/10 are above the average and ratio in remaining fiscal years are below the average during the five year period. Ratio of NIBL ranges highest 0.042 in the fiscal year 2008/09 and lowest 0.027 in the fiscal year 2006/07. Here average loan loss provision to loan and advances ratio of BOK is higher than the NIBL. Higher ratio indicates the increased volume of non-performing loans and vice versa. Loan loss provision of BOK is in a decreasing trend in on the fiscal year 2007/08, so the decreasing loan loss ratio indicates efficient credit policy and gradual increment on the performance of the company. Here loan loss provision to total loan and advances of NIBL is in increasing trend, which indicates increased volume of non-performing loans of NIBL; we can say this is due to the ineffective credit policy and poor performance of the company.

4.3 Credit efficiency in Bank of Kathmandu and Nepal Investment Bank Limited.

It measures the effectiveness or activity of the company through establishing the relationship between the various assets and credit of that respective organization.

4.3.1 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. Commercial Banks are dependent upon its ability to generate cheaper fund has moves the probability of generating loans and advances and vice versa.

Table 4.7**Interest expenses to total deposit ratio**

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	0.037	0.039	0.029	0.024	0.031	0.032
NIBL	0.025	0.026	0.032	0.028	0.024	0.027

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Above table 4.7 shows the cost of deposit of selected banks over the study period. The Ratio of BOK ranges highest 0.039 in the fiscal year 2005/06 and lowest 0.0247 in the fiscal year 2007/08. Average ratio of BOK is 0.032, ratio in fiscal year 2006/07 and 2007/08 are above the average and ratio in rest of the fiscal year are below the average. Ratio of NIBL ranges highest 0.032 in the fiscal year 2008/09 and lowest 0.024 in the fiscal year 2010/11. Here average interest expenses to total deposit ratio of BOK than higher than of NIBL ratio. Higher ratio indicates the increased cost of deposit. NIBL is able to collect the cheaper deposit than that of BOK.

4.3.2 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. The ratio indicates the costly sources of funds.

Table 4.8**Interest expenses to total expenses ratio**

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	0.391	0.358	0.435	0.465	0.412	0.412
NIBL	0.388	0.473	0.389	0.342	0.312	0.381

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Above table 4.8 shows the interest expenses to total expense ratio of selected companies over the study period. Ratio of BOK ranges highest 0.465 in the fiscal year 2009/10 and lowest 0.358 in the fiscal year 2007/08. Average ratio of BOK is 0.412, ratio in fiscal year 2006/07 and 2007/08 are below the average and ratio in the rest of the fiscal year is above the average. So, this shows the increasing trend of the ratio. Ratio of NIBL ranges highest 0.473 in the fiscal year 2007/08 and lowest 0.312 in the fiscal year 2010/11. Average interest rate of NIBL is 0.381, here ratio in fiscal year 2009/10 and 2010/11 are below the average and ratio of remaining year above the average. Here average interest expenses to total expenses ratio of BOK is higher.

NIBL has low interest expenses to total expenses ratio, which shows that decrease in cost of deposit as decrease in the interest expenses to total expenses ratio decrease.

4.3.3 Non-interest bearing deposits to total deposit ratio

This ratio measures the volume of non-interest bearing deposits to total deposit. The volume of interest expenses in total expenses represents a large portion of the total expenses. How efficiently the deposits were managed affectively in the total volume of expenses. The higher ratio is favorable but in practices, interest bearing deposits always plays a significant role in the mix of deposit liability.

Table 4.9**Non-interest bearing deposits to total deposit ratio**

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	0.21	0.34	0.29	0.26	0.31	0.282
NIBL	0.13	0.1	0.16	0.12	0.11	0.124

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Above table 4.9 shows non- interest bearing deposits to total deposit ratio of selected companies over the study period. Ratio of BOK is fluctuating trend, ranges the highest 0.34 in the fiscal year 2007/08 and the lowest 0.21 in the fiscal year 2006/07. Average ratio is 0.282, ratio of fiscal year 2007/08 and 2010/11 are above the average and ratio of remaining fiscal year are below the average. Non – interesting bearing deposits to total deposit ratio of NIBL ranges highest 0.16 in the fiscal year 2008/09 and lowest 0.10 in the fiscal 2007/08.

From the mean point of view, it can be said that BOK has highest mean ratio .In this way; the deposit mixture of BOK carries the highest level of interest bearing deposits in its deposit mixture. This major portion of non-interest bearing deposit consists of current deposits and this deposit is particularly maintained by business enterprises.

4.3.4 Interest income to total income ratio

This ratio measures the volume of interest income in total income. The high ratio indicates the high contribution made by lending and investment whereas low ratio indicates low contribution made by lending & investment and high contribution by other fee based activities in total income.

Table 4.10**Interest income to total income ratio**

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	0.822	0.795	0.856	0.725	0.812	0.802
NIBL	0.774	0.809	0.789	0.768	0.757	0.779

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Table 4.10 shows the interest income to total income ratio of selected companies over the study period. The ratio of BOK ranges highest 0.856 in the fiscal year 2008/09 and lowest 0.725 in the fiscal year 2009/10. The average ratio is 0.802, ratio in the fiscal year 2007/08 and 2009/10 are below the average and ratio in the rest of the fiscal year above the average. Ratio of NIBL is highest 0.809 in the fiscal year 2007/08 and the lowest in the fiscal year 2010/11 is 0.757. The average ratio is 0.779, the ratio of fiscal year 2007/08 and 2008/09 are above the average and below in the rest of the fiscal years.

From Average point of view, it can be said that BOK has high interest income to total income. This shows that in total income of BOK and NIBL, interest income contributes 80.2% and 77.90% respectively. The lowest ratio of NBIL indicates its low dependency in fund-based activity. The highest ratio of BOK indicates greater dependency on fund-based activities.

4.3.5 Interest suspense to interest from loans & advances ratio

Interest suspense means the interest due but not collected. This ratio measures the composition of due but uncollected interest in the total interest income from loan & 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 loans & advances.

Table 4.11

Interest suspense to interest income from loans & advances ratio

Bank/F.Y	2006/07	2007/08	2008/09	2009/10	2010/11	Mean
BOK	0.26	0.34	0.36	0.28	0.25	0.298
NIBL	0.03	0.03	0.04	0.05	0.04	0.038

Source: Annual reports of the companies (FY2006/07 to FY 2010/11)

Table 4.11 shows the interest suspense to total income from loans and advances ratio of selected companies over the study period. Ratio of BOK ranges highest 0.36 in the fiscal year 2008/09 and the lowest 0.25 in the fiscal year 2010/11. Average ratio is 0.298, ratio in fiscal year 2007/08 and 2008/09 are above the average and ratio in rest of the fiscal year below the average. The ratio of NIBL ranges highest 0.05 in the fiscal year 2009/10 and lowest in the fiscal year 2006/07 and 2007/08. The average ratio is 0.038, ratio of fiscal year 2006/07 and 2007/08 are below the average and above in the rest of the fiscal year.

From Average point of view, it can be said that BOK has high interest income to total income. This shows that in total income of BOK and NIBL, interest income contributes 29.80% and 3.80% respectively. The lowest ratio of NIBL indicates its low dependency in fund-based activity. The highest ratio of BOK indicates greater dependency on fund-based activities.

4.4 Relationship of loans and net profit

Effective loans directly affect net profit volume of the organization. It is regarded as the most important profit indicator. It helps to increase the net profit volume of the company whereas weak level of loans is the signal of lower level of profit. Thus, it is logical to review the relation of loans and net profit.

For the research proposes, net profit and loans during study period (5 yrs) are averaged to get profit and loans variable. After getting profit and loans variable, then data are analyzed using person's correlation coefficient. The following table presents the correlation coefficient of the profit and loans during study period.

Table 4.12

**Relationship between loan and advance and net profit in BOK:
Correlation Matrix**

		Loans	Net profit
Loans	Person Correlation	1	0.9166
	N	5	5
Net Profit	Person Correlation	0.9166	1
	N	5	5

The table 4.12 presents the correlation coefficient between loans and net profit during study period. The calculated Person's Correlation Coefficient was found 0.9166, which shows high degree of correlation. It indicates that loans and net profit were found highly related with each other. That means, increasing loans helps to increase the net profit whereas decrease in loans decreases in net profit

similarly. Coefficient of determination was found to be 0.8119 which indicates that 81.19% of total change in profit has been determined by the loans. Loans have high influence on net profit of the BOK. Effective loans management helps to increase and stable the net profit of the BOK. No exception is found in case of BOK. Thus, it is logical to review the impact of various components of credit in net profit of the BOK.

Table 4.13

Relationship of loans and net profit in NIBL: - Correlation Matrix

		Loans	Net profit
Loans	Person correlation	1	0.953
	N	5	5
Net profit	Person correlation	0.953	1
	N	5	5

The table 4.13 presents the correlation coefficient between loans and Net profit during study period. The calculated Person's correlation coefficient was found 0.953, which shows high degree of positive correlation. It indicates that loans and net profit were found high related with each other. That means, increasing loans helps to increase the net profit whereas increase in loans decreases the net profit. Similarly, coefficient of determination was found to be 0.9111 which indicates that 91.11% of total change in profit has been determined by loans. Loans have high influence on net profit of the NIBL Bank. Effective loans management directly affects to net profit of the NBIL Bank. No exception is found in case of NIBL Bank. Thus, it is logical to review the impact of various components of working on net profit.

4.5 Relationship of loans and non-performing loans

Effective non-performing loans directly affect the volume of the loans of the BOK. It is regarded as the most important indicator. It helps to increase the risky in loans management of the BOK whereas weak level of non-performing loans is signal of the better performance of the loans management. Thus, it is logical to review the valuation of non-performing loans & loans management.

For the research purpose, the non-performing loan and loan management during study period (5 years) are averaged to get non-performing loans and loans variables. After getting non-performing loans and loans, then data are analyzed using Person's correlation coefficient. The following table presents the correlation coefficient of the non-performing loan and loans management during study period.

Table 4.14

Relationship between loan and non-performing loans in BOK:-Correlation Matrix

		Loans	Non-performing loan
Loans	Person correlation	1	-0.656
	N	5	5
Non- performing loan	Person correlation	-0.656	1
	N	5	5

The table 4.14 presents the correlation coefficient between non-performing loan and loans during study period. The calculated Person's correlation coefficient was found -0.656, which shows moderate, negative correlation. It indicates that non-performing loans and loans were moderately, negatively

related with each other. That means, decreasing on performance in loans management. Coefficient of determination was found 0.4536 which indicates that 45.36% of total change in loans management has been negatively determined by non-performing loans.

Loan management has been negatively influenced by non-performing loans. Effectively loans management helps to decrease the non-performing loans. No exception is found incase of BOK Banks. Thus it is logical to review the impact of various components of working in loans management.

Table 4.15

**Relationship between loan and non-performing loans in NIBL:-
Correlation Matrix**

		Loans	Net Profit
Loans	Person correlation	1	-0.265
	N	5	5
Net profit	Person correlation	-0.265	1
	N	5	5

The table 4.15 presents the correlation coefficient between non-performing loan and loans during study period. The calculated Person's correlation coefficient was found -0.265, shows low negative correlation. It indicates that non-performing loans and loans were negatively related with each other. It means, decreasing performance in loan management. Coefficient of determination was found 0.0656 which indicates that 6.56% of total change in loans management has been negatively determined by non-performing loans.

Loan management has been negatively influenced by non-performing loans. Effectively loans management helps to decrease the non-performing loans. No exception is found incase of NIBL. Thus it is logical to review the impact of various components of working in loans management.

4.6 Impact of loan and advances on net profit

Loans have high implication for determining net profit. Effective loans directly affect the net profit of the banks. It means that the net profit of the banks is largely depended by the loans management. Thus, it is more significance to know the impact of loans in net profit. To find out the result the five yes data (study period) of net profit, loans are averaged to get a variable of net profit & loans. Thereafter, simple regression analysis is used for computation. The following table presents the regression analysis of the independent variable loans on dependent variables net profit of the NIBL Bank.

Table 4.16

Regression Analysis on loan and advance and net profit in NIBL

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.955(a)	.911	.890	36.85203

(a) Predictors: (Constant), Loan

Regression equation of Net Profit (Y) on Loan and advances (X) is given by

Regression equation	Constant (a)	Coefficient (b)
= a + bx	-2.489	0.24

Source: Annex

Table 4.16 shows the dependency of Net profit on loans. The calculated R was found 0.911 indicates that there is high relationship dependent variable profit on independent variable loans. After considering the error term, the adjusted R square value was found .890 which indicates that 8.9% of the total variation in the dependent variable net profit has been explained by the independent variable loans. Thus, it can be concluded that loans is a strong determinant of net profit. Therefore management loans should seriously be taken to achieve the goal of the NBIL Bank.

The value of b is found to be 0.24, which means that, on average, 1 rupee change in total loan would result in 1.24 paisa change in the Net profit of NIBL. Given the Net profit of the NIBL for coming years, we can use the above Equation to estimate what the consumer loan of the NIBL would likely to be in the coming years.

Table 4.17

Regression Analysis on loan and advance and net profit in BOK

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.917(a)	.825	0.765	48.49817

(a) Predictors: (Constant), Loan

Regression equation of Net Profit (Y) on Loan and advances (X) is given by

Regression equation	Constant (a)	Coefficient (b)
= a + bx	-166.875	0.045

Table 4.17 shows the dependency of net profit on loans. The calculated R was found 0.917 indicates that there is high relationship dependent variable profit on independent variable loans. After considering the error term, the adjusted R square value was found 0.765 which indicates that 7.65% of the total variation in the dependent variable net profit has been explained by the independent variable loans. Thus, it can be concluded that loans is a strong determinant of net profit. Therefore management loans should seriously be taken to achieve the goal of the BOK Bank.

The value of b is found to be 0.045, which means that, on average, 1 rupee change in total loan would result in 1.45 paisa change in the Net profit of BOK. Given the Net profit of the NIBL for coming years, we can use the above Equation to estimate what the consumer loan of the NIBL would likely to be in the coming years.

4.7 Trend Analysis Least Square Method

Trend analysis is a statistical tool, which will highlight the previous trend of the financial performance and helps in forecasting the future financial results of these banks. Trend analysis shows the trend of loan and advances of seven banks for eight years. Loan and advances shows a bank's efficiency in performance of efficient utilization of the same indicates its success and profitability.

The trend analysis on loan and advances for coming year is following.

The value of Y (loan and advance) when financial is 6th year (2009/10), 7th year (2010/11) and 8th year (2011/12).

Now, Regression equation $Y = a + b X$

Loan and advances on the 6th year

$$Y = 483.54 + 2396.75 * 6$$

$$= 14864.04$$

Loan and advances for 7 th year

$$Y = 483.54 + 2396.75 * 7$$

$$= 17260.79$$

Loan and advances for 8 th year

$$Y = 483.54 + 2396.75 * 8$$

$$= 19657.54$$

Table 4.18

Trend Forecast of Loan and Advance of Nepal Investment Bank Limited

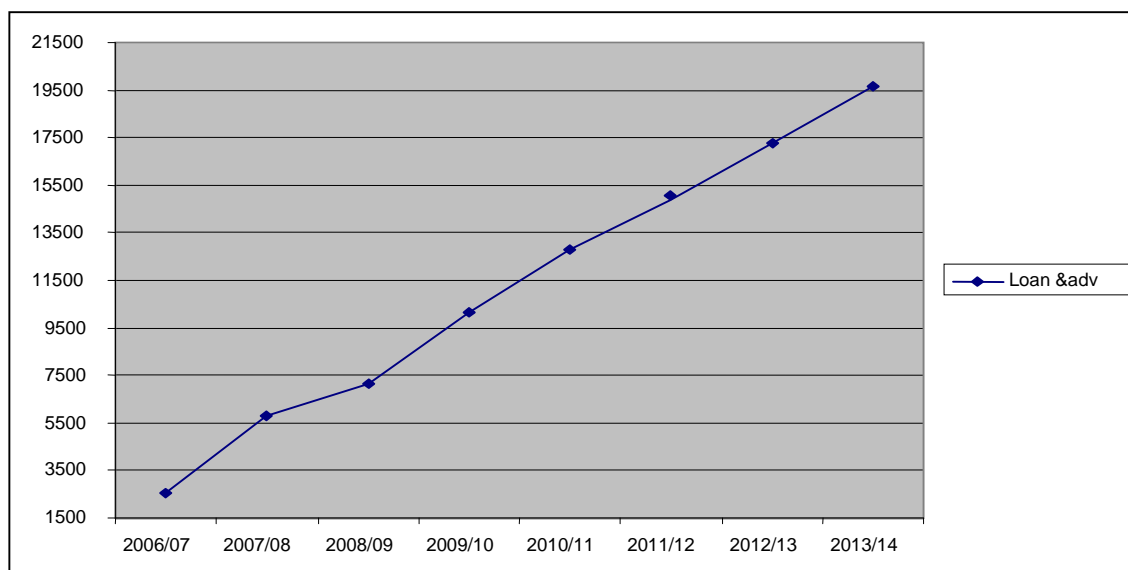
(Rs. In '000')

FY	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Loan & adv	2564.43	5772.14	7130.13	10126.06	12776.2	14864.04	17260.79	19657.54

Source: Annual reports of bank

Figure 4. 1

Loan and advances Trend line of Nepal Investment Bank Limited



Based on analysis presented table that concludes loan and advances has been increasing trend. The expected loan and advances is 14864.04 million, 17260.79 million and 19657.54 million in the fiscal years 2011/12, 2012/13 and 2013/14.

Trend of Loan and advances of Bank of Kathmandu Limited

Computation of straight line trend analysis of loan and advance of Bank of Kathmandu Limited

Now, Regression equation $Y = a + b X$

Loan and advances on the 6th year

$$Y = 7422.81 + 1388.03 * 6$$

$$= 15750.99$$

Loan and advances for 7 the year

$$Y = 7422.81 + 1388.03 \times 7$$

$$= 17139.02$$

Loan and advances for 8 the year

$$Y = 7422.81 + 1388.03 \times 8$$

$$= 18527.05$$

Table 4.19

Trend Forecast of Loan and Advance of Bank of Kathmandu Limited

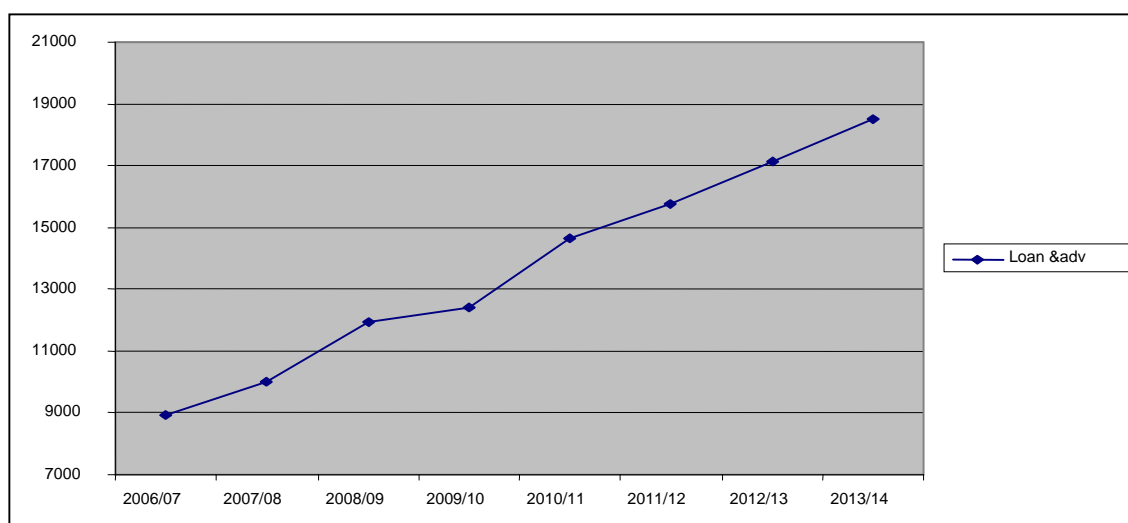
(Rs. In '000')

FY	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Loan &adv	8913.72	10001.85	11951.9	12424.52	14642.56	15750.99	17139.02	18527.05

Source: Annual reports of bank

Figure 4.2

Loan and advance Trend Line of Bank of Kathmandu Limited



Based on analysis presented table that concludes loan and advances has been increasing trend. The expected loan and advances is 15750.99 million, 17139.02 million and 18527.05 million in the fiscal year 2011/12, 2012/13 and 2013/14.

4.8 Major Findings

From the above analyses of credit management, following major findings have been obtained:

-) Average loan and advances to total deposit to total deposit ratio of BOK and NIBL is 0.510 and 0.534 respectively. NIBL has maintained higher loan & advances to total deposit. In this way, it shows that NIBL seems to be strong to mobilize its total deposit as loan & advances. However higher ratio does not mean it is always better from the point of liquidity. Both banks are capable to use more than 50% of deposit on loan and advances. If maintained this, it help make consistency on the profitability of the banks.
-) NIBL has lowest non performing loan to total loan and advances, this NIBL is best performer than the BOK. Banking sector is seriously affected by the non-performing loan. Both banks are not far from this above fact. If non-performing loan increases, the overall banking business will be affected. So provision amount will increase and profit will decrease. So, it is suggested that both banks (NIBL & BOK) to be sincere while granting loan and to do effective follow up for recovery of non-performing loan.
-) Average loan and advances to total assets of BOK and NIBL 0.452 and 0.608 it can be concluded that the higher mean ratio indicates the good lending performance. Here BOK should focus to increase loan and advances to total asset ratio to increase lending performance.

- J Loan and advances to current assets ratio of BOK is in an increasing trend. Average ratio of BOK and NIBL is 4.43 and 6.42. From the mean point of view, it can be said that mean ratio of NIBL has highest than BOK. It can be concluded that the higher mean ratio indicates the good short term lending performance. Here BOK should focus to increase loan and advances to current assets ratio to increase short term lending performance.

- J Increase ratio indicates the increased volume of non-performing loans and vice versa. Loan loss provision of BOK is decreasing trend in the fiscal year 2005/06, so the decreasing loan loss ratio indicates efficient credit policy and gradual increment on the performance of the company. Here loan loss provision to total loan and advances of NIBL is in increasing trend, which indicates increased volume of non-performing loans of NIBL; we can say this is due to the ineffective credit policy and poor performance of the company.

- J Average interest expenses to total expenses ratio of BOK is higher. NIBL has low interest expenses to total expenses ratio, it shows that decrease in cost of deposit as decrease in the interest expenses to total expenses ratio decrease.

- J Total income of BOK and NIBL, interest income contributes 81.70% and 79.10% respectively. The lowest ratio of NBIL indicates its low dependency in fund-based activity. The highest ratio of BOK indicates greater dependency on fund-based activities

- J Correlation Coefficient between the loans and advances to net profit of BOK is 0.9066; it indicates high degree of positive relationship between loans and net profit. This means. Increasing loans helps to

increase the net profit. Loans have high influence on net profit of the BOK. Effective loans management helps to increase and stable the net profit of the BOK Correlation Coefficient between the loan and advances to net profit of NIBL is 0.954; it indicates high degree of positive relation between loan and net profit. Loans have high influence on net profit of the NBIL Bank. Effective loans management directly affects to net profit of the NBIL Bank.

- J Correlation coefficient between non-performing loan and loans during of BOK is -0.666, which shows moderate, negative correlation. It indicates that non-performing loans and loans were moderately, negatively related with each other. That means, decreasing on performance in loans management. Effectively loans management helps to decrease the non-performing loans.
- J Correlation coefficient between non-performing loan and loans of NIBL is -0.275; it indicates that non-performing loans and loans were negatively related with each other. Coefficient of determination was found 0.0756 which indicates that 7.56% of total change in loans management has been negatively determined by non-performing loans. Loan management has been negatively influenced by non-performing loans. Effectively loans management helps to decrease the non-performing loans.
- J Coefficient of determination of N value was found .880 which indicates that 8.8% of the total variation in the dependent variable net profit has been explained by the independent variable loans. Thus, it can be concluded that loans is a strong determinant of net profit. Therefore management loans should seriously be taken to achieve the goal of the NBIL Bank. The value of b is found to be 0.25, which means that, on average, 1 rupee change in total loan would result in 1.25 paisa change in the Net profit of NIBL.

-) Coefficient of determination of BOK is 0.763 which indicates that 7.63% of the total variation in the dependent variable net profit has been explained by the independent variable loans. Thus, it can be concluded that loans is a strong determinant of net profit. Therefore management loans should seriously be taken to achieve the goal of the BOK Bank. The value of b is found to be 0.040, which means that, on average, 1 rupee change in total loan would result in 1.4 paisa change in the Net profit of BOK.
-) Least square trend line shows the loan and advances of NIBL have been increasing with a constant growth rate of 2396.75. The expected loan and advances is 14864.04 million, 17260.79 million and 19657.54 million in the fiscal year 2006/07, 2007/08 and 2008/09.
-) Least square trend line shows the loan and advances of BOK have been increasing with a constant growth rate of 1388.23. The expected loan and advances is 15750.99 million, 17139.02 million and 18527.05 million in the fiscal year 2006/07, 2007/08 and 2008/09.

CHAPTER –V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

As the final chapter of the study, this chapter briefly explains the summary of the study, tries to fetch out findings and conclusions and attempts to offer suggestions and recommendations for strengthen the financial position of the sample banks.

5.1 Summary

Development of any nation depends on capital vested and mobilized in productive sectors like industries trade and business of every nook and corners of the country. In fact, the development of economy of the world is this result of substantial investment in such productive sectors In order to boost up the economy and the social life of any country, it is extremely essential to have a mechanism through which small amount of saving can be collected and transferred into efficient uses. Hence, finance plays a vital role and thus contributes in the economic development of nation and the banks provide such financial services.

The basis of business is borrowing from individuals, firms and occasionally government i.e. receiving deposit from them. With these resources and bank's own capital, banks disburse loan or extend credit and also invest in securities. Bank is an institution, which deals with the transaction of money. They perform several financial monetary and economic activities that are essential to accelerate the rate of economic growth of the country.

At present, 32 commercial banks have been operating in Nepal. After the adaptation of liberal policy by the government in 1990 number of banks and financial institutions are increasing day by day. They have been rendering high quality banking services to the people. There is cut throat competition between banks and financial institution.

This research has been undertaken to evaluate the credit management of commercial banks. Two banks Bank of Kathmandu Limited and Investment Bank Limited banks are under study and five year financial statements of respective banks have been used for the study. The study has been divided into five chapters which include introduction, review of literature, research methodology, data presentation and analysis and summary, conclusion and recommendation. This study mainly based in secondary data, with include published annual report and other publication of banks. Other related information was gathered from the concerned banks, Nepal Rasta Bank, Nepal Stock Exchange, Securities Board of Nepal, different websites. The data have been analyzed by using financial and statistical tools like ratio analysis, correlation coefficient, regression analysis trend analysis etc.

5.2 Conclusion

The research study concludes that credit management of the commercial bank is important to get net profit as well as pay back of the deposit in time of the customer of the organization. Main conclusion of the study are given below:

1. The study shows that over the period, Average loan and advances ratio of BOK and NIBL is 0.510 and 0.534. Both banks are capable to use more than 50% of deposit on loan and advances. If maintained this, it help make consistency on the profitability of the banks.
2. Banking sector is seriously affected by the non-performing loan. Both banks are not far from this above fact. If non-performing loan increases, the overall banking business will be affected. So provision amount will increase and profit will decrease. So, it is suggested that both banks (NIBL & BOK) to be sincere while granting loan and to do effective follow up for recovery of non-performing loan.
3. Average loan and advances to total assets of BOK and NIBL 0.453 and 0.580 it can be concluded that the higher mean ratio indicates the good

lending performance. Here BOK should focus to increase loan and advances to total asset ratio to increase lending performance. Loan and advances to current assets ratio of BOK is in increasing trend. Here

4. BOK should focus to increase loan and advances to current assets ratio to increase short term lending performance. Loan loss provision of BOK is decreasing trend in the fiscal year 2007/08, so the decreasing loan loss ratio indicates efficient credit policy and gradual increment on the performance of the company.
5. Loan loss provision to total loan and advances of NIBL is in increasing trend, which indicates increased volume of non-performing loans of NIBL; we can say this is due to the ineffective credit policy and poor performance of the company.
6. Total income of BOK and NIBL, interest income contributes 81.70% and 79.10% respectively. The lowest ratio of NIBL indicates its low dependency in fund-based activity.
7. Correlation Coefficient between the loans and advances to net profit of BOK is 0.9166 and Correlation Coefficient between the loan and advances to net profit of NIBL is 0.954. It shows the more dependency of profit with loan and advance by both banks.
8. Correlation coefficient between non-performing loan and loans during of BOK is -0.676, Correlation coefficient between non-performing loan and loans of NIBL are -0.275. Non performance loan and loans were moderately related in BOK but Non performance loan and loans were negatively related in NIBL. It means decrease in loan management performance.

5.3 Recommendation

The findings of the study reflect both positive and negative results with respect to the financial performance of the sampled banks. But the recommendations have been presented for the improvement of the negative of the banks. As per the above conclusion the following suggestions can be concluded for the banks:

- a) Both banks should try to increase the loan and advances to deposit; here they have maintained more than 50%. High ratio shows the capability of bank on mobilizing its total deposit as loan and advances.
- b) Banking sector is seriously affected by the non-performing loan. Both banks are not far from this above fact. If non-performing loan increases, the overall banking business will be affected. Banks should be sincere while granting loan and to do effective follow up to recovery of non-performing loan.
- c) Average loan and advances to total assets of BOK is below 50%. So, BOK should focus to increase loan and advances to total asset ratio to increase lending performance.
- d) Banks should do lot exercise in more credit creation and reducing the interest rate for loan and advances. This will help them to maintain more competitive.
- e) Banks could do better by offering modern banking facilities and new product for the development of banking industry.
- f) Provision on doubtful loan should to be maintaining as per the directives of Nepal Rastra bank.
- g) Other recommendation for the achievement of target goals and objective of commercial banks. From above study, analysis and observation with facts we must conclude with a reasonable realistic solution. Some of important and valuable suggestion for strength of commercial bank

establishment ,sustainable growth. Commercial banks have to channelized fund by gradually shifting priorities from consumer loan to the productive sector to help for capital formation in the country. Commercials banks have to improve their quality of services. They have to shift their focus from urban areas to rural areas, where they can collected

- h) I would like to recommend to study about the commercial bank Credit policy particularly about the Non- Performing loan and what types of activity are conducted for the reduction of Non-performing loan.

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